BEFORE THE PUBLIC UTILITIES COMMISSION OF OHIO

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In the Matter of the :
Application of Columbus :
Southern Power Company for:
Approval of its Electric :
Security Plan; an : Case No. 08-917-EL-SSO
Amendment to its Corporate:
Separation Plan; and the :
Sale or Transfer of :
Certain Generating Assets.:
:
In the Matter of the :
Application of Ohio Power :
Company for Approval of :
its Electric Security : Case No. 08-918-EL-SSO
Plan; and an Amendment to :
its Corporate Separation :
Plan. :

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PROCEEDINGS

before Ms. Kimberly W. Bojko and Ms. Greta See, Hearing Examiners, at the Public Utilities Commission of Ohio, 180 East Broad Street, Room 11-C, Columbus, Ohio, called at 9:00 a.m. on Wednesday, December 3, 2008.

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Wednesday Morning Session,
December 3, 2008.

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EXAMINER BOJKO: Let's go on the record.

Good morning. This is a continuation of 08-917 and the 08-918, being In the Matter of the Columbus Southern Power Company and Ohio Power Company for Approval of their Electric Security Plans.

At this time we'll take abbreviated appearances.

MR. RESNIK: For the companies, Marvin Resnik, Dan Conway, and Steve Nourse.

MR. MASKOVYAK: Joe Maskovyak and Michael Smalz on behalf of the Appalachian People's Action Coalition.

MR. MARGARD: Werner Margard, John Jones, Thomas Lindgren, assistant attorneys general, on behalf of the Commission staff.

MR. HOWARD: Howard Petricoff, Michael Settineri, and Betsy Elder on behalf of Constellation NewEnergy, Constellation Energy Commodities Group, Integrys Energy Service.

MS. GRADY: Maureen R. Grady on behalf of the residential customers of the companies, Janine L.

Migden-Ostrander, Consumers' Counsel, Michael E. Idzkowski, and Jacqueline Lake Roberts.

MR. RANDAZZO: Lisa McAlister, Joe Clark and Sam Randazzo on behalf of the Industrial Energy Users of Ohio.

MR. O'Brien: Tom O'Brien and Rick Sites on behalf of the Ohio Hospital Association.

MR. BOEHM: David Boehm and Michael Kurtz on behalf of the Ohio Energy Group.

MR. BELL: Langdon Bell on behalf of the OMA.

MR. WHITE: John Bentine, Mark Yurick, and Matt White on behalf of the Kroger Company.

EXAMINER BOJKO: Mr. Baker is currently on the stand.

Mr. Baker, you realize that you are still under oath.

THE WITNESS: Yes, I do.

EXAMINER BOJKO: Let's proceed. We ended

with Mr. White.

Do you have any --

Oh, Mr. Petricoff has already volunteered to go first this morning.

MR. RANDAZZO: I'll volunteer to go second.

J. CRAIG BAKER
having been previously sworn, as prescribed by law,
was examined and testified as follows:

CROSS-EXAMINATION

By Mr. Petricoff:
Q. Good morning, Mr. Baker.
A. Good morning, Mr. Petricoff.
Q. If you would, turn to page 18, line 15 of your testimony, and there you make the statement that the FAC, which is the fuel adjustment clause, is an appropriate way to reflect changes in the costs of the various components of the fuel adjustment clause, and I'd like to take some time with you now and explore what those components are.
In the fuel adjustment clause we would certainly have coal and fuel oil and natural gas; is that correct?
A. Yes, that would be fuel that would be included.

Q. And the way the fuel adjustment clause would work, it would be the difference between the baseline, wherever that is established as part of this hearing, and the actual cost is what would be passed through the fuel adjustment clause?

A. Yes, that's correct. That would be a

piece of the FAC as described in Mr. Nelson's testimony.

Q. And would purchased power also go through the fuel adjustment clause as proposed?

A. Yeah, it would. And that would be purchases that we would make, for example, the 5, 10, 15 percent purchases. Any purchases that were made through the pool, including the capacity equalization charges that a company may incur, and any other purchases that were made on behalf of the -- that the company would be making.

Q. Let me explore that a bit farther. In the purchased power would it also include economy purchases or purchases from the PJM markets?

A. It would include purchases that were used to serve the load in Ohio. You would exclude purchases that were at the top of the stack that were used to source off-system sales.

Q. One of the things that you mentioned, and

we talked about it a bit in your deposition, are
these AEP pool capacity and energy charges. How do
the AEP pool capacity charges, how would those be
assigned to the fuel adjustment clause?
A. The full amount of -- as I understand it,
the full amount of the capacity purchases would be

included in the fuel adjustment clause. From the standpoint of the energy, it would be that which was used to serve our -- the load of the Ohio companies.

Q. Now, earlier in your testimony you stated that Ohio Power had more than sufficient capacity to meet its peak demands; is that correct?

A. I'm not sure whether those were my exact words, but it's a fair representation. They are surplus to meeting their own load plus their reserve requirements.

Q. Okay. So would Ohio Power have any AEP pool capacity charges, as a practical matter, that would go into their fuel adjustment clause over the ESP three-year period?

A. That, I can't say for sure. I can say if we had one in place today, they would not have any capacity costs associated with the pool agreement included in their 555 account and, therefore, included in this fuel adjustment. But things change over a three-year time frame, and it depends on what capacity they have and what their load is as you look out over the three years.

Q. Let's explore that ability to change. If, for example, Ohio Power would get additional new customers, let's say of the Ormet class, how would the mechanics work there in the AEP pool for Ohio Power to obtain capacity to meet that load?

A. They don't have -- the way the pool works is that when you look out in each month, one has a certain amount of capacity, and then they have -- you have a requirement to carry an MLR share of the total capacity of the AEP East system, and then you compare what you actually have with, you know, owned or contracted for as the sum of the capacity that is your entitlement, you compare that to what your MLR share of the total is and you are either long or short.

Q. The acronym MLR I don't think we have defined on the record. What does MLR stand for?

A. MLR stands for member load ratio, and it's the looking back at the previous 12 months. It's each company's -- each of the five operating companies' noncoincident peak over the sum of those noncoincident peaks.

Q. And that's recomputed every month?

A. That's recomputed every month.

Q. So if, in fact, Ohio Power had a large increase in its load, then basically its MLR ratio would increase and it may have to make capacity payments to other AEP operating companies for capacity?

THE WITNESS: Can I have that read back?

(Record read.)

A. If their MLR increased to a level that their capacity requirements under the pool agreement, MLR times the total capacity, is greater than the capacity that they are entitled to, then they would make the capacity payment to the long companies.

Q. And I assume that this works in reverse. If, for example, the Ohio Power Company had a decrease in its customer load which decreased its contribution to the coincidental peak, then basically it would be receiving a credit from other AEP operating companies for their use of that now freed capacity?

A. All else being equal, Mr. Petricoff -- and I hate to use that because everybody says to me "consider it all else being equal," and I tend to rale on it -- but if you assume everything else being equal, then yes.

Q. Now, let's move to the AEP pool energy side. How would the energy be calculated under the AEP pool -- well, just leave it like that. How would energy transfers among the operating companies of the AEP pool be calculated and transacted?

A. Each hour we determine what the loading is on each of the five operating companies' generating units. After the fact we know what it is, and we know what the specific load is for each of those operating companies. So we stack all of the generation that is not dedicated to a company from low to high, lowest variable production cost to highest variable production cost. And then what you do is you strip off the highest variable production cost generation in each hour up to the amount of off-system sales that we made.

So I now have a adjusted load at each power plant that's owned by any of or entitled to by any of the companies, of the five companies. So I now know what the total generation that was created in any hour to serve the total AEP internal load.

Then I compare each company's generation, after having adjusted out the off-system sales, expense of generation, and I compare that with the load of each company, and each company then is either long or short. And what happens is the short companies pay the long companies and the long companies get a receipt.

Q. Let's say for clock hour one today, Ohio Power is long, that is, it has produced generation that has now been used by another AEP operating company. And as I understand your example, then there would be a payment, then, from that operating company to Ohio Power.

MR. RANDAZZO: Your Honor, I hate to do this, but I think it may be important to the record.

Mr. Petricoff, are you talking about the AEP pool agreement related to the eastern side of the operations or the western side of the operations? Or something else?

MR. PETRICOFF: Thus far the witness has not distinguished between east and west. We've just been talking about AEP pool, so until the witness tells me that there's a distinction, I'm going with whatever the witness defines as the AEP pool, and I can assume you can ask him if it's not clear when I get done.

MR. RANDAZZO: I thought it might be important to you.

EXAMINER BOJKO: I assume the witness will clarify now regarding this.

THE WITNESS: Can I have the question read back, please?

(Record read.)

A. First of all, let me make a

clarification, and that is, when I talk about the AEP pool agreement, I talk about it as the East agreement that governs Columbus & Southern and Ohio Power and the rest of the East operating companies. There's an agreement in the west which I call the West operating agreement, so if we get there, we'll use that nomenclature.

And then there is an agreement that overarches the two former -- or, the former East AEP and West Columbus & Southern Power that is the merged company which I'll call the SIA agreement, so hopefully I will use the nomenclature right going forward, but that is the clarification.

To get into your question specifically, we have to remember that the payments, you may very well have multiple long companies and multiple short companies, and so the short companies pay both long companies, and if there are two long companies, three short companies, the three short companies pay the two long companies, or whatever the combination is, so the payment comes in as a payment for being short and then is assigned by the pool manager out to the individual companies who were long.

So it comes through kind of a clearing area for the -- to be collected from the short companies to be paid to the long companies.

MR. RESNIK: Mr. Petricoff, may I just -- I think the witness may have misspoken, and I don't really want to have the whole answer read back, but in the attempt to clarify, I think he may have mentioned the West Columbus Southern Power companies.

EXAMINER BOJKO: He did.

MR. RESNIK: Instead of Central Southwest companies.

THE WITNESS: I get those mergers mixed up.

MR. PETRICOFF: Thank you.

Q. I think I'm going to change my tactic here and accept clarifications from not only the Bench but from the Bar.

Let's go back so that everybody is clear. When you were discussing before in answering your other questions, can we assume that Ohio Power and Columbus Southern are in the East?

A. Yes.

Q. And the descriptions that you've given thus far are the mechanics on how the East pool works.

A. Yes.

Q. Now let's continue to funnel down here because I'm trying to follow the money either into or out of the fuel adjustment clause. So we've now got this allocated payment that's come into Columbus Southern or Ohio Power because they're long from one of the operating companies that are short. How is that going to be treated in terms of the fuel adjustment clause for allocating the revenues? Would any of the revenues in that credit go to the fuel adjustment clause?

A. I'm sorry, I need that question reread. There was a lot in that one.

Q. Let me start over.

We're still working on this example in which we've had -- well, use Ohio Power. Ohio Power was long on clock hour number one. Ohio Power has now been allocated a credit. How is that revenue then accounted for by Ohio Power? Where does that money go once it's received as a credit for clock hour one?

A. The credit -- the fuel associated with that transaction goes to reduce the total cost of fuel for the Ohio company that then gets allocated to the internal customers of Ohio Power.

Q. Okay. Let me just give an example here, and these will be easy numbers as opposed to representative figures. So let's say that the payment that Ohio Power got in its credit is $10, and $5 of that is associated with fuel cost, in which case then $5 would go as a credit to the fuel adjustment clause and, thus, back to the customers, and $5 would inure to the bottom line of Ohio Power?

A. I would point you first to Mr. Nelson's testimony just to make sure that my statement about fuel was correct and not the total payment, but I'm pretty sure that's the way it works. If Mr. Nelson has it as total, then I would stand behind what Mr. Nelson has in his filings.

But let's just go under the assumption that my recollection is correct. In that case the fuel would go as a credit to the total fuel. It isn't a revenue that goes back to customers. It's a reduction in the fuel component that then becomes what's in the FAC.

Your numbers are grossly out of

proportion, and I think it's very important to recognize that because the other factor that is in the pool energy charge is the variable operation and maintenance cost, and the variable operation and maintenance cost is a very small piece, very small, less than 5 percent, I would say, somewhere in the zero to 10 percent range of the total energy charge that a long company will receive.

And then I think you -- I don't remember where you said it went, but it actually goes to compensate the company for the variable production cost of -- it's actually maintenance.

Q. Okay. Well, my purpose in the example was not to give a representative accounting but to understand the mechanics, that basically when the credits came in, that some allocation -- some allocation of the credit would be deemed to be fuel and would reduce the amount that went into the fuel adjustment clause to customers and the rest would be retained by the company.

A. Yes.

Q. Now, I've used Ohio Power as an example, but the same would be true of Columbus Southern?

A. If we're talking about a situation where Columbus & Southern is long, yes.

Q. Now let's focus on the other side. Let's assume that for clock hour number one Ohio Power is short and the payment is $10. At that point would the $10 then go to the fuel adjustment clause?

A. Again, I would point you to Mr. Nelson's testimony, but I believe it does.

Q. Okay.

A. But one has to remember that that was done because it's more economic than any other opportunity for generation on the Columbus & Southern system.

MR. BOEHM: Excuse me, your Honor, may I ask counsel a question?

When you said short, would that $10 -- would the $10 go to the fuel adjustment clause, in your example? I thought you were talking about when the company is short, so it wouldn't be a $10 credit, it would be a $10 debit?

MR. PETRICOFF: It would be a $10 debit.

MR. BOEHM: Thank you.

Q. Mr. Baker, you understood that as a $10 debit as well?

A. That was my assumption when I was answering the question.

MR. BOEHM: Thank you.

Q. Mr. Baker, wouldn't you agree with me
that under the application a customer who is shopping
would not be paying the fuel adjustment clause, it's
bypassable?

A. Yes, I would agree with that.

Q. Now I am going to switch subjects with you a bit. I want to take you to page 18, line 18, and there you have a sentence that says that: Section 4928.02 of the Revised Code recognizes "the continuing emergence of competitive electric markets." Do you see that language in your testimony?

A. Yes.

Q. Do you believe that there is a competitive electric market today in the AEP service territory?

A. Yes.

Q. Is that competitive market on the wholesale side?

A. I believe it is more active on the wholesale side than it is on the retail side.

Q. But it's your belief that it is -- that we have an active competitive market right now in both wholesale and retail in the AEP-Ohio service territories.

A. We have a -- as I said, we have a very active wholesale market in my view in the AEP service territory, and then I would say that we have shopping. It's limited, but we have shopping in Columbus & Southern.

Q. Now I want to talk to you a bit about the deferrals. Maybe this would be the faster way to do it. Could you describe for me mechanically at a 50,000-foot level how the calculations would be determined of how much of the fuel adjustment clause would be deferred every month?

A. At the 50,000-foot level the easiest way to think about it is we have a number of adjustments that we are proposing to make to rates in our filing, and we would assume that all of those go first toward the, what we call the 15 percent cap, which is the approximate cap that we have talked about, and then we would flow the FAC costs through to customers so that we don't run up against that cap or we run up to the cap, and then anything that exceeds the cap would be deferred for future collection.

Now, your question before was is the FAC bypassable, and I was considering up to that 15 percent. If there is deferred dollars, they would be collected from all customers when you move out into the period of collection.

Q. Okay. We'll come back to the period of collection momentarily.

So let me give you an example. Let's say we've done the calculations for this month and it looks like the fuel adjustment clause should be a penny a kilowatt-hour, but there's only enough headroom between the cost of power with all the other adjustments and the 15 percent cap of half a penny, in which case then the fuel adjustment clause would be set at half a cent and half a cent a kilowatt-hour would be deferred?

THE WITNESS: Could I have the question read back, please?

(Record read.)

A. Just for clarification, Mr. Petricoff, where I was having difficulty was the term that you threw in the middle, "the cost of power," and I don't know what that meant.

To clarify, if what you were saying would be that the rate including the full FAC exceeded by the half a penny, half a penny would then be deferred, I would agree with that.

Q. Thank you.

Mr. Baker, if you know, do the AEP

operating companies print on the bills to customers a price to compare for generation for shopping purposes?

A. I believe it does.

Q. Just out of interest, do you know whether or not there's a Commission rule that requires that?

A. I don't, but I would not be surprised if there is.

Q. Now, for purposes of the price to compare, I want to go back to our example now we just went through where half a penny went into the FAC and half a penny was deferred. On the price to compare for generation, would that include the full FAC cost of a penny or only the half a penny that was invoiced?

MR. RESNIK: Your Honor, if I could just interject, I'm not sure it's an objection but maybe seeking a clarification because I believe the price to compare may be one number that includes more than generation. My recollection is that transmission may be in there as well, and your question assumed that the price to compare was just focusing on the generation number.

MR. PETRICOFF: Okay. Thank you.

MR. RESNIK: That's my recollection.

MR. PETRICOFF: Well, first of all, I believe your recollection is correct, it is the full package of generation.

Q. And so to make everything clear I want everyone, especially the witness, to understand that I'm just talking about when the company goes to calculate that number of the total package of fuel adjustment clause, including what's been deferred as well as what's going to be invoiced, or is it just the part of the fuel adjustment clause that is being invoiced that month?

A. I believe it would just be the amount that was going to be invoiced that month and would not include the deferrals in your example.

Q. Okay. So in that case wouldn't you agree with me that it is possible that the price to compare that's going to be on the bills for people to use when shopping could be a price that is less than the actual cost of the generation?

A. I would -- I probably wouldn't describe it quite that way because you're talking about the actual cost of the generation. It's a rate. It's a rate that comes about through a series of actions over time.

Without the deferrals the rate could

clearly be higher. I wouldn't dispute that. And one
has to recognize that what we were trying to
accomplish here was to help customers by putting the
15 percent cap and, therefore, that's what a customer
would avoid if they chose to go to another supplier.

If as a result of all of these actions

parties don't want the deferrals across the AEP East -- the two companies, you know, that's not -- we did it to help customers. If customers don't want that, we'd be okay with putting the full amount in on a monthly basis to the charge and, therefore, the full amount in the avoided cost.

Q. I want to leave the whole question and answer because I think it was very instructive, but I want now just to focus back on the original question, and that is, if the price to compare does not include the fuel costs that were deferred, then won't the price to compare actually reflect a number that is less than the true cost of the generation?

A. And as I said, the question is it's a rate; it's not the cost of the generation. It's a rate after having unbundled the fuel and having an ongoing fuel clause and a nonfuel -- or, non-FAC generation component adjusted by any of the changes that we have proposed.

Q. But would you agree that the rate is less than the true cost of the generation which the company will ultimately seek from the customer?

A. I would say that the rate is lower than what the rate would have been had we not had the deferrals.

Q. And wouldn't you agree that if that rate is lower than the true cost, that it could depress conservation efforts?

A. I can't answer your question because you keep going back to "true cost" when I tell you that it is a rate. And if you want to keep putting "cost," I'm just going to say no, I won't agree.

Q. Okay. If the rate that's charged to the customer in 2009 is less than the amount that AEP intends to actually collect for that generation, wouldn't the fact that the rate that is offered is artificial -- wouldn't that make the rate that was offered artificially low?

A. Well, in my view the rate even with the deferrals would be artificially low. So I guess I have trouble not agreeing with the fact that if you take deferrals as well out of it, that it is artificially low relative to what I think it should be, yes.

Q. When the FAC -- strike that. Let me
start again.

The company intends to charge carrying costs on the deferral amount; isn't that correct?

A. That is correct.

Q. And so ultimately the customer, the

standard service customer, is going to be paying more for each kilowatt-hour that they use in the ESP period than would occur if the customer did not have part of the fuel cost deferral.

THE WITNESS: If I could have that read back, please.

(Record read.)

A. If you are just talking about the sum of the payments, that would be true. But I don't think you can stop there. One has to consider in any customer what the time value of money is for them and is it, in fact, better for them to have the dollars deferred and pay it later with a carrying charge or is it better to pay it up front? And that led me to the statement I made earlier, that if people are interested in not having the deferrals, the company would not oppose that.

Q. In nominal terms, the payments would be greater.

A. In nominal terms.

Q. And since you've just offered that customers may or may not want to delay the payment given their cost of money, wouldn't it make sense, then, to offer to the customer the option of whether they want the deferral or not?

A. We just -- we've talked about that, and we just can't figure out how to mechanically do that in the time frame we're talking about and keep track of the millions of customers that we have on these two companies, whether they would want to pay up front or wait and pay it later. We just -- it's a logistical issue more than a philosophical issue.

Q. But you'd agree with me that under the application at the moment, all customers will have to take the deferral and customers will be charged the carrying costs for that deferral.

A. That is what the application provides for, and we did that, as I said, in the interest of customers.

Q. Mr. Baker, does AEP anticipate that the cost of power will be less in 2012 when the deferral payments come due than the cost of power today in -- or, the cost of power for 2009?

A. Well, you know, my answer is going to be if I knew the cost of power in 2012, I'd be out trading it rather than being on the stand, so I can't answer that question.

Q. So it is possible by deferring, then, that all we've done is just push the problem of high rates back a couple of years plus the carrying costs.

A. I don't know. Depends on what you believe is the price of power in the future.

Q. Let's take an example now of a customer who is shopping, and they continue to shop through the whole ESP period, 2009, '10, and '11. Will they have to pay the FAC deferrals in 2012?

A. Yes, they would.

Q. Did they get any benefit of delaying the fuel -- do they get any benefit from the fuel costs that were delayed?

A. If they had left before the ESP started and truly stayed off the system for the entire three-year period, they would not have gotten any direct benefit associated with the deferral.

Q. Now, is it your belief that the purpose of the deferral was to basically assist customers to adjust to a higher overall rate for generation?

THE WITNESS: Could I have that question read back, please?

(Record read.)

A. I would say it was to moderate the impact of the fact that we've had rates that haven't had a fuel clause, haven't had an environmental clause, and, therefore, customers would see a very large increase without these deferrals in year 1, in 2009, and it was to moderate the impact to customers.

Q. Couldn't AEP have achieved that same goal of moderation if instead of deferring the FAC they deferred the distribution, part of the distribution charge?

A. No. I don't see -- what we are looking at was deferring some of the new rate adjustments, and the distribution adjustment is so small that it would not anywhere come close to what we can accomplish with fuel.

Q. Well, I'm not talking about the distribution adjustment, I'm just talking about a deferral of the distribution charge itself. Let me retract that. Let me start with an example.

We had indicated before in our earlier example on the FAC that we were deferring half a cent a kilowatt-hour. So instead of deferring half a cent a kilowatt-hour for fuel, what if the company just deferred half a cent a kilowatt-hour against the

distribution charge and then collected that between
the years 2012 and 2018?

A. As I said, the way we looked at it was
deferring new charges over the rates where they are
at the end of '08. That's the way we looked at it.

Q. I understand that. Let's look at the

other end of the telescope, though, for a moment. Let's look from the perspective of the customer, okay?

If the goal of the deferral is to moderate the price that the company pays -- the price on the bill that says "pay this amount" that's at the bottom of the bill, wouldn't the customer be indifferent whether the credit was for the fuel component or the distribution component?

A. Mathematically it would be, but I don't know what the ramifications -- we have not thought what the ramifications would be if you tried to defer instead the distribution. I don't know what the accounting treatment of that is, so I can't say what the ultimate impact to customers would be in the long range because we haven't looked at it.

Q. Let's go back to my hypothetical about the customer who's been shopping and shopped in 2009, 2010, 2011. Would they be better off if the deferral

was against the distribution rate as opposed to the
deferral being against the fuel adjustment clause?
A. Again, I would say that if you want to do
this purely on a mathematical basis, the answer would
be you would have more in the avoided cost. I would
agree with the math. I can't say what the impacts to

the -- total impacts to the customer because I haven't looked at it.

Q. One final question for you in this area. Would you agree with me that all of the components that we listed earlier today that were in the fuel adjustment clause are generation related?

A. Yes, I would agree with that.

EXAMINER BOJKO: Mr. Petricoff, before you move on to a different subject area, I just want to --

Something in your testimony was confusing to me, and then Mr. Petricoff today used some words of other adjustments up to the 15 percent cap, and I just want to be clear that the 15 percent cap is on G only, it's on the FAC charges; is that right?

THE WITNESS: No, it's a 15 percent change in the bill.

EXAMINER BOJKO: In the total bill?

THE WITNESS: In the total bill.

EXAMINER BOJKO: So distribution increases could count towards this 15 percent cap.

THE WITNESS: Yes.

EXAMINER BOJKO: Okay.

MR. RANDAZZO: Your Honor, if I may, I mean, we've already got record evidence that shows that the transmission piece is not included for purposes --

EXAMINER BOJKO: Well, excuse me, you did exclude two things, the transmission cost recovery and any government mandates. I apologize. But your testimony seemed to say that it was the total rate, which you just said total bill. The application on page 6 seemed to me to say that it was deferring the FAC expenses, and I wanted to make sure that the 15 percent could include other adjustments outside of FAC or generation-related costs.

THE WITNESS: That's right. You work up to a total, and once you hit that 15, you know, at that 50,000-foot level you defer FAC.

EXAMINER BOJKO: Okay. Thank you.

Thank you, Mr. Petricoff.

MR. PETRICOFF: My pleasure, your Honor.

Q. (By Mr. Petricoff) Let's switch now and talk about the POLR, provider of last resort, charge.

Is the POLR service a utility service or a competitive service, in your opinion?

THE WITNESS: I'm sorry, could I have that read back?

(Record read.)

A. The best -- in my view the best way to answer that, and it may or may not answer your question, is as I see Senate Bill 221, it puts that responsibility on the electric distribution company, and that the company has to, as we talked about yesterday, has to provide the opportunity for customers to buy at tariff rates.

They can shop, leave the electric distribution company, and come back to the electric distribution company, except perhaps in the case of governmental aggregation, at tariff rates. So the electric distribution company has that responsibility.

Q. And a CRES provider could not provide -- could not be the provider of last resort; it has to be the utility.

A. I don't see how a CRES provider can, under Senate Bill 221 --

Q. Yes.

A. -- today with the ability not to go a hundred percent to market, I don't know how a CRES can relieve the electric distribution company of their responsibility.

Q. If the POLR service is a utility service, should it be priced as a traditional utility service?

A. You're using the word "utility service," and I just want to make it clear that I said this is a responsibility that an electric distribution company has under Senate Bill 221. If those are synonymous, then I would accept it, and the way it should be priced is the way we have proposed in the filing.

Q. Let's take a look at the way that you have proposed to price this in the application. Basically this is going to be -- you've priced this using the Black-Scholes model to develop a value for the POLR service?

A. Yes.

Q. And, let's see, is it fair to say, just, we're at 50,000 feet, that the Black-Scholes model is designed to project a value for an optional -- for an option?

A. It produces a value for a series of options.

Q. Let's turn to page 32 of your testimony

where I think you have a chart where we talk about
the variables that go into the Black-Scholes model.
First of all, am I correct in describing the
Black-Scholes model as basically a differential
equation?

A. I believe that's a fair description.

Q. And one of the attributes of a distribution equation is that you can keep all the variables but one constant and then change a variable to see what difference it makes in the outcome?

A. You know --

MR. RESNIK: Can I have the question read back, please?

MR. RANDAZZO: Well, to shorten this up, you said "distribution equation," you meant differential equation.

MR. PETRICOFF: Differential equation, thank you.

MR. RESNIK: Thank you.

EXAMINER BOJKO: Do you still need the question read back?

MR. RESNIK: No. No.

A. And you're taking me back to math that goes a long, long way back, and we have experts who use the Black-Scholes model and they did the work to develop the numbers based on the parameters that we laid out for them, so if you're going to take me down into the depths of differential equations, we're going to be here a long time.

Q. I can assure you there will be no test here in which you have to calculate a differential equation, and that's done for my protection, not yours.

A. Okay.

Q. Let's go back to 32. On 32 you have -- page 32 at the top in the chart you have the major variables that are going into the differential equation; is that correct?

A. That's fair.

Q. Okay. And is it fair to say that, if you looked at these items, if we had an increase in the No. 2, the ESP strike price, relative to the competitive benchmark price, the market price if you will, that basically the cost of the POLR would go up, it would be more expensive?

A. I would agree with that, and that was one of the conservative things we did in developing this POLR charge, was we used as the strike price the proposed ESP price for only year 1. We didn't use years 2 and 3, which, in fact, would have done just what you said, Mr. Petricoff, increased the value of the POLR.

Q. Okay. And you would agree with me that, relatively speaking, the higher the price of the ESP versus the competitive benchmark, the higher the POLR cost, even if the price of the ESP crosses the competitive benchmark price.

THE WITNESS: Could I have that read back?

Q. Actually, let me strike that and come at it this way. We've agreed that the direction is such that the closer the strike price is for the ESP to the market price, the higher the POLR. First of all, we're in agreement there; is that correct?

A. You have to break the value proposition into the series of options that are provided here. And in discussions I had yesterday I termed it the put and the call, and the put being the right to shop and leave the company with the generation where it's no longer getting the tariff rate which was the contract with the customer, in my view, and then the call, which is once they have shopped, the ability to come back to the tariff rate.

Your proposition I believe is correct for the put. It may be different for the call.

Q. Let me ask a prefatory question. When
the company ran the Black-Scholes model to develop
the prices that we see in the application, were they
assuming that the customers who were leaving would go
to governmental aggregation programs and not be
returning at the ESP strike price?

A. No. The assumption was the customers would leave independently and come back at the strike price. It was the put, as I described it, to go to the market and come back at tariff.

Q. So what we see in the application in terms of pricing and what we have in your testimony here is based on the assumption that basically customers would shop and have the option to come back at the strike price.

A. That's right. And as I said in my testimony, we're not a hundred percent sure that even if it was governmental aggregation that they wouldn't be coming back at the ESP strike price.

Q. Okay. And so now I'm ready to go back to my question for you. Because we've not changed any of the -- we've now clarified what the pricing is and what your testimony is on page 32. Are we in agreement that, relatively speaking, as the strike price approaches the market price, the POLR cost will increase?

A. Again, what I said was I would agree with you on the put side of it; I wouldn't agree with you on the call side.

Q. But in terms of the prices and the POLR numbers that we have seen in this application, we've assumed that there's both a put and call.

A. Correct.

Q. Now, the next question, what happens when the strike price exceeds the market price?

A. I believe customers will shop.

Q. And the POLR would have to continue to increase?

A. We're setting a POLR rate. The POLR wouldn't change if the Commission approves our charge here. It's what it is. We're not recalculating it. As market prices go down, as, again, similar to the strike price going up, if the market price comes down, then the put side of the POLR also would get higher. So you could have things change over time that would change it, but as I said earlier, I think we took a conservative approach in what we did which reduced the POLR charge.

Q. I want to go back to my prior question but we're going to break it up. Theoretically, if you know, if the strike price exceeds the market price, would that continue to push up the value of the POLR?

THE WITNESS: Can I have the question read back?

EXAMINER BOJKO: Yes.

(Record read.)

A. I'd have to run the model to answer that question because you'd have to value the put and the call, and I just don't know what the answer would be.

Q. That's fine.

And now go to the second part of that, and that is for purposes of the application in the matter at Bar, the POLR will be set for the 36 months and will not be changed or adjusted.

A. That was the proposal.

Q. Mr. Baker, do you have with you Mr. Roush's testimony, in particular Exhibit DMR-5?

A. Yes, I do.

Q. Now, am I correct in assuming that DMR-5 is a forecast that Mr. Roush made on behalf of the company that includes what the current POLR is and what the POLR charges would be under the application?

A. I believe what this is intended to do is to look at what the Commission has deemed to be POLR in our current rates and then looks at the increase as a result of our doing the modeling that we used to develop the total POLR charge.

Q. Okay. Let's look at Columbus Southern Power. If, in fact, the forecasted kilowatt-hours take place and there is no shopping in 2009, then under the application the company would basically experience an increase of some $93 million worth of -- I guess $94 million worth of revenue?

THE WITNESS: Can I have that read back, please?

(Record read.)

A. That would be for all customers, yes.

Q. Okay. And would you agree with me that today 99 percent of the customers in Columbus Southern are standard service offer customers?

A. We have very little shopping in Columbus & Southern.

Q. And you would agree with me that even for that 1 percent that are shopping, they would be paying the POLR charges as well?

A. Yes, they would.

Q. Now let's assume that for 2009 all customers shopped with a CRES. In that case would the company receive $94 million in POLR charges and then be free to sell all the generation that otherwise would have gone to the shopping customers, the now-shopping customers?

A. Yeah, I would agree that we would continue to pay the -- collect the 94 million, but we would then be selling power in the wholesale market below tariff and we would experience a loss relative to what we would have gotten had the customers stayed on tariff.

Q. Now, earlier today you told me that you couldn't project what prices were going to be in the future.

A. I'm not projecting what the prices are in the future. I'm projecting that customers would not shop unless it was economically advantageous to them.

Q. But it could be possible, then, that -- I'm going to the part of your answer where you said that "we would be selling below tariff." It's possible that when you sold into the wholesale market, it was above these tariff prices.

A. I can't fathom -- that doesn't mix with the model that I just laid out for you that it's economically advantageous for a customer to shop. If that's the case, the wholesale prices have to be below tariff.

Q. Theoretically, you would agree with me, though, that the -- actually, strike that.

Mechanically what would happen if all customers shopped, was that the company would collect the $94 million and then would collect whatever the value of that generation was in the wholesale market.

A. Assuming the generation dispatched in the wholesale market, yes.

Q. Okay. Now let's take the example that all the customers shopped but it wasn't with a CRES, it was with a governmental aggregator, and the governmental aggregator submitted the notice under 4928.20(J) that they were -- if anyone returned, it would be at market. Would the company collect the $94 million in POLR fees then?

A. Yes.

Q. I'm sorry, you said yes?

A. I said yes.

Q. So it's your view that in municipal aggregation if the municipal aggregators agree that they will -- their customers would only come back at market, they would -- those customers would still have to pay the POLR charge?

A. That's what the proposal is. You have to -- it gets real complicated, Mr. Petricoff,

because, A, you have to assume a bunch of things to
get to where you want to get to, which is there's no
value to those customers. No. 1 is I don't -- as
outlined in the testimony, I'm not sure they would
come back at market. But let's assume they do. How
do you set the market price? And when they come back

at the market price and we set a market price for the remaining time, let's just say it's two years, they then have the put again and could leave again.

Q. So it is your interpretation that under 4928.20 --

A. Can you give me a minute just so I can get there.

Q. Yeah, let's all go look at the language.

And I would direct you to subsection (J). And the language I'm looking at here says: "The electric distribution utility shall not charge any such customer" -- and we're talking about now we've had this notice that's come under the section -- to whom electricity is delivered under the governmental aggregation for the standby service." And your view is that the POLR is not a standby service?

MR. RESNIK: Your Honor, I'm going to object for a moment. When we look at this language, for one thing, it talks about standby service within the meaning of section (B)(2)(e) of 4928.143. When we look at (e), standby service isn't even in there.

EXAMINER BOJKO: Right. It's probably a typo.

MR. RESNIK: Pardon me?

EXAMINER BOJKO: It was probably a typo.

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MR. RESNIK: Probably. Probably referred to (d).

EXAMINER BOJKO: Right.

MR. RESNIK: But I would note that even at that, it talks about standby service within the meaning, and when you look at (d), it just uses the term; it gives it no definition.

EXAMINER BOJKO: Another good aspect of the law.

MR. RESNIK: Another what?

EXAMINER BOJKO: A good aspect of the law that I think we need to clarify. I mean, Mr. Baker on page 27 uses the word "standby service" when he says no government aggregation may elect not to receive standby service so, I mean, I have that exact question written in my notes.

Do you think standby service is synonymous to POLR? And I guess what I'm hearing you say today is no, and I didn't gather from your

testimony that you were saying that government
aggregators still have to pay the POLR, but that's
what you're saying; is that right?

THE WITNESS: What I have on page 7 is
the discussion of the protection, and I'm not -- what
I just want to say is I haven't done a legal analysis

as to whether, in fact, standby is absolutely synonymous with POLR. We just put in a POLR charge as part of our ESP. If we are required by law not to charge customers that POLR charge as a result of them -- governmental aggregation, we won't charge it. I just haven't done the analysis -- had somebody do the legal analysis for me.

EXAMINER BOJKO: Well, does the company offer in their application a standby service charge that would be distinct from a POLR charge?

THE WITNESS: We just have -- we have a POLR charge, we don't have any new standby charge.

EXAMINER BOJKO: I'm sorry, Mr. Petricoff, I needed clarification as well.

MR. PETRICOFF: Yeah.

EXAMINER BOJKO: Please proceed.

Q. (By Mr. Petricoff) I guess I have to laugh for a moment. I mean, the witness has indicated that he has to get a legal analysis.

Apparently LSC had the same problem. They may not have completed their legal analysis either since we have this view.

But let me go back and ask you this point. At the moment, from your understanding, at the moment in terms of what the application is, is it fair to say at this point that you are uncertain whether or not the POLR charge would be made to customers who are engaged in municipal aggregations if a notice has been given?

A. I would say that I would wait for the Commission order to tell me whether or not they considered the POLR to be a standby service and, therefore, effectively bypassable through government aggregation.

MR. PETRICOFF: Mr. Baker, you and I will wait together to see what the wisdom of the Commission is on that point.

I have no further questions. Thank you.

MR. RESNIK: Your Honor, can I just confuse things a little more? The question was asked about standby service, and I would just point out that in Mr. Roush's Exhibit DMR-9, page 91 of 285, there is a schedule SBS for standby service, and I think we have our own meaning of what -- in our tariffs of what standby service is, and then there's whatever meaning the legislature thought they were attributing to the term "standby service."

EXAMINER BOJKO: But that's in addition to the POLR rider?

MR. RESNIK: That is correct. That is

correct.

EXAMINER BOJKO: Obviously, this witness doesn't know that exists so I guess I can't ask that question.

MR. RESNIK: Right. I just want to let you know there is a reference in the tariff to standby service.

MR. PETRICOFF: And, your Honor, we would point out that the statute is what the statute is and that's just a proposed tariff, and we will argue this on brief.

MR. RANDAZZO: No. No. Come on. The record's a mess here, and Mr. Resnik's comment didn't clarify anything. I'll cover it on cross and we'll straighten this out.

MR. RESNIK: All right.

MR. BOEHM: Your Honor, it seems that the order of cross is now being determined by volunteering, so I will volunteer to go after

Mr. Randazzo.

EXAMINER BOJKO: Okay.

MR. BELL: Does that mean I'm stuck in last place?

MR. BOEHM: You didn't volunteer.

MS. ROBERTS: Yes, because I'm going to

go after Mr. Boehm.

MR. PETRICOFF: You're the cleanup hitter.

MR. BELL: I'll clean up.

EXAMINER BOJKO: Let's move on. Mr. Randazzo.

MR. RANDAZZO: Thank you, your Honor.

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CROSS-EXAMINATION

By Mr. Randazzo:

Q. Mr. Baker, we had a brief dialogue, as we occasionally do in this hearing, about a tariff for standby service. Are you familiar with that tariff?

A. I have some familiarity, not a whole lot, Mr. Randazzo.

Q. Does that apply to customers that have their own generating capability?

A. That's my understanding.

Q. And so whatever role that tariff has --

and it's a current tariff?
A. Yes.
Q. And it's been in place for some time?
A. Yes. And that's why I said there wasn't a new standby charge.
Q. Right.

A. I was remembering that there was that standby tariff.

Q. And historically that standby tariff was something that AEP and many other utilities were required to put in place to accommodate requirements under federal law related to the public utilities legislation sometime ago.

A. I believe that's the genesis of it.

Q. Okay. So that has absolutely nothing to do with the migration risk of customers to shopping, right?

A. That's my understanding.

Q. Now, let's try to work through your testimony, if we can. And what I'd like to do first is try to -- Mr. Petricoff's discussion with you regarding the AEP pool arrangement for the eastern companies was helpful because it eliminated a discussion I was going to have with you, but I want to talk about another structure in addition to the

AEP pool that affects responsibilities, relative
responsibilities, for serving the demand that may
materialize on Ohio Power and Columbus & Southern's
system.

One of the things that has occurred
during this transition that we've been involved in

over the last couple decades really is the creation of what are called regional transmission organizations, right?

A. That's correct.

Q. And for purposes of the eastern side of AEP, AEP currently participates in what is known as the PJM Interconnect, correct?

A. We are a member and we participate fully, yes.

Q. Right. And that is the regional transmission organization that AEP selected for purposes of complying with various requirements either federal or state, correct?

A. We were told by the FERC we had to join an RTO, and that was the one that seemed to us to be, at the time, the best option.

Q. Right. Hindsight is both a gift and a burden at times.

A. I would agree with that.

Q. With regard to the things that are done
by the regional transmission organizations, it's my
understanding, for example, that what AEP currently
does, again, for the generation fleet on the eastern
side of AEP, is that each day on a day-ahead basis
AEP on behalf of all of its eastern operating

companies, including Columbus Southern and Ohio Power, offers energy from all of the generating assets into the PJM market; is that correct?

A. We bid in all the generation that is available.

Q. Right.

A. On any given day into the market.

Q. Right. And as part of that bid-in process, you provide PJM with information, including the cost of operating those various generating units that you will offer to PJM, right?

A. What we do is we bid a price, Mr. Randazzo.

Q. But you also provide PJM with cost information related to the operation of that generation fleet, do you not?

A. I don't know whether we provide that information on a daily basis. I do know that we provide them cost information.

Q. Okay. Which, if any, of the offers that
you submit to PJM is actually accepted to PJM is up
to PJM, right?

A. That's correct.

Q. And so on any given day the actual load
that is presented on the Columbus & Southern and Ohio

Power system, that load as it materializes may be served by generators that are owned or operated by AEP. It could be served by generators that are owned and operated by other companies. It's up to PJM to determine which generating units get dispatched, right?

A. On a theoretical basis, Mr. Randazzo, I would agree with you. On an actual basis, what we have found is that our own generation gets loaded and, therefore, goes to serve our customers when you actually come back through the pool.

Q. And the reason it gets dispatched -- and your answer's helpful relative to a comment you made to Mr. Petricoff because you qualified an answer earlier by saying that -- giving him a yes answer and assuming your generation is dispatched in the wholesale market. But PJM dispatches generation based upon the information that you provide to PJM relative to the cost of operating those generating units as well as PJM's judgment about what needs to be dispatched in order to maintain reliability in the RTO footprint, correct?

A. That would be another factor in the dispatch, would be the reliability as well as the bid prices.

Q. Right.
A. Let's just for clarity sake,
Mr. Randazzo --
Q. Yes.
A. -- can we -- we are talking about day-ahead, and there's a day-ahead settlement and then there is a realtime settlement.
Q. Right.
A. Which is where they actually dispatch the generation on a minute-by-minute basis in order to meet the load and then those two activities are settled up.
Q. Okay. And let's just assume hypothetically that in the realtime sense, not the day-ahead sense, but let's assume hypothetically that AEP, the operating companies of AEP in Ohio, Columbus & Southern and Ohio Power, did not have any generation, did not have any generation that they could use to meet their load. They had divested that

generation to third parties. Would you assume that with me?

A. Okay.

Q. Now, isn't it true that the load that would actually present itself on Ohio Power and Columbus & Southern would create a demand which PJM would recognize and dispatch generation to serve regardless of who owns that generation?

A. That's the case -- I hope I'm not mucking up the -- that's the way it works regardless of whether we had divested the generation or not.

Q. Right.

A. I'm just saying in practical terms it ends up coming from our own generation.

Q. And in the structure, in the RTO structure, AEP is what's called a load-serving entity?

A. We are a lot of things.

Q. Well, let's start with that one.

A. We are a load-serving entity.

Q. Okay. And if there was a retail supplier, a competitive retail supplier operating in your service area and actually serving customers, PJM would require them to satisfy any requirements that attach to load-serving entities; is that correct?

A. We are talking about day-ahead and energy right now; is that correct?

Q. We're talking about more globally. For example, let's be specific then. Are the reserve obligations that attach to load-serving entities subject to PJM's tariff?

A. As I understand it, under the FRR if a CRES supplier comes in, we are still responsible for meeting the reserve requirements as if that customer was ours.

Q. Okay. And that's because AEP elected to go with the FRR, right?

A. That was a condition of the FRR. And just to help out, that's a fixed resource requirement under the reliability pricing model or the capacity market inside of PJM.

Q. Okay. And under that option within PJM, the FRR option, there can only be one load-serving entity within the AEP zone to meet the resource adequacy requirement that is specified by PJM's rules, right?

A. As long as we remain an FRR.

Q. Right. And you have elected that option for a period of five years, correct?

A. That is correct.

Q. Now, how many -- are you also providing the resource adequacy or reserve for rural co-ops that may be located in your zone?

A. We have that requirement for retail. Rural co-ops and UNEs can be members and meet their own resource requirements as long as they're not under contract for us -- from us. If we have a full-requirements service with them, then that just gets included in our load.

Q. And that full -- do you have a separate POLR charge for your wholesale customers?

A. No. Our wholesale customers that we have under full requirements contracts don't have the right to shop and to come back during the period of the contract.

Q. Okay. So you're saying that if a wholesale customer of AEP leaves, you do not have an obligation to provide service if they come back to you and request service?

A. Not at any kind of a tariff-based rate. It's a market-based rate.

Q. Okay. And under that circumstance it would not be appropriate to charge them a POLR charge, correct?

A. If -- I don't believe if -- Mr. Randazzo,

I don't know that I can answer that right now because
we haven't had the issue ever on our system, and I
haven't researched what FERC would do about requiring
us to take back a customer. That's never happened,
and so I don't know whether I can say that a POLR is
appropriate or not because so far it's always been

the case that if a customer goes to market as a wholesale customer, they just go out and find another supplier. We bid on it, and we either get it or somebody else gets it and takes on the full responsibility.

Q. Okay. Now, there's been a fair amount of discussion from time to time during the course of this case about off-system sales, and it's something you discuss in your testimony relative to the excess earnings calculation. But I want to talk to you about other opportunities that exist in the PJM structure for AEP or Columbus & Southern or Ohio Power to make money, generate revenue.

What other revenue streams are available to owners of generating capacity under the PJM structure?

A. Well, there's the capacity markets, the energy markets.

Q. Well, let's stop with the capacity

market. Under the FRR election that AEP made to satisfy the resource adequacy requirement of PJM, you have the opportunity to sell generating capacity into the other capacity market RPM, correct?

A. We have some ability. It is limited under the FRR.

Q. Yeah. And the limitation is what, if you recall?

A. The limitation is we have to meet our -- we have to come forward first with our load plus the reserve margin that's been dictated by PJM. Right now I believe that's about 15-1/2.

Q. Right.

A. So we have to have your load times 1.155 is what you first have to assign. Then we have to hold back 450 megawatts, and then we are allowed to have, if we have it, the next 1,300 megawatts into the RPM, or the reliability pricing model, and then once we go above 13 -- if we still have capacity above the 1,300, we're not allowed to bid it.

Q. Right. And have you been releasing that capacity or selling that capacity in the PJM RPM market?

A. When we've had surplus within that bandwidth I described, yes, we have sold it into the market.

Q. You mentioned next the energy market. How is AEP using its assets to participate in the energy market?

A. In that case, going back to your description, we bid in our generation supplies day-ahead, and let's just assume there's only one dispatch so we don't complicate the world.

Q. Yes. And you're distinguishing there between day-ahead and realtime, right?

A. That's correct. So let's just assume there's one for simplicity sake. We would bid in our generation, and PJM would dispatch our generation as long as it was economic and they could maintain the reliability of the system, and we would get orders to dispatch our generation fleet, and we would have a certain amount of megawatt-hours from each of our generating units that had been bid in utilized by PJM.

We would then bid in our load, and both our generation and our load would be priced at LMP, or locational marginal pricing.

Q. Right.

A. Effectively, if you assume there aren't constraints within the AEP system, the load and the generation of an equivalent amount both price out at LMP, so without constraints, without marginal losses, you end up with basically a payment and a receipt of equivalent values. Now, it does get adjusted by those two things that I talked about.

Anything that wasn't needed to serve

AEP's load is then priced at the LMP, and that is what we've termed off-system sales, along with other off-system sales that we make outside of the pool, outside of the PJM pool.

Q. Right. And, of course, it takes fuel costs and other variable costs are incurred to run your generating assets in order to sell into the PJM market, and I'm talking here specifically above the level of your own load, right?

A. We have what we term a variable production cost, which is fuel and one half maintenance that we incur as we believe for the off-system sales.

Q. Okay. Now, so that's the energy market. What other opportunities do you have to deploy generating assets in PJM's market to collect revenue?

A. Then there are the ancillary service markets and like the capacity and the energy market it's a service, there are a number of ancillary services, and AEP, along with any other generator, can bid into those ancillary service markets, and if, in fact, they are chosen, then they receive a payment from PJM.

Q. Okay. You are, in fact, doing that. You are bidding your generating assets into those ancillary service markets; is that correct?

A. I don't know whether we are right at the moment and which ones we are. It just depends. We evaluate whether we want to be in the ancillary service market or the energy market because they are in some of the -- ancillary service markets you either have to be in one or the other.

Q. Then the RPM capacity market is a market where you're satisfying essentially planning reserves for other load-serving entities in PJM; is that correct?

THE WITNESS: Could I have that read back?

Q. Let me withdraw the question.

What function -- let's back up.

You mentioned ancillary services markets. Can you give me some examples of those markets?

A. Those would be realtime reserves, and I'm going to fall back to old terms, spinning reserves.

Q. Spinning reserves, fine.

A. And there's black start and there may be a few others.

Q. Operating reserve?

A. Well, I had operating reserves in the -- but you're right, spinning in 10-minute makes up operating reserve.

Q. And PJM will instruct generators, will they not, on the extent to which generators need to be providing those ancillary functions?

A. Yes.

Q. And if, for example, you are following PJM's instructions as a generator and PJM is asking the generator, being you in this example, to provide ancillary service, let's say operating reserve, for example, and your cost of providing that is in excess of what you receive back in payments, doesn't PJM also give you what is called a make-whole payment?

A. I believe they do, and any time you're called upon and -- in those services and you don't receive -- if you don't cover your costs.

Q. Okay. And so under the PJM structure, PJM will compensate generators that PJM instructs to run for reliability purposes so that the compensation the generator receives recovers its cost; is that correct?

A. If you're called on for -- are we talking
energy market now, Mr. Randazzo?

Q. No, we're talking about for reliability
purposes. If you were instructed as a generator to
provide operating reserves and to operate your

generator, to run the generator, produce energy in this circumstance but you don't receive sufficient revenue as a result of that to cover your cost, PJM will send you a make-whole payment, correct?

A. They will send you a make-whole payment, as I understand it. The issue is -- what I don't know is the definition you have of "cost." And I know that it covers your variable cost. I don't know if there's any contribution to fixed cost; I don't remember.

Q. Okay. And in the example that we've been talking about, the make-whole payments, it's my understanding that AEP allocates the revenue received from those payments back to the eastern operating companies in accordance with the member load ratio; is that your understanding? If you know.

A. Where I'm -- the reason I'm having some trouble coming up with a quick answer is we allocate revenues, we assign costs, and it by definition, it

doesn't necessarily mean there's a margin there. And
I didn't know whether that's where you were going.

Q. Well, there's revenue and cost.

A. Right.

Q. And what PJM does in the form of
make-whole payments end up being allocated costs and

revenues back to the operating companies in accordance with the member load ratio mechanism that you discussed with Mr. Petricoff, right?

A. Yes.

Q. Now, have there been instances, again, talking about the structure of PJM, where entities have defaulted on their obligations to -- financial or other obligations?

A. Yes.

Q. And how does PJM handle the cost of the default?

A. They assign the cost of the default back to the members.

Q. Okay. So what PJM does is essentially socialize the risk of default across the entire membership of PJM, right?

A. Yes.

Q. And that has happened, and relatively recently, correct?

A. Unfortunately that's true.

Q. And I agree, unfortunately.

And when that cost is socialized through PJM in the manner we've just discussed, is the cost then passed on to AEP in some proportion?

A. Yes.

Q. And more specifically, you have reflected the cost in the transmission charges that you have collected through the TCRR mechanism; is that correct?

A. I will accept that, subject to check. I haven't looked at that specifically, how we assign that.

Q. Okay. So are you proposing to -- if your POLR concept is approved, are you proposing to not pass on the costs in the way that you have historically that PJM may impose or socialize through its structure through your TCRR mechanism?

A. For example, the socialization of a default?

Q. Yes.

A. No. We consider those to be independent.

Q. Okay. Now, you were here during Mr. Hamrock's testimony, correct?

A. I was.

Q. And if you recall, not that it was
notable, but I -- my question, not Mr. Hamrock's
testimony, I'm sorry. I meant that differently than
it sounded.

I inquired of -- what was not notable was
my inquisition of Mr. Hamrock, I inquired of him

regarding an attachment to his testimony that is known as the Corporate Sustainability Report.

A. Yes, I know that's attached.

Q. Pardon?

A. Yes, I know that's attached.

Q. Right. Have you read the report?

A. I have, but not in preparation for testifying.

Q. Of course. There's a statement in the report at page 10 of 68, one sentence under the Strategy and Management section that goes like this: "We also have to obtain adequate and timely recovery of AEP's costs and earn a reasonable return for our shareholders on the investments we make in the company."

And I suspect you subscribe to that objective as well. Is that correct?

A. I do.

Q. Very good.

EXAMINER BOJKO: Mr. Baker, would you
like a copy? I don't know how many questions --
He does not have a copy of this.

MR. RANDAZZO: That's really that one
question, I think, on that. I'm happy to provide you
a copy if you'd like.

Q. Now, could we turn to page 5 of your testimony and the answer that begins on line 14. This is where you're discussing what you used for purposes of comparing the MRO outcome with your proposed ESP, and you explain there that you'd been advised by counsel the 10, 20, and 30 percent values are what you should use for purposes of computing what the MRO looks like. Do you see that?

A. I think counsel advised that we used the blends in the law at the time that our ESP applications were filed, and we assumed a 10, 20, and 30 percent, which would be permissible under either law.

Q. Okay. I'm sorry if I was implying anything other than that.

Did you do a sensitivity analysis to look at other percentages?

A. No, we didn't. We believed that those would be the percentages that likely would be enacted in the event that we would go to an MRO.

Q. Okay. On page 6 you indicate, as I read it anyway, that you have relied to some extent on auctions in multiple states that have taken place. And my question to you is -- and there was a bit of a discussion about this yesterday regarding the slice-of-system approach and tranches. Have you read the Commission's order in the -- dealing with FirstEnergy's MRO application?

A. I have not.

Q. And relative -- a rather fundamental question. Why did you pick a three-year term for your ESP?

A. There are a couple of reasons, Mr. Randazzo. One is just the uncertainty of -- the uncertainty around things that may change over the next few years, and it was a nice time line. But the other factor that was a driver was our understanding that if we chose something greater than a three-year period, during the period the Commission could reexamine the ESP against an MRO option and effectively force the company into an MRO position.

Q. That's true under the significantly excess earnings test during the three-year term, too, isn't it?

A. But I believe that becomes our option.

Q. Any other reason why you selected a three-year term?

A. Those were the major reasons.

Q. You indicate on the bottom of page 9 that you place some reliance on things that were done in

Delaware and Maryland, and Mr. Rinebolt asked you some questions yesterday regarding what may have happened in those states.

Are you aware of any sort of -- I was going to use "uproar," maybe not the right term -- reaction to the -- by customers to the results that occurred in Maryland as a result of relying on the competitive bidding process to set electric rates?

A. I know of an uproar, Mr. Randazzo. I'm not sure that it was because of the auction as much as the results, and clearly market prices were higher than what the capped rates were and there were some relatively significant increases. I don't presume that the rates would have been different significantly if you had tried a different form of auction to supply or had gone to the market and just supplied it on an hourly basis.

Q. All right. On page 10 you are discussing there -- beginning to discuss the scientific method, the Black-Scholes method in your inputs, and you note on line 12 that "forward market quotes are not available for the AEP Zone." Why not?

A. It's just not a trading hub. I would -- I appreciate your using the word "scientific." As I thought about it last night, I thought that was probably not the best term, and I would say a qualitative way of looking at the value of the options.

Q. Okay.

A. So I appreciate that.

Q. Good. That saves a few questions. Thank you. Thank you for that.

MR. RESNIK: I'm sorry, could I have the answer read back?

(Record read.)

A. Or quantitative, I'm sorry, rather than qualitative.

MR. RESNIK: Thank you.

EXAMINER BOJKO: Let's go off the record.

(Discussion off the record.)

(Recess taken.)

EXAMINER BOJKO: Let's go back on the record.

Mr. Randazzo, please continue.

MR. RANDAZZO: Thank you, your Honor.

Q. Mr. Baker, page 11, lines 13 and 14, one of the inputs that you used for purposes of pricing the POLR is the PJM Reliability Pricing Model, the Capacity Auctions. I assume there you're talking about the RPM.

MR. RESNIK: Sam, what page were you referring to?

MR. RANDAZZO: Page 11.

MR. RESNIK: Thank you.

MR. RANDAZZO: Lines 13 and 14.

A. The section we're looking at was to come up with a benchmark price. This section was for the JCB-2, but it is the price that we then carried over into the calculation of POLR.

Q. Right. You're using -- for purposes of developing the input value for this component, you're using PJM's RPM, correct?

A. That's correct.

Q. You're not using a value for FRR.

A. That is correct, because there is not a -- we don't have a value for FRR. And what we're trying to do is look at what the competitive price would be, and the competitive supplier is likely to be an RPM participant given the fact that we're the only FRR -- major FRR entity at this time.

Q. Now, what I'd like to do if we can, Mr. Baker, is I'd like to ask you a few questions about your JCB-2, which is the schedule, as I understand it, that shows the MRO versus ESP comparison. Now --

EXAMINER BOJKO: I'm sorry, are you looking at the revised one, Mr. Randazzo?

MR. RANDAZZO: Yes.

Q. Let's take the Columbus -- well, let's just look at the whole thing, the revised schedule. You have a column of numbers for each of the years 2009, '10, and '11 as well as totals for both Columbus & Southern and Ohio Power, correct?

A. That's correct.

Q. And the first three rows deal with the estimated cost of the slice of system power purchase approach you describe in your testimony; is that correct?

A. It would -- yes, it would be an estimate of what we would get if we did a slice of system for the 10, 20, 30 percent blending in a certain amount of market supplies each year over the three years.

Q. And that's for the MRO option, right?

A. That's for the MRO option, yes.

Q. And then you have in the third row you have Estimated Purchase Costs of 10, 20, and 30 percent, estimated annual costs in millions of dollars as shown there for making what is the slice of system power purchase, right?

A. That's what that's intended to do, yes.

Q. Now, there are two more rows of data there underneath that line. Can you tell me what those two additional rows are designed to represent?

A. Certainly. I need to take you down to the ESP to work my way back to that.

Q. Okay.

A. We have proposed a carrying cost associated with environmental -- environmental investments for the 2001 -- that occurred, the investments that occurred in 2001 through 2008, and this would be the carrying costs associated with 2009, '10, and 11. And let's just use Columbus & Southern for this purpose, and that's a $26 million additional carrying charge.

Since we -- moving back up now into the 2001-2008 Incremental Environmental under the Market Rate Option, we felt that since you would be blending 10 percent of the power being supplied by the market purchase, as I look at it, you would only be charging for 90 percent of that load, that 2001 through 2008 incremental environmental. So we multiplied the 28 times 90 percent to get the 23 million, times 80 percent in the second year, et cetera, so it actually blends its way back down as you have less supplied from AEP's -- the Ohio companies' generation.

Similarly, in the case of POLR we have a value that was amended down in the estimated cost, and since we would -- our approach was a slice of system, we would expect that we would be passing that POLR responsibility for that 10 percent, 20 percent, and 30 percent on to the supplier and, therefore, it wouldn't be appropriate to charge the full amount of POLR in that case because that risk would stand with whoever won the auction.

Q. Okay.

EXAMINER BOJKO: Mr. Baker, you meant 26 instead of 28 with regard to the environmental incremental carrying charges?

THE WITNESS: I meant 26 instead of 28.

Q. And would it be correct to characterize the results that you are attempting to portray on this schedule, JCB-2, as an incremental analysis?

A. Yes.

Q. In the bottom half of this schedule where
you're talking about the ESP, comparing that to the
top half, my understanding is what you're trying to
do there is to put the two options on an
apples-to-apples basis.

A. That's what we were attempting to do.

Q. Well, under both the ESP and the MRO sections on this exhibit, you do not have a row of data or information associated with fuel costs, right?

A. No, there is not.

Q. Why have you not shown fuel costs? And by "fuel costs" here I'm referring to the costs that you're proposing to recover through the FAC.

A. Because we did it on an incremental basis, as we described, and I was trying to compare the changes.

Q. Okay. Well, if you are purchasing 10 percent versus 5 percent comparing the MRO to the ESP, wouldn't your fuel costs be different?

A. They could be, yes.

Q. Well, wouldn't fuel be reflected in the cost of the slice of system purchase?

A. Yes.

Q. Okay. So if the slice of system

percentage is bigger on the MRO option, you would expect to see a smaller FAC as a result of that, correct?

THE WITNESS: Could I have that read back?

MR. BELL: Excuse me, Mr. Randazzo, on

the ESP?

MR. RANDAZZO: Well, either way.

EXAMINER BOJKO: Read the question back, please.

(Record read.)

A. As compared to the ESP I think that may be right.

Q. Okay. And the point would be the same regardless of which percentage of slice of system we picked. It's the same whether we're doing 20 percent and 10 percent or 30 percent and 15 percent. There's a fuel-related variable that hasn't been picked up in Exhibit JCB-2, correct?

A. I understand the point you made. I have to -- I'd have to think it through and see if there's an adjustment, but I understand that you would have a different FAC.

MR. RANDAZZO: Okay. Now, if we can, what I'd like to do is begin a somewhat tedious

process, your Honor, and I apologize, I don't know
any other way to do it.

Your Honor, I'm not sure where we are in the exhibits for IEU. If the Bench could help me with that, I'd appreciate it.

MR. CONWAY: I think it's No. 3.

EXAMINER BOJKO: 3.

MR. RANDAZZO: Your Honor, I'm distributing a document that has the United States Security and Exchange Commission at the top, I would like to have it marked as IEU Exhibit No. 3.

EXAMINER BOJKO: This will be so marked as IEU Exhibit 3.

(EXHIBIT MARKED FOR IDENTIFICATION.)

MR. RANDAZZO: IEU, Exhibit No. 3, thank you, your Honor.

Q. (By Mr. Randazzo) Mr. Baker, do you have before you what's been marked as IEU Exhibit No. 3?

A. Yes, I do.

Q. It's entitled United States Securities and Exchange Commission.

A. Yes.

Q. And would I be correct or would you accept, subject to check, that this is a portion of the most recent form 10-K filed by American Electric

Power with the Securities and Exchange Commission?

A. It would be -- it looks to be a copy of the one that was for the fiscal year ended December 31st, 2007.

Q. Right. And it would be a portion of that document.

MR. RANDAZZO: Your Honor, I would ask that the Bench take administrative notice of the full document. I simply as a convenience to the parties made a copy of the portion that I wish to make reference to.

EXAMINER BOJKO: Okay. We will take administrative notice of the document.

Q. Mr. Baker, this document provides information on the structure of AEP, the AEP -- various AEP pool agreements, information about the risks associated with being in the business of a public utility and that sort of thing, correct?

A. Yes.

Q. For example, at page 5 of the document, at the top of the page it would discuss AEP's systemwide approach to financing working capital needs, correct?

A. There is a discussion of working capital.

Q. Do you believe that discussion is

accurate?

A. I would believe it was certainly at the time it was filed.

Q. And this was filed -- this is the 10-K for 2007, and it would have been filed sometime this year, correct?

A. It would have been filed, yes, this year.
Q. 2008.
A. Yes.
Q. And on page 7 of the document it shows the historical and projected environmental investments for the various AEP operating companies.
A. Yes, I see that.
Q. And consistent with the discussion that we had earlier, on page 8 there begins a discussion of the AEP power pool and the Central Southwest operating agreement, correct?
A. Yes, there is a discussion on that.
Q. And on page 12 of this document, for example, there's an indication of the ownership interest that AEP has in the Ohio Valley Electric Corporation, correct, at the bottom of the page?
A. Yes. I'm reading it, Mr. Randazzo.
Q. Yeah, sure.
A. Yes, there is a discussion of OVEC on

page 12.

Q. Okay. Page 23 begins a discussion of the various risk factors.

A. There is a section, Item 1A, that is -- has as a heading Risk Factors.

Q. And on page 29 there's a specific

discussion about Risks Relating to State Restructuring; do you see that?

A. Yes. I would like a chance to read it if you wouldn't mind.

Q. Mr. Baker, any time you need some time and space to read something, please inquire and you shall receive it.

A. Thank you.

I didn't read the rest of it, Mr. Randazzo, but this one certainly reflects what we termed the risks relating to state restructuring at the time it was written and does not reflect the fact that Senate Bill 221 is different than it was at the time this was written.

Q. Certainly, Mr. Baker.

In the paragraph, the first paragraph under "In Ohio, our future rates are uncertain," it talks about the potential risks related to a return to cost-based rates. Has AEP quantified the risks

associated with return to cost-based rates or done
any analysis to determine what the impact of a return
to cost-based rates might be?
A. We have done some analysis, Mr. Randazzo,
but without knowing the specifics of that cost-based
system, I wouldn't say it has the level of precision

that you would have once you had a bill.

Q. Okay. And from your testimony and other places and other testimony from witnesses for AEP, it's my understanding that AEP believes that Senate Bill 221 did not return us to what we traditionally would call cost-based rates.

A. I would say it is not cost-of-service regulation, and some of the provisions that we have, for example, the 3 and 7 increases in the generation cost, non-FAC generations costs, are not cost based.

Q. Okay.

MR. RANDAZZO: Your Honor, at this time I'm handing out a document that's actually a series of press releases. I'd ask this to be marked for identification purposes as IEU Exhibit No. 4.

EXAMINER BOJKO: It will be so marked.

(EXHIBIT MARKED FOR IDENTIFICATION.)

Q. Now, during your questions and answers yesterday and also in your testimony at page 42, line

21, you talk about a reversal in -- that occurred as a result of legislation that affected your ability to transfer generation, and I think yesterday you may have indicated that you thought, in somewhat jest I suspect, but you thought it was unfair.

A. I did say that.

Q. What. Now, during the last ten years there have been a variety of reversals that have taken place in the area of electric utility regulation and philosophies associated with that subject, correct?

THE WITNESS: Could I have the question read back?

(Record read.)

A. I guess I'm not sure on the number of -- your statement about number of reversals, Mr. Randazzo, because I'm thinking of state by state, and I'm trying to figure out on that specific subject where there have been significant changes other than Ohio.

Q. Well, let's talk about the changes in direction that may have occurred within AEP. Do you have IEU Exhibit No. 4 in front of you?

A. This is the news release that --

Q. Yes, press releases.

A. -- says AEP expands European market and trade agreement?

Q. Yes.

A. I do.

Q. I'll tell you what I did and ask you to accept, subject to check, that this is an accurate set of the press releases that I assembled. I went to AEP's website and pulled down press releases from January 8th, 2002, through April 23rd, 2003.

Will you accept, subject to check, that these are accurate copies of AEP press releases issued during that period of time, not all of them, but some of them?

A. I would accept, subject to check, that these are a group of press releases that are on our website. I wouldn't consider that they are perhaps all of the documents associated with the issues that are addressed in these news releases.

Q. Mr. Baker, the first page, and I've numbered each page in the lower right-hand corner, and they're front and back.

A. Yes, I see it.

Q. On the first page this press release was issued in conjunction with the activities that were underway at AEP to expand its energy trading platform, correct?

A. It is a press release about our expanding in Europe.

Q. Right. And the expansion in Europe was occurring based upon your successful U.S -- United States wholesale structure and business model, as it indicates in the middle of the page there?

THE WITNESS: Could I have the question reread, specifically --

Q. I'll withdraw the question.

Page 3, the press release that appears at page 3 is related to activities that were underway by AEP to complete its corporate separation plan, correct?

A. Yes. This was an approval we received from FERC to separate out the Ohio generating assets and the Texas assets.

Q. And you received authority from FERC to do that as well as other states, including the state of Ohio, correct?

A. I'm just trying to remember, Mr. Randazzo. This was separating them from the AEP pool agreement and the CSW operating agreement and the right to transfer those assets within -- in one case to an unaffiliate and in the other to leave it in the distribution company. The states were all at FERC during this process, and as a result of a settlement with those states who were participating, FERC approved it. It doesn't necessarily reflect what was happening at a state level.

Q. Well, let me be more specific, then. You received authority from the state of Ohio, the Public Utilities Commission of Ohio, to transfer generating assets, correct?

A. I believe what we got was the ability to transfer our T and D.

Q. You don't recall an application being filed with the Commission to transfer generating assets to an exempt wholesale generator pursuant to the Public Utility Holding Company Act?

A. I do remember the EWG, but I believe the EWG was going to be Ohio Power Company, not a separate subsidiary. That's the only distinction I'm making.

Q. Okay. Let me try to get to the point more quickly. Assuming you did get some authority from the Public Utilities Commission of Ohio to transfer generating assets, you didn't exercise that authority, did you?

A. That's correct, we did not. And the

reason we did not, because we were -- by the time we got all the approvals, we were starting to look at 2006, and we thought there might be some RSP kind of -- we didn't know it was going to be an RSP, but some continued transition period.

Q. And if we turn to page 4 and page 5,

those press releases are related to things that were going on very generally, not just in the case of AEP, but as a result of concerns about the quality of information that was being reported in energy markets, correct?

A. The two press releases were specifically about activities by five AEP employees, and it was specific to gas; it in no way was electricity.

Q. Right.

A. I'm just making a distinction about energy markets.

Q. Right. But during this period of time there was also a great deal of turmoil in the electricity markets as well, correct? You seem to be hesitating. I'll withdraw that question.

And would you agree with me that as we move through the balance of pages 7, 9, 10, 11, 12, what we're seeing is AEP -- press releases that were issued in conjunction with AEP's decision to back

away from energy trading and go back to its core
utility business.
A. The press release on page 7 dealt with a specific time where we decided to reduce our trading exposure, which was at that time across the 48 states, and to focus more around our own service

territory and our own assets.

The one on page 9 dealt with a decision to divest certain generating assets that had been bought under our unregulated subsidiary.

And similarly, the one on 11 deals with our movement out of those unregulated assets.

I don't know really how to characterize No. 13, Mr. Randazzo.

Q. Let's go to page 9.

A. Page 9?

Q. Yes. And the third full paragraph, a portion of which is in quotes, is attributed to Dr. Draper. Of course, you knew Dr. Draper, right?

A. Yes. I knew him well.

Q. And would you agree with me that at this point in time, approximately January 24th, 2003, AEP, based upon the disappointing experience in energy trading in the wholesale market in general, had made a business model change to return to the more traditional model of regulated utility?

A. Well, I think that I would best describe it, as I did before, that we had decided to be in the regulated business in most of our states, and we would be in the case of Ohio, therefore, at that point another two years with an expectation that we would be going to market at that point, but that we were getting out of places where we didn't have significant assets.

Q. Okay. If we go back when we had bundled service and traditional regulation, do you know whether all the generating capacity of Ohio Power and Columbus & Southern, the cost associated with that generating capacity, was included in rates?

THE WITNESS: Could I have the question read back?

(Record read.)

A. At the time we would have done our cases in the mid-'90s, all of the generating assets at that time owned by those companies -- and I want to make the distinction, the assets owned by the companies -- I believe would have been included in our revenue requirement, the costs associated with those.

Q. Right. And if you recall, going back to that period of time, and specifically with regard to

Ohio Power, there were various parties that argued that Ohio Power had excess capacity and urged the Commission to reduce the rate base by the amount that they claimed was in excess of the value that was used and useful for retail customers.

A. I'll accept that, subject to check. At that time I was not doing the job I'm doing now. I was doing wholesale trading and marketing.

Q. Well, if the Commission -- all right.

For purposes of your presentation here today, did you make any assumptions about what was -- what costs were actually reflected in the non-FAC portion of your proposed rates?

THE WITNESS: I'm sorry, can I have that read back?

(Record read.)

A. What we did, Mr. Randazzo, is we took our current rates, developed what we term a baseline for the FAC, subtracted that baseline from the current G rates to get a non-FAC generation-related rate.

Q. Right. And as I think you indicated yesterday, historically, going back again to a traditional regulatory model, there were reserves included, generating reserves included in the cost that was embedded in the price that customers paid for bundled service, correct?

A. There was generation, and the sum of all the generation that was owned was included. It wasn't broken out as a cost of the reserves; it was a cost of all the generation that the company owned to supply its customers' needs.

Q. Okay. And whatever -- in the electric business, in the industry as you are familiar with it, in order to reliably serve load, you have to have a generation reserve in order to deal with contingencies, forced outages, acts of God, those sorts of things, in order to provide reliable service, correct?

A. Yes.

Q. Okay. And that physical reality is not new to us as a result of electric restructuring, it existed back when we had traditional regulation, right?

A. Yes.

MR. RANDAZZO: Now, your Honor, I would ask that a document with -- a brightly colored document with "American Electric Power" on the front of it, "Fall EEI Conference," be marked for identification purposes as IEU Exhibit No. 5.

EXAMINER BOJKO: It will be so marked.

(EXHIBIT MARKED FOR IDENTIFICATION.)

MR. BELL: Mr. Randazzo, just for clarification while you're distributing this and not to interrupt your thought process, this is the same document that's been referenced by various counsel during cross-examination of the company's witnesses over the preceding days hearing?

MR. RANDAZZO: I have no idea.

MR. BELL: Okay.

MR. RANDAZZO: I've been attending when I could be.

EXAMINER BOJKO: Did you say you have no idea?

MR. RANDAZZO: Yeah, I did.

MR. BELL: The record I think will speak for itself.

Q. (By Mr. Randazzo) Mr. Baker, do you have before you what's been marked as IEU Exhibit No. 5?

A. Yes, I do.

Q. Am I correct that this is a copy of a presentation that was provided recently at the Edison Electric Institute Conference, I believe in Phoenix, on November the 11th, 2008, by Mr. Morris, chairman, president, and CEO of AEP?

A. I certainly can accept that, subject to

check. I have not seen this document prior to
yesterday.
Q. Okay. I'd like to ask you some
questions. And if you would turn to page 4, do you
agree that as we stand here in the fall of 2008 the
conditions that we're seeing have no resemblance to

the conditions that surrounded AEP and the entire industry in the fall of 2007?

A. I believe there are significant changes in conditions that exist today as opposed to existed in the fall of 2007.

Q. Okay. And if you would turn to page 6, would it be fair to characterize that is an effort on the part of Mr. Morris to identify the management priorities for AEP during 2009?

A. I believe that Mr. Morris chose a number of points that he wanted to convey to the people at the EEI conference, and certainly these are some of the significant management priorities for 2009.

Q. Well, who attends the EEI conference?

A. A lot of different people. There are analysts. There are bankers. There are other utilities.

Q. And, in fact, the presentation that I've handed you and has been marked as IEU Exhibit No. 5

is one that's posted on AEP's website, correct?

A. I accept that, sure.

Q. Yeah. And so quite a diverse audience, financial analysts, utility representatives, other stakeholders would have been the audience at this conference, right?

A. Yes.

Q. Okay. And as part of the presentation, page 7, AEP is announcing its intention to reduce capital expenditures in 2009?

A. That is what this states, and what we are trying to do is reduce some of the activities that we've previously planned to do, not so much things that are already in progress.

Q. Understood. But there's a projected $750 million downward adjustment in capital spending for 2009 relative to the prior forecast for 2009, right?

A. Yes, that's what this says.

Q. And then we go to the next page, and it shows where the money is going to come from, where the cash is going to come from to do the things, right?

A. Yes. There's sources and uses of cash flow.

Q. And is it fair to say that based upon the latest projections that AEP's capital spending is going to be funded most significantly by cash flow from operations rather than taking recourse to the capital markets?

A. I'd say what this shows is we are

reducing debt dramatically, and that reflects the reduction in capital spent.

Q. And given the turmoil in the financial markets, you would judge that to be, and so would I, a prudent thing to do?

A. I think I would describe it in a couple of ways, Mr. Randazzo. One is it's a prudent thing to do because of the fact that the markets are in turmoil, but as well, it's an issue about timely recovery of investments.

Q. Sure.

MR. RANDAZZO: Your Honor, I would ask that another document, brightly colored, titled "American Electric Power, Fall EEI Conference, Handout on Additional Topics," be marked for identification purposes as IEU Exhibit No. 6.

EXAMINER BOJKO: It will be so marked.

(EXHIBIT MARKED FOR IDENTIFICATION.)

THE EXAMINER: May I have another one,

please?

MR. RANDAZZO: I'm sorry, yeah. I wondered why I had one extra.

EXAMINER BOJKO: Thanks.

Q. (By Mr. Randazzo) Mr. Baker, do you have before you what has been marked as IEU Exhibit No. 6?

A. Yes, I do.

Q. And would I be correct that this is a set of handouts that accompanied the presentation that Mr. Morris made and is described in IEU Exhibit No. 5?

A. That's certainly what it appears to be, yes.

Q. Now, I'd like for you to turn to page 6. Do you have that page in front of you?

A. Yes, I do.

Q. And am I correct that this page is indicating AEP's information on what has happened to the price of electricity as well as the NYMEX-related price of coal as stated by various indices, with the price of electricity being referenced to the AEP-Dayton hub?

A. Yes, that's true.

Q. And the testimony and exhibits that you filed in this case were filed on July 31st; is that

correct? If you know.
A. Yeah, I believe it was July 31st.
Q. And according to at least these trend lines, there's been a fairly dramatic reduction in both the price of electricity and price of coal since that period of time; am I correctly reading the

graph?

A. There has been a reduction in the forward price of both of these commodities as I look at the graph for the 2009 delivery year.

Q. Right.

A. Yeah.

Q. And maybe others know, I have to confess I'm not as comfortable with this term as I probably should be, but what is the "dark spread"? Other than something I find in my refrigerator after the expiration date has moved on.

A. I don't know what dark spread is.

Q. Okay. Now, also in conjunction with the materials that were handed out at the EEI conference that have been marked as IEU Exhibits No. 5 and 6 there is a document that's known as the 2008 Fact Book, F-a-c-t, Fact Book for AEP. Correct?

EXAMINER BOJKO: I'm sorry. Did you mark this as IEU Exhibit 7?

MR. RANDAZZO: I haven't yet. I asked the witness if there was such a document handed out in conjunction with the EEI conference. But I am going to ask that this be marked as IEU Exhibit No. 7.

A. I can accept that subject to check. I was supposed to be out at this conference and I would have more information, but I was kind of busy here in Ohio.

Q. Yes.

EXAMINER BOJKO: So it will be so marked as IEU Exhibit 7.

(EXHIBIT MARKED FOR IDENTIFICATION.)

Q. Mr. Baker, the document that sits in front of you, do you have IEU Exhibit No. 7 in front of you?

A. I do.

Q. Okay. This document provides loads of information regarding AEP and its various operating companies from corporate strategy to financial plans to operating company statistics and so on, correct?

A. It provides a lot of information that our investors and analysts who follow the company are interested in knowing.

Q. For example, on page 7 you have a brief

paragraph articulating the business strategy of AEP,
right?

A. Yes.

Q. Okay. And on page 12 we see a very brief
description of how AEP operates its generating
capacity, again referring to the various power pools

that exist within AEP, correct?
A. Yes, there is information about our generation fleet and how it's dispatched.
Q. And on page 16 there is shown there as of September 30th, 2008, original cost and net plant values for individual categories of assets, production, transmission, and distribution, for the entirety of the utility operations, correct?
A. Yes, that's information as of 9/30/08. It's a composite of all of our investments' original cost, the accumulated depreciation to date, and net those out, and you get a net utility plan.
Q. If we go to page 19, we begin information for each of the AEP eastern region operating companies. Appalachian Power is the first one, Columbus & Southern, as well as Ohio Power are included in that section beginning at page 19, right?
A. That's correct.
Q. And part of the information by operating

company shows the average cost per kilowatt-hour for residential customers that would appear on page, for example, page 22 for Appalachian Power.

A. I see the average cost per kilowatt-hour, yes.

Q. Right.

A. Based on -- it looks to me to be based on 2007.

Q. 2007 data, right.

And on page 26 we would see a similar cents per kilowatt-hour number for Columbus & Southern, just by way of example, right?

A. There's one for Columbus & Southern on that page, yes.

Q. Right. Now, in the case of Ohio Power, if you turn to page 36, on page 36 it shows the total amount of generating capacity held by Ohio Power at almost 8,500 megawatts. Do you see that?

A. I do see that.

Q. And page 38 would show Ohio Power's system peak in 2007 of roughly 5,500 megawatts.

A. I do see that.

Q. And that would be another indication of Ohio Power being long on generating capacity as a member of the AEP pool?

A. At that point in time it's a reflection,
and I don't know whether they had a peak this year
and how that changed.

Q. Okay. And on page 54 we see there a
discussion about overall regulatory strategy.

A. Yes.

Q. And on page 56 there is beginning a discussion of the state-by-state or operating company-by-operating company regulatory activity that is currently underway, right?

A. Yes.

Q. And on page 57 it talks about the Ohio Electric Security Plan filing.

A. Yes. There is information and a synopsis there.

Q. The last sentence is the one that I would guide you to on that page. It says there that AEP anticipates an order from the Commission in the first quarter of 2009. Is that your understanding?

A. As we've talked about in the early part of this hearing, we are in every way hoping that there is an order out before that period, but we -- given everything that's happened, we think that that's unlikely and should come out in the first quarter.

Q. You're telling the financial community,
at least, that you believe that it will happen in the
first quarter of 2009 sometime, correct?

A. Well, I think what we're telling the
financial community is to, as they think about
looking at modeling our system, that they shouldn't

assume that it's necessarily going to come out on the 150th day.

Q. Okay. So when you tell them "We anticipate an order in the first quarter of 2009," you're not suggesting to them that they should expect an order in the first quarter of 2009 sometime?

A. I'm saying that's what we have indicated here and we're telling them. It's just the distinction is that we are hoping and wanting an order by the end of '08.

Q. I understand that, but this, again, this Fact Book was distributed on November the 11th, 2008, right? It was before we had the experience that we've been through in this hearing.

A. No; but the point is that we knew we were No. 3 in the queue. We knew there was a delay requested by Consumers' Counsel and a number of other parties, so we had some pretty good information at that point.

Q. Okay, I'll let that go.

Page 62 --

EXAMINER BOJKO: I'm sorry, though, you did say it was distributed November 11th, 2008. Is that when the conference was? I've been wondering when the conference was. Is that what you stated, 2008?

THE WITNESS: It appears that the conference, according to this document, was November 9th through 12th.

Q. And the presentation, Mr. Baker, will you accept, subject to check, the presentation and the materials were distributed on November the 11th?

A. I would accept that it was -- I would accept that the presentation was done on the 11th. There's the possibility that some of the documents were given to people when they got to the conference.

Q. Sometime between November 9th and the 12th.

A. That's correct.

Q. Okay. And on page 62, this page discusses the recent application that has been made by the AEP East companies to increase their transmission tariff prices.

A. It's a request to increase the revenue requirement. And I would have to look at what the loads were at the time when we set the 507 versus the 606 to see if it increased the rate. That's the only distinction I'm making.

Q. Well, you've made a filing with the Ohio Commission to increase the transmission component of

the retail rate, right?
A. That's right.
Q. And at least based -- do you know how much revenue is associated with that increase as it's proposed here in Ohio?
A. I don't have that number with me.
Q. Page 62, the third bullet point indicates that there's approximately 31 million of the overall increase that's related to third party and Ohio. Does that refresh your recollection at all in terms of the --
A. I don't know how that breaks out between third party and Ohio.
Q. Okay. And who would be the third party here?
A. That would be other parties who utilize the AEP system, transmission system, for example, municipal loads, cooperatives, anyone who's buying network service or point-to-point service on our

system other than us.

Q. Okay. Page 80 of the document, this would show the generating capacity that AEP has, AEP in total, available to it, correct? Domestically that is.

A. Yes, I think that's a fair representation of that page.

Q. And the Ohio Valley Electric Corporation capacity is shown there, correct?

A. That is generation that is available to the system to utilize.

Q. Right. And if we would turn to page 125, am I reading this correctly, that the capitalization goal for AEP is to maintain a 60/40 debt to capital ratio?

A. I read that to say that it is a maximum, not a target.

Q. Okay. And the data above that would show where you are currently relative to that objective?

A. Yes, it would, for the whole AEP system.

Q. And are you aware, sir, that for purposes of computing carrying costs that the capitalization ratio of 50/50 has been used?

A. Yes. We were trying to reflect more of what the capitalization is as we look at our

operating companies and looking at it from a
rate-making standpoint.

Q. And the carrying cost or carrying charge
rate that we have just been discussing is the one
that applies to the environmental-related
expenditures, correct?

A. Yes.

Q. Are there special types of financing that are available for environmental equipment such as pollution control bonds?

A. In cases, yes.

Q. And if we turn to page 132, we see there on the top of the page the debt schedule as of September 30th, 2008, for Columbus & Southern that includes some, almost -- well, a little bit over a hundred million dollars of pollution control bonds. Do you see that?

THE WITNESS: Could I have the question read back, please?

Q. Let me restate it. It might be quicker. At the top of page 132 am I correct that the information in this Fact Book shows that Columbus & Southern has as of 9/30/08 approximately a hundred million dollars in pollution control bonds outstanding?

A. Are you adding the 48, the 43, the 44 and the 56?

Q. Well, excuse me, my question was badly worded.

The fixed interest rate component is approximately a hundred million dollars, correct?

A. That's what this schedule shows.

Q. Okay. And if we were to go to page 133, we could also see for Ohio Power Company the extent to which pollution control bonds had been utilized to finance -- raise capital related to environmental compliance equipment, correct?

A. Yes, I believe that's what this schedule shows.

Q. And these pollution control bonds are issued with the assistance of various states or other divisions of government, correct?

A. I'll accept that.

Q. And they tend to have, relatively speaking, advantages that are not otherwise available in the public capital markets.

A. That's not an area I do a lot of work in, Mr. Randazzo, so I wouldn't want to characterize them.

Q. Well, if you could secure capital at

4 percent through the use of pollution control bonds
as contrasted with using common equity proceeds
associated with issuing more shares, would you --
common equity shares, would you expect that you would
take full advantage of the pollution control bonds to
finance environmental equipment?

A. I think you would, depending on the terms and conditions of those pollution control bonds.

Q. And of the incremental environmental expenditures that occurred between 2001 and 2008 upon which you're requesting carrying charges in this proceeding, how much of that plant or equipment was funneled through the use of pollution control bonds?

A. I just don't have that information.

Q. Now, I'll try and shorten this up a little, Mr. Baker. I was going to hand out a bunch more documents, but I think we may be able to shortcut this.

We talked earlier about AEP's participation in PJM and the use of the FRR approach to satisfy your resource adequacy obligation back to PJM. Do you recall that?

A. Yes.

Q. And that entire subject area has been producing outcomes that reflect an evolution over time in the approach to resource adequacy. Is that a fair statement?

A. There was a -- the evolution, nothing's happened evolutionary. It has been under siege since the first day it was suggested, but there was a single-approved FRR RPM approach that is now under siege once again.

Q. Right. And the exact outcome associated with the debate associated with resource adequacy is going to be very difficult for anybody to predict, correct?

A. I think it is -- it is difficult to predict, but I probably don't expect that there will be major changes.

Q. Okay. As part of AEP's interaction in that process, am I correct that one of the things that AEP has been trying to do is to get more of an opportunity to sell capacity into the RPM market?

A. I would like to put that in context, Mr. Randazzo.

Q. Yes.

A. AEP was the major advocate for FRR, and as a result of that, we came out with the conditions you and I talked about earlier, the amount of reserves we had to carry, how much we held back before we were able to bid into RPM and then ultimately a ceiling cap.

We were very satisfied with that. It may not have been our desired outcome, but it was a negotiated settlement which we were willing to accept.

At the time others put FRR under siege, as I called it earlier, we took positions that tried to make it perhaps a little more attractive to us and was consistent with what the Brattle Group did, so I would consider it part of a negotiation as opposed to our taking an initiative to try to change that.

Q. Well, would it be fair to say that one of the things that AEP hopes for is an improved opportunity to sell more capacity into the RPM market?

A. We would be -- we were satisfied where we were. We were not pursuing this except for the fact that we don't know what's going to come out of the whole aspect, so we were trying to preserve against downsides.

Q. Were you asking also for a better opportunity to have demand response counted against your resource adequacy obligation? Do you recall?

A. I'd have to look at -- do you have a

document that I could look at?

Q. You bet.

A. I'm sorry to ask you that, but I'd like to know the context within which that question is being asked.

MR. RANDAZZO: Can I approach the

witness, your Honor?

Q. Mr. Baker, I'm going to hand you a document called Wholesale-Retail Interface in AEP's Regulated States, dated May 9th, 2008, for purposes of refreshing your recollection.

A. Thank you.

Q. And would direct you to page 10. And if I could look over your shoulder.

Presently --

A. This --

Q. Go ahead.

A. Seems to me these are a list of issues as we described it that exist inside the DR capacity market.

Q. Right. And is this from an AEP presentation?

A. It certainly looks like an AEP presentation, although it isn't marked that way. I'll accept that it is.

Q. As part of the advocacy that AEP has undertaken at PJM, and if you would turn to the next page, page 11, doesn't AEP indicate that a better outcome would occur when AEP is allowed to offer more than 1,300 megawatts into the RPM market in any combination of generation or retail demand response?

A. That's what this says, and again, I think it just needs to be put in context of when and why it was done.

Q. Right. And believe me, Mr. Baker, I mean this sincerely, it is a credit to AEP that you were able to get the FRR through PJM.

MR. RANDAZZO: Your Honor, I would ask that a document titled Annual Report 2007 for Ohio Valley Electric Corporation be marked as IEU Exhibit 8, I believe it is.

EXAMINER BOJKO: It will be so marked.

(EXHIBIT MARKED FOR IDENTIFICATION.)

Q. Mr. Baker, do you have before you what's been marked for identification purposes as IEU Exhibit 8?

A. Yes, I do.

Q. And will you accept, subject to check, that that's the Annual Report for 2007 issued by the Ohio Valley Electric Corporation?

A. Yes, I'll accept that.

Q. And Ohio Valley Electric Corporation is an affiliate of AEP; is that correct?

A. Yes. That's what's stated in the second paragraph on page 1.

Q. And, in fact, Mr. Morris, the president and CEO of AEP, is also the head of Ohio Valley Electric Corporation, correct?

A. That's correct.

Q. And page 2 of the Annual Report provides information on the power costs associated with the generating capacity owned and operated by Ohio Valley Electric Corporation, correct?

A. It does have information about the dollars per megawatt-hour compared year on year.

Q. Okay. And the sales that are made by OVEC are -- are they subject to the jurisdiction of the Federal Energy Regulatory Commission?

A. Yes, they are.

Q. And am I correct that the Ohio Valley Electric Corporation has elected to remain with cost-based regulation for purposes of FERC rate-making?

A. Yes. The sales to the sponsoring companies are done based on cost.

Q. Okay. So one of the sponsoring companies would be Columbus & Southern, for example.

A. Yes, it would.

Q. And Ohio Power as well?

A. Yes, it would. I would note, though, that the costs associated with these have -- or the sales associated with the power we receive from OVEC has virtually all been used in the wholesale market.

Q. Okay. So you're taking electricity that you purchase at cost-based rates and you're selling it into the wholesale market at market based rates, right?

A. That's correct.

Q. That would be the kind of arbitrage that you frown on in the context of demand response programs, right?

A. The difference is that we -- AEP took ownership, took the risks associated with OVEC building this capacity, ended up in a situation where the customer chose to close down shop and left us with capacity, which could have been positive or negative to market prices.

This was a risk that we took on, so yes, I think it's appropriate.

Q. Is the ownership interest of Columbus &

Southern in OVEC reflected in its balance sheet, in Columbus & Southern's balance sheet?

A. I believe it would be.

Q. So the common equity on Columbus & Southern's balance sheet would reflect its ownership interest in OVEC, correct?

A. I don't know the answer to that question, Mr. Randazzo.

Q. Well, if it is reflected in the common equity balance on Columbus & Southern's balance sheet, it would also be included in your proposed excess earnings test, correct?

A. Yes, it would be. Or I believe it would be.

Q. And on page 3 -- never mind.

As I understand your testimony, one of the things that you're asking the Commission to do is to permit you to transfer whatever interest you hold in OVEC, at least the Ohio side of your operations; is that correct?

A. I don't believe that's what we're asking the Commission. I believe what we were asking the Commission to permit is the transfer of Darby and Waterford, should we choose to do it, and we indicated that it was our belief, just so they saw the full picture, that if we wanted to move OVEC and/or Lawrenceburg, that that would be a FERC jurisdictional decision -- or, they would have jurisdiction over that decision.

Q. Okay. In your testimony you describe the Ohio Power and Columbus & Southern interest in OVEC

as contract entitlements, right?
A. That's what I've described it, yes.
Q. Right. And I thought we just established that at least for Columbus & Southern, there is an ownership interest in the assets of OVEC, right?
A. There is an ownership interest in the assets, but the procurement of the power and energy is under a contract.
Q. Right. And you understand one of the reversal -- the reversal that took place that you describe in your testimony is the General Assembly has now said you can't transfer any generating asset without the Commission's permission, right?
A. There is a provision about moving assets, and it was our interpretation that neither Lawrenceburg nor OVEC fell under that.
Q. Okay. Now, I want you to just bear with me and tolerate an assumption that I'd like you to make. And I'd like to you make, at least in the case

of Columbus & Southern, that PUCO permission is required in order to transfer Columbus & Southern's ownership interest in OVEC. Will you bear with -- accept that assumption?

A. I will accept that assumption.

Q. In the event that the transfer occurs --

I'd like if you would focus on page 5.
A. Page 5 of?
Q. Of the IEU Exhibit 8, the Annual Report. Do you see -- and this is part of OVEC's balance sheet as reported in the Annual Report, correct, page 5?
A. Yes.
Q. Do you see the Regulatory Liabilities category?
A. The $5 million?
Q. Actually, the regulatory liabilities consists of the total of 89 million.
A. Oh, okay.
Q. Okay?
A. I see the total of 89 million.
Q. Now, as regulatory groupies end up spending a lot of time talking about regulatory assets, can you tell me what a regulatory liability is?

A. Generally a regulatory liability, as I understand it, is something that is on a company's books that they would ultimately be returning to customers. In that context I'm not sure, I haven't analyzed what that means as far as OVEC's concerned, but we can certainly walk down that path.

Q. Okay. My question is, in the event that Columbus & Southern would transfer its interest in OVEC, what would happen to the regulatory liability amount? Would Columbus & Southern be paid what it's owed at the transfer, or would the new owners get the benefit of that, or how would that work?

A. I think that would depend on what the transaction terms and conditions were.

Q. All right. Now, despite all the change that has taken place, as described on page 4 of IEU Exhibit No. 3, which is the page with the four pictures on it titled "What has changed?"

A. Yes, I see that.

Q. Despite all of that, has AEP adjusted its earnings guidance for 2009?

MR. RESNIK: Are you referring to IEU Exhibit 3?

MR. PETRICOFF: Exhibit 5.

EXAMINER BOJKO: Page 4, Exhibit 5.

MR. RANDAZZO: Yes, I'm sorry. Thank
you.

MR. RESNIK: Okay.

MR. BOEHM: It's 5, huh?

MR. RANDAZZO: Yes. Sorry.

MR. BELL: Do you need the question

reread, Mr. Baker?

THE WITNESS: No, I'm not sure I do.

I don't have in front of me what our earnings guidance for 2009 was earlier. I just know that on page 9 of that report we now have an earnings guidance of $3 to $3.40 a share.

Q. Right. And do you know if AEP yesterday affirmed its earnings guidance for 2009? Or this week.

A. I believe that's true.

MR. RANDAZZO: Now, your Honor, I'd like to have marked for identification purposes IEU Exhibit No. 9, a multipage document with the case number 08-196-EL-AIS and a PUCO stamp on the front page.

THE WITNESS: What number is this again, Mr. Randazzo?

EXAMINER BOJKO: IEU Exhibit 9.

THE WITNESS: 9?

MR. RANDAZZO: 9, yes.

THE WITNESS: Thank you.

EXAMINER BOJKO: This was the application filed in this case?

MR. RANDAZZO: Yes, your Honor.

EXAMINER BOJKO: It will be so marked as

IEU Exhibit 9.

(EXHIBIT MARKED FOR IDENTIFICATION.)

Q. (By Mr. Randazzo) Mr. Baker, do you have what has been marked as IEU Exhibit No. 9 in front of you?

A. Yes, I do.

Q. And would you accept, subject to check, this was an application that was filed on behalf of Ohio Power Company to obtain authority to issue securities in PUCO case number 08-196-EL-AIS?

THE WITNESS: Could I have the question read back?

(Record read.)

A. I see that it's requesting authority to refinance portions of environmental and pollution control facilities to enter into loan agreements or installment agreements for a number of entities and to enter into interest rate management agreements.

Q. Will you accept, subject to check, that when an application bears the letters AIS, it's an indication by the Commission that it's an application to issue securities?

A. I'll accept that subject to check.

Q. Okay. If you would turn to page E-14, which is a page in the exhibit that's attached to the

application -- do you have that page in front of you?
A. Yes, I do.
Q. And if you would go down to the Expenses category --
A. Yes.
Q. -- and more specifically to the Fuel and Other Consumables Used for Electric Generation line.
A. Yes, I see it.
Q. And would you accept, subject to check, that there AEP is providing its income statement-related fuel and other consumable used for electric generation expenses for each of the three years 2005, 2006, and 2007?
A. Yes, I would.
Q. And am I correct that between the years 2005 and 2007 the expense for that item declines by more than $60 million, from 2005 to 2007?
A. I would accept that that single line is a reduction of about $52 million.

Q. And the fuel and other consumables is part of what you're proposing to recover through the fuel adjustment mechanism proposed in this proceeding, right?

A. Yes, it is.

Q. Okay.

A. But I think it's important to note that this is a single point in time, and what we're talking about is looking at a baseline going back to what's in rates.

Q. Right. In fact, it's not a single point in time, it's three years worth of information, right?

A. Well, I was talking about 2007. But three years, correct.

MR. RANDAZZO: Your Honor, I believe I'm about done. If I could use a few minutes to sort through my stack, I think everybody would be better served --

EXAMINER BOJKO: Please.

MR. RANDAZZO: -- to get me over.

EXAMINER BOJKO: Please.

MR. BOEHM: Excuse me, if we're off the record.

EXAMINER BOJKO: We're not.

Let's go off the record.

(Discussion off the record.)

EXAMINER BOJKO: Let's go back on the record.

Q. (By Mr. Randazzo) Mr. Baker, earlier I asked you a question related to Ohio Power and one of

the pages in the Fact Book, page 38, that shows the
2007 system peak on August 23 for Ohio Power of
approximately 5,500 megawatts. Do you recall that?
A. Yes, I do.
Q. And was Ormet being served at that point
in time?
A. Ormet was certainly on the system. I
don't know whether it was running at that peak time.
Q. Okay. I can't resist. I have a couple
of questions about the Black-Scholes. Did you use
for purposes of trying to compute the POLR charge
alternative measures of risk-free interest rate? For
example, did you run the model using a Treasury note
interest rate?
A. I'm not sure whether we did or not,
Mr. Randazzo, but when we talked about this
yesterday, I indicated that the Treasury, the federal
rate was lower than the LIBOR and, therefore, would
have increased the POLR value.

EXAMINER BOJKO: Is your microphone on?
Or pull it closer.

Q. And do you know what degree of sensitivity there is in the outcome based upon which risk-free instrument you may have used to run the Black-Scholes model?

A. I think -- as I understand it, there's less sensitivity to the interest rate than there is to the other components.

Q. But you didn't run the model to check sensitivity based upon different risk-free interest rate --

A. As I said, I don't know.

Q. Do you know how many different LIBORs are published?

A. Well, there are -- I went out on the internet last night, and just so that we'd be at least somewhat on the same page, and looked up -- and there were a lot of sources to go to. What we used was Bloomberg, which puts out a rate for LIBOR, I believe for more than ten years.

Q. Are there 15 different loan durations? If you know.

A. Bloomberg gives a number, as was reported to me, for values on a monthly basis looking out that far.

Q. So you used a one-month LIBOR?

A. What was being projected for each of the months for the three years.

Q. And did you use an average?

A. Yes. We used an average of the three

years.

Q. All right. But you used the one-month published value.

A. The numbers were provided as part of a data request, and they are broken down by month, and then there is an average of the three years.

Q. Right. Is there a three-year rate? We have a three-year ESP.

A. I would -- I know that LIBOR itself puts out 12 months, and then I understand that there is trading that goes out in those longer periods of time.

Q. All right. And when we talk about a risk-free rate of interest, the risk that that interest is free of is the risk of default, correct?

A. I think that's the major component of why it's risk free, yeah.

Q. And would you characterize the interbank lending rate presently to represent a risk-free rate of interest?

A. I think it's a proxy for it, and, as I said, in picking two points in time it was lower than the three-year Treasury.

Q. Are you aware, Mr. Baker, some of the major international banks have been on the brink of default here recently?

A. As I understand it, if there's a concern about LIBOR, it may understate the interest rate, and if it, in fact, understates the interest rate, then again, that inures to the fact that you will get a lower POLR than if you used a higher interest rate.

Q. We had this discussion, Mr. Baker, yesterday, and I agree with you completely that you can't evaluate a model based upon the outcome. So if the LIBOR is not a risk-free interest rate, then it's not appropriate to use it in the model regardless of what the results are, correct?

A. I believe what I said was it was a proxy for the risk-free rate.

Q. Well, but if it is not, in fact, a risk-free rate, it shouldn't be used for purposes of the Black-Scholes, right?

A. No; I don't agree with that.

Q. Do banks buy insurance to protect against default?

A. I have not done an analysis of the banking industry. I don't know.

Q. Does AEP have any debt instruments that are reset to LIBOR?

A. I don't know.

Q. Are you aware of whether or not AEP has attempted to get out of debt instruments that are reset to LIBOR because of the volatility in the LIBOR?

A. Again, I don't know.

MR. RANDAZZO: That's all I have.

Thank you, Mr. Baker, for your patience.

EXAMINER BOJKO: Thank you.

Let's go off the record.

(Discussion off the record.)

(At 1:04 p.m. a lunch recess was taken until 2:30 p.m.)

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Wednesday Afternoon Session,
December 3, 2008.

- - -

EXAMINER BOJKO: Let's go on the record.
Mr. Boehm.

MR. BOEHM: Yes, your Honor.

EXAMINER BOJKO: Did you have something, Mr. Randazzo?

MR. RANDAZZO: Would you rather I moved my exhibits at the end?

EXAMINER BOJKO: I thought we would do all the exhibits together for Mr. Baker at the end because the company has some, too. Are you going to be here?

MR. RANDAZZO: Yes, your Honor.

EXAMINER BOJKO: Please proceed, Mr. Boehm.

- - -

CROSS-EXAMINATION

By Mr. Boehm:

Q. Afternoon, Mr. Baker.

A. Good afternoon, Mr. Boehm.

Q. I just have a few questions for you, Mr. Baker, just some knicks and knacks that were left over.

There was a question I think several hours ago by Mr. Petricoff with respect to the interconnection agreement or the pool agreement, as you call it, and --

EXAMINER BOJKO: Can you speak up, Mr. Boehm, please?

MR. BOEHM: Excuse me.

Q. -- the pool agreement, as it's been identified variously, or the interconnection agreement and there was, I thought, a gap, one small gap, and that is the question was asked, I believe, when there is a transaction as between a member who is deficit and the rest of the pool or members who are surplus under the interconnection agreement, and the deficit member essentially buys power from the pool, I guess my question is, what does he pay for it? What is the price based upon?

A. I need some clarification, Mr. Boehm.

Q. Okay.

A. Are we talking about capacity or energy?

Q. Let's start with capacity.

A. Okay. In the case of capacity, and yesterday when you and I -- or, when I was talking to somebody, I said -- I made a comment as to whether or not the capacity equalization was purchased power, and what I was talking about there was in the context of the discussion where I was talking -- people were talking about going out and acquiring capacity in the market, and that was the difference that I was making. It is truly purchased power and included in the purchased power accounts.

But on that case what we charged was the weighted cost of all the capacity that the long company has plus their fixed O&M. So it's basically the fixed charges, the average fixed charge for the long companies gets paid by the short companies.

Q. I'm sorry, go ahead.

A. In the case of an energy, which is done on an hour-by-hour basis, that's based on the monthly primary energy rate, which is -- I believe it's fuel plus one half O&M. I believe those are the components.

Q. These are based on the fuel costs and the O&M costs of the seller.

A. Of the seller on a monthly basis.

MR. BOEHM: Your Honor, at this point in time I don't have any really many more questions on the interconnection agreement because most of them have been taken care of, but we do address it in our testimony, and it would be good, I believe, to have the Commission take administrative notice of that interconnection agreement. It's like 130-something pages. I'm not going to try to have it filed here or anything else but so that people may be able to refer to that document in their briefs.

EXAMINER BOJKO: Is it publicly filed somewhere?

MR. BOEHM: Yes. It's a FERC document.

MR. PETRICOFF: It's a FERC-approved document.

EXAMINER BOJKO: But, I mean, is it on their website as well, easily accessible?

MR. BOEHM: I can undertake to make sure that link is available to everybody so they won't have to --

EXAMINER BOJKO: Any opposition?

MR. RESNIK: No.

EXAMINER BOJKO: Okay, we'll take administrative notice of that.

MR. BOEHM: Thank you.

Q. (By Mr. Boehm) Mr. Baker, going to page 21 of your testimony, actually, 21 going over to 22, as I understand it, you see the 5, 10, 15 percent fuel purchases proposed to be made by the company in this case "as a limited feature for the continuing transition to market rates," and I'm quoting then from the very top line on page 22. Do you see that?

A. The word you have in the middle of that confused me. I think you said purchased -- fuel purchases. I think you're saying 5, 10, 15 percent of purchased power.

Q. Oh, I'm sorry, purchased power, yes. Thank you for the correction. In any event, you see there on page 22 where you say this is "a limited feature for the continuing transition to market rates"; is that right?

A. That is one of the pieces of the discussion around why we believe it's appropriate to make the 5, 10, 15 purchase, but it actually carries through through line 15 on that page.

Q. Yes. The references to Mon Power and Ormet. Is that what you mean?

A. Yes.

Q. Do you see the filing by AEP in this case of an ESP as a movement toward market?

A. No, I don't. I don't consider that -- I think that's one of the features of the 5, 10, 15, that if you were ultimately to move toward market, you start to do some blend, but I don't see that this dictates whether we are moving to market in year 4,

assuming the ESP is approved, or at a future time.
It's just -- it starts a part of the process.

Q. I guess that's why I'm confused. I'm looking at the words, quote, "continuing transition to market rates," end quote, and somehow that means to me that it is the company's object or goal to move to market rates.

A. I don't read it as a goal. I think I mentioned earlier that I thought the rates in Ohio are undervalued relative to the market, and ultimately I believe that rates at distribution companies in Ohio will reflect market without going to market just because costs of building new capacity, putting on equipment that may be needed for carbon, any number of things can move rates toward market. And so it has the limited feature of moving those rates more toward a market or a value proposition.

Q. Let's take those observations and climb about 20,000 feet, and let me ask you a question. I think you've answered this in part before, but I want to make sure that I understand.

Some of your AEP filing I understand you characterize as being cost based and some of your filing I think you characterize as not being cost based. Am I correct?

A. I'm not sure I've used the term "some of it is cost based." I may have. But clearly what's in the FAC, for example, is a reflection of actual costs incurred during the period of the ESP.

Q. And the non-FAC, in fact, most of the non-FAC I think you characterize as noncost based; isn't that true?

A. I would say they are not cost-of-service based.

Q. Is it the company's view of its burden of proof in this case that it need only show that the ESP that it has proposed is to some degree lower than the MRO?

MR. RESNIK: Your Honor, I'm going to object to asking this witness what the company's burden of proof is in this case. That's a legal determination.

MR. BOEHM: I will rephrase the question

then, your Honor.

EXAMINER BOJKO: Please.

Q. Is it the company's view in this case, when it engineered and constructed its ESP, that it was only required to show that the costs that are in the ESP and the benefits in the ESP are to some degree, however slight, superior to the MRO in the aggregate? Compound question here, okay? Let me finish the compound, okay?

MR. RESNIK: Okay. I wasn't sure if you were going on or not.

Q. Or does the company believe that it is somehow constrained in the rates that it asks for in this case by cost considerations or prudency considerations?

MR. RESNIK: Your Honor, if I can object, I think asking what he thinks -- what the company's thinking as far as what it was required to show is no different than asking what it thought its burden of proof was.

MR. BOEHM: I believe, your Honor, if you look at the question, it was what his view was, not what he thought he was required to show. If the court reporter would read the question, I think you will see that's what I asked.

EXAMINER BOJKO: Let me just see the question, please, Maria.

Well, you did ask "was it required to show." Why don't you just rephrase and ask him --

MR. BOEHM: Try it one more time.

Q. Regardless of what you think you were required to show legally, Mr. Baker, when AEP constructed this ESP, was it its view that the ESP could be satisfactory merely if it were to some degree below the cost of the MRO and more beneficial to the MRO, or did the company believe that it should justify the cost increases and the rates that it asked for in the ESP on prudency or least-cost basis?

A. As we looked at the legislation, we were to develop a plan, an ESP, and as I read it, there are -- we have a opportunity to take the current rates and adjust them without limitation by a number of things that are listed here.

That then gets submitted to the Commission, which we did. When I look at it, I think the Commission has to decide whether in the aggregate it's better than the MRO. What we did here was to try to show the Commission that we thought it was better than the MRO.

Q. You don't believe that, in your view, then, that the company is required to show that all of the costs that it included in these rates are least cost or prudent costs.

A. No.

Q. Okay. Let's go to the second year of the company's ESP, if, in fact, the ESP as the companies filed it is approved. As you look at it with respect to the part of the code that relates to whether or not the company has significantly excessive earnings, what would the job of the Commission be at that time?

A. As I look at it, the Commission -- let me just back up. We proposed in this filing a process and a way for the Commission to perform the excessive earnings review, and as I see it, our burden would be to come in -- well, we would want it to be under the mechanism that we have described as the way to determine whether they're significantly excessive earnings or not.

We would make a filing that would show whether we, in fact, based on that, did have significantly excessive earnings or not, and at that point the Commission could rule that we didn't or allow others to comment on it.

Q. And do you recall, Mr. Baker, what the companies recommended -- did they recommend a number for Columbus & Southern or Ohio Power as this is the threshold for significantly excessive earnings?

A. No.

Q. Do you recall what the calculated current rate of return on Columbus & Southern is?

A. We have talked about this at other times.

I believe the number today is close to 20 percent return on equity. Ohio Power's significantly below that, but when I look at it, we also put pro formas in which show what we think the earnings will be in 2009, '10, and '11, both on a consolidated basis and the individual companies, and the historical returns are not in any way meaningful when you're looking at what happened in 2009 in the 2010 time frame.

Q. Let's assume, Mr. Baker, that in the first review of significantly excessive earnings the Commission determines that the company's rate of return, and we'll use your number, went from 20 percent to 25 percent by virtue of the moneys that you requested and were granted in this case, okay?

A. Okay.

Q. And let's assume that the Commission comes out with a determination that anything over 20 percent is significantly excessive. What would happen, in your understanding of the process, in that event?

MR. RESNIK: Can I just add a clarification to the question?

MR. BOEHM: Yes.

MR. RESNIK: Was the increase from 20 to 25 percent attributable to the adjustments made in this proceeding?

MR. BOEHM: I'd like to see whether the witness has an answer. If he needs some more information, I'll be happy to give him some.

MR. RESNIK: Okay.

Q. (By Mr. Boehm) Can you answer the question as I stated, Mr. Baker?

A. Well, I'd start with the statement that I read your question to mean as a result of the adjustments, because I think you said that results from the changes approved in the ESP.

Q. Okay. In this case.

A. In this case.

Q. Yeah.

A. So I take it to mean it comes from the adjustments.

And then let's move to the second part of it. As I see it, I'm not sure where the just flat 20 percent came from. Are we assuming that that goes through a process to determine, like companies and all of that, and going through that significantly excess like he -- that's described in the bill --

Q. Yes.

A. -- that's the number?

Q. That's the number.

A. Then I believe it sets it up for the company to rebate the excessive earnings to customers.

Q. Okay. I ask you to bear with me. This list has been decimated by prior cross, and I'm going to try to not repeat -- not repeat that cross.

Let me skip over for a moment to the POLR. You've been asked a variety of questions about the POLR and the Black-Scholes model, Mr. Baker. Let me ask you this question, and I think you've probably heard me ask this before in some context. Assume that you have a customer, a large customer, and that customer tells you that -- they see your rates as they come out of this proceeding, and they say: "Those are pretty good rates. I can tell you that I'm not going to leave you for three years. I'm going to stay on these rates that you've got here for three years."

Under the Black-Scholes model what

risk -- what is the amount of the risk that the company represents to you? And you can put it in terms of a put or call or however you'd like.

A. I don't know how a customer, unless we enter into a special arrangement, can just give away rights that they have under law. So --

Q. Well, I don't want to argue the law with you, Mr. Baker, but I ask you to accept that people can waive their dearest constitutional rights, and do so every day, and I would assume, and please assume for this question, that it is legal for that party to waive their rights to go shopping.

A. And what I'm saying is the waiver would have to be contractual.

Q. Yes.

A. And ironclad.

Q. Yes.

A. And if that were the case, I don't think it's in keeping with the policies of Senate Bill 221, but if that were the case, that customer to me would look like a customer who's guaranteed me tariff rates for three years and the risk would not be there. But that's with all the caveats I put in front of it.

Q. Sure. Sure.

That customer, what we just described, is sort of like your old-fashioned pre-Senate Bill 3 captive customer. His situation doesn't present him with either a put or a call, he's your customer, right?

A. It looks somewhat like a customer who does not have choice under state legislation.

Q. Let's skip over that.

Your concern, as I understood you in previous conversations and testimony, AEP's concern for the most part is the customer who departs and says he's going to stay out and he doesn't, he comes back, and AEP is concerned because of past precedent that that customer may somehow be let out of its commitment to come back at market rates; isn't that true?

A. We've got to go back, unfortunately, to the put and the call because you said the major concern, and the major part of the POLR charge is related to the put, the fact that they leave at a period where market prices are below tariff rates.

Q. But you're not familiar with any precedent where a customer has said, "I will take power from you for three years, I won't leave," and then leaves, are you?

A. Under the old regime?

Q. Yes.

A. That's how I kind of look at Ormet.

Q. Ormet.

A. We were under tariff and they left. And it was a -- we agreed upon it, but it was -- they were looking to get out from under a no-shopping

situation. And if you're asking did it ever happen?
Yeah.
Q. Well, you said you agreed upon it, didn't you?
A. It was something that we worked out together because they were pushing to have the change made whether we agreed or not.
Q. You will agree with me, Mr. Baker, will you not, that you can't complain about it if you agreed to it, right?
A. You know, there are times when as a utility you agree to stuff that you would just as well not choose, so yeah, I feel like I can complain a little.
Q. I wasn't laughing at you. Mr. Randazzo made an irreverent remark about his first wife.
MR. BELL: I'll stick up for Virginia if Sam won't.
MR. BOEHM: I understand she was a peach.

THE WITNESS: Mr. Boehm, it wouldn't bother me if you laughed at me.

MR. BOEHM: No, that wouldn't happen.

EXAMINER BOJKO: The funny thing is I heard the whole comment because no one thinks I can hear anything.

MR. RANDAZZO: I was sort of hoping you did hear it, quite frankly.

Q. (By Mr. Boehm) Let's go to the recommendation that I understand that you have, Mr. Baker, that for the purpose of administering the significantly excessive test that Columbus & Southern and Ohio Power be looked at together.

A. Yes, that is what we're proposing.

Q. And I think in one of your comments yesterday you recognized that there are -- some have posed legal questions about whether or not that can be done; isn't that right?

A. That's right.

Q. Okay. Let's assume for the purpose of these questions that it can be done.

A. Can be.

Q. That it can be done. And let's discuss perhaps the wisdom or rationale behind doing it, okay?

A. Okay.

Q. And again, the structure, as I understand it, is that Columbus & Southern -- both Columbus & Southern and Ohio Power Company are independent companies whose stock is held by, and I may miss the right name, but it's American Electric Power, is it?

Or American Electric Power Holding Company?
A. American Electric Power, Inc.
Q. Inc., okay. Now, notwithstanding the fact that they're both owned by American Electric Power, Inc., do they keep separate books?
A. Yes, they do keep separate books, but they are operated functionally as a single company.
Q. When you say they're operated functionally as a single company, you mean, I am sure, at least that they are centrally dispatched, right?
A. They have the same management team. Their assets along with the rest of the assets are centrally dispatched. Many of the decisions on how to allocate dollars among the facilities are done on a combined basis to see where you get the most bang for the buck, various ways.
Q. And isn't some of that also true of Kentucky Power?

A. Just the --

Q. Same management team, centrally dispatched.

A. Kentucky Power has a management team that only has one company.

Q. Does AEP provide management services for

Kentucky Power?

A. I wasn't talking about Service Corp. We were talking about individual operating companies. Each of the -- AEP-Ohio has a single president and chief operating officer for the two companies, Kentucky Power has a president, chief operating officer for both companies -- or, for the one company.

Q. Is Kentucky Power dispatched -- centrally dispatched with Ohio Power and Columbus & Southern?

A. I believe I said that, yes.

Q. Okay. And how about Appalachian Power?

A. I will stipulate that from a generation standpoint the units are dispatched centrally. We don't need to go through each of the companies.

Q. Okay. You're not proposing in this case that we look at Columbus & Southern and Ohio Power and Kentucky Power and Appalachian Power when we're trying to determine who's making how much money and

what their rates of return are, right?
A. No.
Q. Okay. Do Columbus & Southern and Ohio Power have separate assets, generating assets?
A. Yes.
Q. Is Ohio Power Company responsible for the

debts of Columbus & Southern?
A. No.
Q. And vice versa, I take it.
A. That's correct.
Q. Okay. Are you familiar with a legal concept called piercing the corporate veil, Mr. Baker?
A. I have some knowledge of it.
Q. Okay. And that's a concept, is it not, where one party charges that a corporation is a mere sham, that it's not -- doesn't maintain a separate identity from either its officers or from another corporation; isn't that true?
A. That's a pretty fair description of it.
Q. Okay. You wouldn't regard Ohio Power or Columbus & Southern identity as -- corporations as shams, would you?
A. No, I wouldn't. We're not talking -- I've already agreed, Mr. Boehm, that they are

different legal entities and different sets of books.
It's how we deal with this purely from the significantly excessive earnings, and how the company would manage -- how they would manage themselves if, in fact, they had two parties subject to the earnings test as opposed to one.

Q. Let me ask you a question, Mr. Baker. You were talking about the companies in your testimony, about the companies' corporate separation plan, were you not?

A. Yes.

Q. Would you see that -- the idea of that corporate separation plan running in any way counter to the idea that Columbus & Southern and Ohio Power ought to be viewed for earnings as the same entity?

A. Can you point me to the specific part of that that you're talking about? Because the corporate --

Q. The part of your testimony?

A. Yes.

Q. Yeah.

A. Because the corporate separation talks about moving assets. What we do with Darby, I mean, it had a number of pieces to it, so if you point me to something, I may be able to answer it better.

Q. Just talking about the ideas that the companies would -- both of these companies would divest themselves of some of their generating assets. Does that in any way philosophically or otherwise strike you as being counter to the idea they ought to be considered the same for earnings?

A. It doesn't for me. When we looked at doing the corporate separation initially, we would have treated the unregulated generation all as part of one grouping.

Q. Let me go back to the testimony, I think, of Mr. Roush on DMR-5. No. No. No. No. Strike that.

Let me go first to your testimony with respect to the inputs of the model for determining the POLR, and I think that's, what, page 31?

A. We should know it by heart by now, shouldn't we?

Q. 31, 32?

A. 32.

Q. Okay. Now, you talked about, with some of the other attorneys, the interest rate and the strike price, et cetera. The market price that was used is an input and, as I understand it from your testimony -- I should more properly say the market prices, isn't that right, because there were -- weren't there a number of different prices that were used for this input or not?

A. We looked at the first five days for the first month of each of the first three quarters.

Q. Okay. For the first three quarters of

2008?
A. 2008, yes.
Q. And you've seen, I take it, from one of the exhibits I think that Mr. Randazzo introduced, and I don't remember what the number is, it was an AEP exhibit that showed a downturn in energy prices over some period of time concluding probably somewhere around November 11th of 2008, as I recall.
A. Yes, I do remember seeing that schedule.
Q. And I'm not at all implying that the company should have gotten day-to-day data on energy prices, but if, in fact, the energy prices for that period of time, this most recent period of time, were brought into the analysis and that data showed that the market price was lower, is it a dynamic of the calculation that that would mean that the POLR option would be cheaper or more expensive?
A. It would be more expensive, which is --

Q. The POLR, you're saying the POLR calculation would be more expensive if the market price were lower?

A. If we held all other parts constant, it would be lower.

MR. RESNIK: Could we have that last

answer read back, please?

EXAMINER BOJKO: Yes.

MR. BOEHM: I think you meant --

A. I'm sorry, if we hold the market price down, the POLR, if we take that down and hold everything else constant, the POLR would be a larger number.

Q. POLR would be a larger number.

A. Yes. I apologize. Sometimes getting confused as we move these numbers around.

Q. Is it true -- do you see a relationship, Mr. Baker, in that the higher the company's rates are that come as a result of this case, that the more inclined the customers would be to go shopping?

A. The likelihood increases, and that was one of the conservative things we did in developing the POLR charge, was we held the strike price, the No. 2 input component, to be the same ESP price that we had in year 1, and so if you had put in the additional increases that are proposed in year 2 and year 3, the POLR, once again, charge would have gone up.

Q. Just one follow-up. I was looking again at one of IEU's interesting exhibits, and this was a series of press releases that he got off the internet

I believe that related to -- I think Mr. Randazzo was attempting to show that these -- and I don't want to mischaracterize his purpose of this. He was attempting to show that the company had somehow reversed its positions about whether it was going to go to the market. Do you remember those?

A. I remember the set of news releases that Mr. Randazzo showed me. I wouldn't accept your characterization of them.

Q. I understand you wouldn't accept it, but I believe it's -- I didn't see in there a mention of Virginia. Now, AEP's got a subsidiary in Virginia, doesn't it?

A. Yes, it does.

Q. Appalachian Power.

A. Appalachian Power.

Q. And some time ago, maybe three or four years ago, the Commonwealth of Virginia, which was otherwise on a course to be deregulated, reversed itself and passed a reregulation bill; is that true?

A. I think that's a fair characterization.
That was done early in 2007.

Q. Okay. And now in Virginia utility
companies are -- I wouldn't call it the old
traditional regulation, but the framework is

essentially as it was here post -- or, pre-Senate Bill 3; isn't that right?

A. Well, I think you could characterize it as a cost of service with, for all intents and purposes, no customer choice. There is a small component of large customers who could potentially leave, but it's a very limited amount of the load of the company that can leave, and some very updated ways of looking at how you set rates going forward.

Q. And is it true, Mr. Baker, that Appalachian Power supported that legislation?

A. Yeah, we supported that legislation.

Q. Okay.

A. But that legislation doesn't look anything like Senate Bill 221.

Q. I agree.

A. And nobody was proposing to go back to pure reregulation in the state of Ohio that I knew about.

Q. We were. We offered to show you the
plan. Ohio Energy Group.

A. Well, that's --

Q. Do you remember that?

A. I remember a period in front of the
legislature where you were very supportive of Senate

Bill 221.

Q. You don't remember a period before that when the Ohio Energy Group was proposing essentially the Virginia plan?

MR. RESNIK: Objection, your Honor.

EXAMINER BOJKO: Sustained.

MR. BOEHM: I really don't have any more questions. Thank you, Mr. Baker.

THE WITNESS: Thank you, Mr. Boehm.

EXAMINER BOJKO: OCC.

MS. ROBERTS: Thank you.

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CROSS-EXAMINATION

By Ms. Roberts:

Q. Mr. Baker, let's just stay with POLR and Black-Scholes, since Mr. Boehm has already introduced that AEP operates in 11 states; is that correct?

A. Yes, we provide service in 11 states.

Q. And in any of those states does AEP have

a POLR charge?
A. None of the states have a regulatory model that looks like Ohio.
Q. Is that yes, they have POLR charges, or no, they don't?
A. No, they don't.

Q. They have no provider of last resort charge or anything resembling that.

MR. RESNIK: Your Honor, I'm going to object. Unless a foundation can be made that the legislation's comparable to Ohio, it's irrelevant what's going on in the other states with these types of charges.

MS. ROBERTS: That remains to be seen.

EXAMINER BOJKO: Hold on. I would like a little more foundation laid. Were you talking about all 11 states that AEP operates in?

MS. ROBERTS: In any of the 11 states.

EXAMINER BOJKO: Do they have a POLR charge in any of the 11 states; is that your question?

MS. ROBERTS: Other than Ohio, yes.

EXAMINER BOJKO: Mr. Baker.

THE WITNESS: If I can look through our states, Texas does not have a situation where the

distribution company is required to supply a
generation supply, so there is no need for POLR
because customers come and go to a unregulated
wholesale or retail marketer so the distribution
company has no need for it.

In the other states, now with the change in legislation in Virginia and the change in legislation in Michigan, customers don't have the right to come and go so there is no need for a POLR because they don't have the options that are provided for in Senate Bill 221.

And in the rest of the states, once again, the customers have no ability to come and go from the standpoint of shopping in the market and, therefore, there's not a need for the POLR.

Q. And are you aware of other states that operate in the PJM region that have POLR charges?

MR. RESNIK: Your Honor, again, I object. If Ms. Roberts want to refer to a particular state that has a regulatory structure like Senate Bill 221 and ask if Mr. Baker knows if there are POLR charges in that state, that's fine. But just to talk generally about states where there's no idea what the regulatory structure is is irrelevant.

MS. ROBERTS: And, your Honor, I would

say --

EXAMINER BOJKO: I think that everybody's been talking about other states, and Mr. Baker refers to numerous other states in his testimony, so I think he can answer, and I have confidence that your witness will clarify his answer to the extent necessary.

Mr. Baker, please respond.

MS. ROBERTS: Thank you, your Honor.

A. Let's think about the environment in those states, the PJM states with competition and customer choice. In those states the distribution companies do not have generating assets and are not required to put those generating assets for supply to the customers for them to come and go at a tariff-based rate that is not market.

What happens in those states is the distribution company generally goes out for an auction. In the auction the POLR responsibility and the effects of customers coming and going then sits with the supplier, and we have bid on those auctions, and when we've bid on those auctions, we've put in as part of our market price a cost for the risk of customers coming and going, and we use the Black-Scholes model in determining how to value that

proposition in setting up the bid that we put in to
serve those customers.
Q. And is that the basis upon which you
decided -- is that the or one of the primary bases
upon which you decided to use the Black-Scholes model
to calculate the POLR cost in this case?

A. We picked the Black-Scholes model to value the POLR because we think it is a very effective way of pricing options, and we use it in a lot of our business activities.

All I wanted to point out was that we have enough faith in it that we're willing to put our money at risk in using that for bidding purposes when we effectively take on that POLR risk when we bid into auctions in states that have deregulated where the distribution company doesn't carry that risk.

Q. And you see no difference between the company's use of Black-Scholes in the bidding process -- in bidding into markets in other states and the company's use of the Black-Scholes model for calculating POLR in this proceeding.

A. I see Black-Scholes as a way of pricing the value of optionality. I believe your witness indicated that she saw it as a good method of pricing optionality. Now, she limited it, I agree, to coal and to stock options, I think she said, but since it's used in many other areas, I just consider that a good method to price optionality.

Q. Okay. So I just want to go back and make sure I have an answer to my question, which is, you see no difference in the company using Black-Scholes in pricing options when it bids into -- bids power supply into other markets as compared to the way you use Black-Scholes in this case.

A. I'm saying the use of the model is an effective tool to price optionality, so I see it similar between the optionality that the distribution company in this case provides customers as to a supplier who provides that optionality to customers in a deregulated state like Maryland or New Jersey.

Q. All right. On page 32 of your testimony you have a chart that shows what the Black-Scholes inputs are; do you not?

A. Yes.

Q. All right. And the first input listed is the market price.

A. It's the competitive benchmark price that we used in the -- in discussing the relationship of the ESP to the MRO.

Q. I would direct you to the row above where

you're reading where it says "Black-Scholes Inputs"
and No. 1 is Market Price; is that correct?

A. That's correct.

Q. So when you're bidding power into
Maryland, or whatever state you're bidding it into,
would there be a market price that you would be using

for -- when you calculate the Black-Scholes?
A. We would be looking at future market prices as were projected for the period that we were bidding on that, would be one of the inputs.
Q. But yet in this calculation you're using a proxy for that, which is competitive benchmark prices discussed in relation to the MRO; is that correct? You're not using a market price as you did in the auction; is that correct?
A. Yeah, we're doing the same thing. We're looking at what the price is that we expect market prices to be, and we would be looking at capacity. We'd be looking at the various inputs that we do in the -- for purposes of Ohio.
Q. So the market price that you would input for that purpose of selling -- bidding on the power contract in another state would not be the price at which you were offering to sell the power?
A. It would be our expectation of a market

price, and then you have the volatility that would
tell whether people may come or go, and it would be
an estimate of the market price. We'd be putting
various things into the bid.

Q. Let me ask you this, would the strike
price Black-Scholes input for calculating power sales

into other states be the price that you were bidding?
A. Yes.
Q. Okay. So that would be your bid price.
MR. RESNIK: Can I have that question and answer read back, please?
EXAMINER BOJKO: Please read it back.
(Record read.)
MS. ROBERTS: Are we waiting for a question from me?
EXAMINER BOJKO: Yes.
MS. ROBERTS: I'm sorry, I thought Mr. Resnik was considering the answer.
MR. RESNIK: No. I'm sorry.
MS. ROBERTS: I'm sorry.
Q. And the time frame that you would use the Black-Scholes input on bidding on the power contract in another state would be the duration of the contract.
A. The period we were bidding for, yes.

Q. Yes. And in this case you used as a proxy the ESP period, the period over which these rates would be in effect.

A. That's correct.

Q. And the interest rate you used for the Black-Scholes input for purchased power sales in other states, was that LIBOR?

A. I believe it was.

Q. Was it? Do you know?

A. As far as I know.

Q. And how would we determine whether LIBOR was used in calculating Black-Scholes for bidding into power markets in other states?

A. I can check on a break.

Q. Okay. And for volatility, the fifth input, for this case --

(Discussion off the record.)

Q. And so for the volatility input and bidding on purchased power contracts in other states what did you use?

A. We would use the historical volatility looking out at periods and seeing what the changes were.

Q. Okay. You understand that the Black-Scholes model is a nothing more than a mathematical equation, don't you?

A. I think it's dramatically more than a mathematical equation. It's used for option pricing in many, many different areas. I think that's more than just a mathematical model.

Q. But it's a model that captures that

relationship; wouldn't you agree?
A. What relationship?
Q. The relationship between the hedging of options and -- the relationship of the hedging of options.
A. I don't know what that means.
Q. What is the purpose of Black-Scholes?
A. In order to value options.
Q. I'm sorry?
A. In order to value optionality.
Q. All right. So it's a mathematical equation that captures the valuation of optionality. You would agree with that, wouldn't you?
A. It's a model, yes.
Q. Yes. And relative to the questions that were asked of you by Mr. Boehm and Mr. Randazzo and others, it doesn't capture any of the behavior of customers around that optionality, does it?
A. It assumes the customers will leave when

it's economically advantageous for them to do so.

Q. But it doesn't capture the behavior of customers that may enter into a three-year contract term with a CRES provider, does it?

A. Are we saying that a customer who leaves and commits not to ever come back to the ESP for the period of the ESP?

Q. Or for -- or that kind of behavior. It doesn't account for that kind of behavior either, does it?

A. Well, I'm asking you a question to find out which behavior you want me to say does it capture. If it's a case of somebody leaving during the period to go to a CRES provider and potentially coming back, either on their own or because the CRES provider fails, yes, it does.

If, in fact, it were to be a situation where we were guaranteed that the customer could never have access to the ESP rates over the term, it doesn't capture that.

Q. Right.

A. But I don't think that happens.

Q. I'm sorry?

A. But I don't think that happens.

Q. What happens?

A. That someone would leave before the ESP starts and never come back.

Q. But it's not designed to capture that, is it?

A. It doesn't capture that.

Q. No. So, you know, what we think about that is not relevant to the Black-Scholes model and what the Black-Scholes model does.

A. It absolutely is relevant because what it relates to is exactly what Senate Bill 221 provides.

Q. When you used the Black-Scholes calculation, you used as the strike price the ESP. We discussed that earlier; is that correct?

A. The first year only ESP.

Q. And for the first year wouldn't that examine the option from the perspective of a returning customer and not a current customer? In other words, wouldn't the ESP be the option the way you've structured this? If you know.

A. The issue is, again, I think you're only dealing with the call side of the optionality as we've discussed it. You have to think of both the put and the call, and the call doesn't come about until a customer exercises the put.

Q. But if you had used instead of the ESP for the strike price the MRO, would that not calculate -- produce a calculation where the option price is the market price and not the ESP price?

THE WITNESS: Could I have that question read back, please?

(Record read.)

A. I can't see a reason why you would ever do that. We're not proposing an MRO. That's not what the price is based on. The price is based on the ESP.

Q. And so you wouldn't agree then that if the strike price were based upon the MRO, then the option would be calculated from the perspective of a current customer and not a returning customer.

A. I'm sorry, you're going to have to help me out. I don't understand what that question was.

Q. I'll ask it again.

A. Okay.

Q. But it's not going to sound much different.

When you calculated Black-Scholes and you used the ESP as the strike price, had you used the MRO as the strike price, you don't agree that that would have determined the option from the perspective of a current customer instead of a returning

customer?
A. I guess I'm just going to have to say I don't agree because I don't understand it.
Q. Okay. I believe that you testified on page 35 that when you use all three prices, and I'm talking about, you know, the ESP and the MRO, that

the option price was too high?

A. I'm sorry, can you point me to where we talked about that on page 35?

Q. Yes. If I can get to it.

I must have written the wrong page number down. I'll come back to that as I find the page.

Do you intend to take the funds that the company's paid if you're allowed the Black-Scholes revenues and purchase a hedge with those revenues?

MR. RESNIK: Your Honor, I'll object. That's been asked and answered.

EXAMINER BOJKO: I think it has, but it's been a long day. If you can --

MR. RESNIK: Actually, it was yesterday so it's been even longer than that.

EXAMINER BOJKO: If you can answer for us, that would be great, Mr. Baker.

A. At this point I can't say. The company could go out and buy some options, or it may choose to just take the risk on itself.

Q. Okay. Now, I understand from your previous testimony that you view the interest-free rate required for input in the Black-Scholes model to be satisfied by using LIBOR as a proxy; is that correct?

A. I said that LIBOR was a proxy, yes.
MR. RESNIK: I'm sorry, could I have that question and answer read back, please?
(Record read.)
MR. RESNIK: Maybe I don't understand. Did you mean "interest free" or "risk free"?
MS. ROBERTS: Risk free.
MR. RESNIK: Thank you. I think the question was "interest free."
MS. ROBERTS: Well, let me direct you -- yes, it is risk-free. And what did you say?
MR. RESNIK: It's not what I said, it's what you said.
Q. (By Ms. Roberts) Well, Mr. Baker, I direct you to your testimony on page 31, line 17. Do you state there that the Black-Scholes model input is -- one of them is a risk-free interest rate?
A. I do make that statement, and I believe that LIBOR is a proxy for a risk-free interest rate.

Q. All right. And have you done any studies or analyses to demonstrate that LIBOR is a proxy for a risk-free interest rate?

A. I think it is -- it's generally accepted as a proxy.

Q. And can you point me to any sources that demonstrate -- is it anywhere in your testimony? Can you point me to a place where you demonstrate that it is an appropriate proxy for a risk-free interest rate?

A. Well, I can't because there's nothing in my testimony right now that has that, but I guess when I listen to what the dialogue we're having, it seems like there are Black-Scholes police who come in, and if you use the wrong risk-free proxy, will tell you you're not allowed to use it anymore.

I think people using it use it at their own risk and -- in pricing their options, and what we have stated a number of times is if you, in fact, used a three-year Treasury, which I believe you may consider to be not a proxy but a truly risk-free, I'm confident that if we ran the Black-Scholes with that, you would come out with a higher proxy -- or a higher POLR charge.

Q. Based on when you made this calculation in July, correct?

A. I am confident that if we changed all the inputs, as people have suggested, changed -- lower the market price, go to a Treasury-type rate, change the ESP to be the three-year ESP, if we made all those changes, I'm confident that the POLR charge would be higher.

Q. Do you recall AEP Exhibit 2D that was a discovery response to OEG that was marked for identification yesterday?

A. I'm sorry, what was the number?

Q. It is AEP 2D, and it's a two-page document. The second page is a list of interest rates.

A. Oh, yes. Okay, I have it.

Q. All right. Before I ask you about this, I know that you've been asked about running the Black-Scholes model an indeterminate amount of times, as you have testified to before, and I understand from your testimony that you were doing that in attempt to find the most accurate and representative data to present to the Commission.

A. Can you show me where in my testimony I say I ran it an indeterminate number of times?

Q. It's actually in your deposition. Would

you like me to show it to you?
A. Okay. No, I'm okay. I was just trying to figure out where it was in here because I considered this to be my testimony.
Q. Yes.
A. And what I've done on cross-examination,

I don't think I've used that term. That was all.

THE WITNESS: So can I have the question read back, please?

Q. Why don't I just restate it --

A. That's fine.

Q. -- if that's fine. In your deposition you said that Black-Scholes had been run an indeterminate number of times; is that correct?

A. That was a statement that I made in testimony, yes. Or, not in testimony, in the data request, and then I may have said it as well in the deposition.

Q. And you had said earlier today that you didn't think you'd ever run it with a three-year Treasury note; is that correct?

A. I believe we ran it with different interest rates. I said I don't know whether we ever ran it with the three-year Treasury.

Q. Can you explain to me why on page 32 of your testimony it states that for the interest rate you used the interest rate of the three-year Treasury note?

A. It was in error in the drafting.

Q. And do you know what the basis of that error would be? Could it be that it was run on a three-year T-note?

A. You know, I think I've said a number of times to everyone that I don't know whether we ran it with the three-year Treasury note. I don't think the fact that there was a typo on this page indicates anything one way or the other.

Q. So you consider the difference between stating in your testimony that you used a three-year Treasury note when you actually used LIBOR, you consider that to be a typo?

A. I consider it to be an error in what we put in the table.

Q. All right. You testified earlier today that you looked up LIBOR last night on the internet and that you saw that LIBOR was actually a rate that was only calculated up to 12 months. Did you say that?

A. I said when I looked on -- I believe what I said was when I looked on the internet, I could

find 12 months that the bank put out for interest
rates, and then in checking on it, I found out that
there is an active market in those kind of interest
rates going out significantly further than that, I
believe I said greater than ten years and in a
secondary market, and that's where we were able to

collect the information that is on the exhibit that you just asked me to look at.

Q. All right. And the bank in your answer, you mean the British Bankers Association that does the LIBOR calculation?

A. I believe that was what it was, I was whipping through the internet and also watching TV.

Q. So you can tell this is real important.

A. No; it's very important, but I knew what we had put in and I knew this exhibit existed.

Q. And you used the Bloomberg LIBOR?

A. The Bloomberg quotes was what I understand we used.

Q. And that is a derivative market for LIBOR, isn't it?

A. It's a service that prints what they believe to be the LIBOR rates.

Q. But I want to understand. The British Bankers Association calculates LIBOR only up to 12 months, but then Bloomberg and other financial houses take those calculations and do their own calculations, that they make derivative calculations of the BBA, and they publish those as an index for the financial markets; is that fair?

A. I don't want to -- I have not done the

research to know whether they're derivatives or not
or whether they are just quotes of what people are
trading.

Q. All right. So then you know that the LIBOR calculated by the British Bankers Association is the interbank loan rate. Do you know how the British Bankers Association, which calculates LIBOR, how that LIBOR relates in terms of risk to the derivative LIBOR that you've used from Bloomberg?

A. I've already -- I think I've described that. I don't -- I'm not assuming it's a derivative, I'm just telling you that we went to Bloomberg, which had quotes for these 36 months that are on the request No. 3.5. We took those numbers, we averaged them, and that was the input which we put into the Black-Scholes model.

Q. All right. I'm only going to ask one other question about this. Didn't you say that the LIBORs you used were from the secondary market?

A. I said they were from Bloomberg and I
believe they reflect the secondary market.

Q. All right. Have the LIBOR rates come
down since you made the Black-Scholes calculation on
July 24th?

A. Yes, they have.

Q. And how much have they come down?
A. A recent quote I had reduced it about 60 basis points.
Q. To?
A. The number I have just scratched in here is 2.7.
Q. All right. And do you know where the -- whether the LIBOR itself is highly volatile? When I talk about LIBOR, I'm talking about the British Bankers Association, the LIBOR, calculated --
A. I believe it's pretty volatile right now, and I think interest rates are volatile right now.
Q. And do you know how -- do you know whether the volatility of the LIBOR is reflected in the three-year projections in the secondary market that you've used?
THE WITNESS: Sorry, could I have that read back?
(Record read.)

A. If an interest rate or any other kind of commodity is volatile, it's also reflected in the secondary market.

Q. Depending upon the term of the projection, correct?

A. Right.

Q. Could you have used the three-year
Treasury note if you had wanted to in the calculation
of the Black-Scholes model?
MR. RESNIK: Objection, your Honor. It's
irrelevant. It was not used.
EXAMINER BOJKO: I think he's already
answered that at least three times so I'm going to
sustain it on asked and answered.
MS. ROBERTS: Why don't I rephrase the
question.
Q. Do you know if the Fed is still issuing a
three-year T note?
A. I believe they are.
Q. I'm sorry?
A. I believe they are.
MS. ROBERTS: May I approach, your Honor?
EXAMINER BOJKO: You may.
Q. Mr. Resnik, has the -- what I've handed
you is a press release from the U.S. Treasury

Department. Have you had a chance to look at this?

MR. RESNIK: Your Honor, let me object, and, first of all, say I think Ms. Roberts has returned the favor for the time I referred to her as Ms. Baker.

MS. ROBERTS: What did I do?

MR. RESNIK: Your question, which was directed to the witness, referred to him as Mr. Resnik. I'm not sure who's being complimented.

MS. ROBERTS: Sorry to whomever I should apologize to.

MR. RESNIK: More importantly, I'm going to object. This was not used. We're just showing the witness paper. I don't see the purpose in this.

MS. ROBERTS: I'll move on, your Honor.

Q. (By Ms. Roberts) I want to ask you a couple questions about the FAC deferrals, Mr. Baker. Have you testified that they don't include transmission costs, that FAC deferrals do not include transmission costs, do they?

A. Can you point me to a spot in my testimony?

Q. Well --

EXAMINER BOJKO: I'm sorry, did you say transmission or transition?

MS. ROBERTS: Transmission, transmission costs.

Q. Is the company proposing a separate rider to collect transmission costs?

A. Oh, if your question is is the 15 percent approximate cap for customer classes, does that exclude transmission costs or the transmission cost rider? Yes.

Q. And if you look at your schedule JCB-2, if you want to pull that up, I'll ask you some questions about it in a minute, you're proposing carrying charges on the deferrals; is that correct?

A. On JCB-2?

Q. I said if you could turn to that and I'll ask you questions about that in a minute.

A. Okay.

Q. Right now I was asking about the carrying costs that you applied to any FAC deferrals, were they to occur.

A. All right. I know the topic.

Q. All right. And how are they calculated? Is that using the same method as for the environmental carrying costs?

A. It would be based on our weighted average cost of capital.

Q. All right. Have you before by this Commission been allowed to earn a return on deferrals? Let me back up and ask this question: Your cost of capital would include an equity component, would it not?

A. Yes, it would.

Q. And as compared to just using a cost of debt to calculate carrying charges, which would exclude the equity component.

A. If you had a carrying charge based on debt, by definition it wouldn't have an equity component.

Q. Has the Commission ever allowed AEP to recover the cost of capital as a carrying charge on deferrals?

A. I'm not sure.

Q. All right. Regarding the environmental carrying costs, that also includes an equity component, does it not?

A. It's the weighted average cost of capital. Yes, it has an equity component.

Q. 50 percent equity, 50 percent debt?

A. Yes.

Q. And earlier today in one of Mr. Randazzo's many exhibits, I think the IEU 7, which is the Fact Book, the facts for Ohio Power were discussed on page 37. And does Ohio Power, has it in the last three years had a 50 percent equity rate?

A. The -- I'm sorry, let me -- page 37?

Q. Page 37.

A. In the last three years, from the

standpoint of looking at the books of the company, the debt to equity has not been 50 -- has not been 50/50, but in the way we would traditionally propose this in jurisdictions, it would come out to be a 50/50.

Q. I'm sorry, what do you mean by "the way we proposed it"? You mean the way you proposed to recover the carrying charges?

A. The way we've done carrying charges, yes.

Q. So it would not be based on actual --

A. It's adjusted for short-term debt, and there may be some other adjustments as well, but --

Q. And one of those adjustments would be to include the percentage of equity in the carrying charge?

A. I'm saying it would be an adjustment that was made to the debt equity ratio in rate-making that would provide a 50/50 debt to equity.

Q. All right. In requesting carrying costs on environmental in your testimony on lines, let's see, page 24 around line 22 -- do you have that?

A. Yes, I have page 24, line 22.

Q. -- you refer to the provisions within SB 221 that authorize the recovery of these costs through automatic increases.

A. Yes.

Q. And what specific provisions of 221 are you basing that statement on?

A. It would be 4928.143, (2)(b).

Q. All right. And in the carryover language on page 25 you indicate that this proposal helps advance the policy outlined in 4928.02(C) to promote diversity of electric suppliers. Do you see that?

A. Yes.

Q. And is this policy -- in your -- how do you relate that you're trying to promote diversity of electric suppliers with seeking carrying costs associated with environmental investments?

A. Well, it's a diversity of electricity supplies in that it is a cleaner source than it would have been had we not put that environmental equipment on.

Q. That's what you meant by that statement?

A. And it also would increase the rates,

which has the opportunity for more marketers to
perhaps come in and compete.

Q. You also indicate on page 25, lines 8 and 9, that: "The Companies are not proposing to recover carrying costs associated with a large portion of their 2001-2008 environmental investment." Is that

correct?
A. Yes.
Q. And what do you mean by "large portion"? What does that mean in this testimony?
A. That would reflect that we adjusted it down for the 4 percent which we -- is in rates associated with the cases that were run in 2007 and '08.
Q. Okay. On that same page, lines 10 to 11, you indicate that: "What is being requested is only what is not presently reflected in the Companies' existing SSO rates." Is that correct?
A. That's what it says.
Q. And the SSO rates you're referring to were the current SSO rates, but they were set in the RSP cases?
A. They were the unbundled rates adjusted for the outcome of the RSP case and the various 4 percent cases.

Q. And that was -- and that information came out of the RSP case, or were the carrying charges that you're referring to determined in some other case; do you know?

MR. RESNIK: Can I have that question read back, please?

(Record read.)

MR. RESNIK: I guess I would object only because I don't know what's meant by "that information."

EXAMINER BOJKO: Let's see if the witness can answer, if he knows.

A. My answer would be the one that I just gave before this, and I would suggest that you direct your attention to Mr. Nelson's testimony where I think he lays out in great detail exactly how he came up with the carrying costs associated with the environmental.

Q. Thank you.

In your testimony you compare the ESP to the MRO; is that correct?

A. Yes.

Q. And are there -- do you agree that these similarities exist between the ESP and the MRO, that they both have market priced power components?

A. One has a 5, 10, and 15 percent blend of market power, and the MRO has 10, 20, and 30; is that correct?

THE WITNESS: Can I have the question read back?

(Record read.)

A. Yes, I believe that's true.
Q. And the effect of the difference in what kind of -- what the level of market power included in the MRO and the ESP is that the MRO has twice the dollars associated in its calculated rate; is that correct?
A. The same value is used for the market price, and so when you go from 5 to 10, 10 to 20, it doubles the price.
Q. And on your Exhibit JCB-2, or the revised JCB, for purposes of this question they would be the same, the estimated price cost of 10, 20, and 30 percent is 200 million in the MRO; is that correct?
A. That is the number that's listed there for Columbus & Southern for the year 2009.
Q. And as you've testified, it would be half that for the ESP, and it's shown here as a hundred million; is that correct?

A. That's correct.

Q. And your estimated benefit at the bottom of the page, would that change if the same percentages were used in each rate, let's say the 10, 20, and 30 percent were also used in the ESP rate? That would change the estimated cost, would it not,

from a hundred to 200 dollars?
A. But that wouldn't be representative with what the ESP has proposed.
Q. But you proposed this ESP in the company's discretion and judgment, didn't you?
A. But this is what we proposed and --
Q. It is what you proposed.
A. -- what it's comparing is what we proposed with what we believe would be the cost to customers if instead of an ESP we went to an MRO.
Q. I understand. And if there were an opinion that there should be an apples-to-apples inclusion of the blended market power in these two rates, wouldn't it show that the estimated benefit of the ESP was eliminated?
MR. RESNIK: Your Honor, I'm going to object. Unless someone has filed testimony that I've missed that suggests that the company should be -- as part of its ESP should be purchasing 10, 20, and

30 percent of its requirements, I think the question is irrelevant.

MS. ROBERTS: Your Honor, I think there was a lot of testimony about the percentages used in the MRO that increased the rate of the MRO to suggest that the benefit of the ESP existed. If the company's -- I'm just trying to ask Mr. Baker if the companies had not used different percentages, wouldn't it eliminate the benefit of the ESP. There's been a lot of testimony on this issue.

EXAMINER BOJKO: I guess I'm not sure there's been a lot of testimony on the percentages of the company's proposal. You can ask about the company's proposal, and if you'd like to give him a hypothetical, that's fine, but let's keep it in that context.

Q. All right. Hypothetically, if the company had included the same blend of purchased power in both rates, wouldn't the estimated benefit of the ESP be negative in your JCB-2?

A. If all we're talking about is a mathematical calculation that has no relevance to what is -- the filing we made, yes, if instead of -- on this table if I replaced the estimated purchase cost under the ESP with a 10, 20, and 30 percent, the bottom number would, in fact, go negative.

I don't see any relevance to that because that's not what the Commission needs to look at. They need to look at what we proposed relative to instead having the customers subject to an MRO and seeing if that's better in the aggregate.

Q. But it's certainly available to the Commission to exercise their own discretion and judgment about what components the company has included in its proposal; isn't it?

A. I guess I'd have a hard time seeing how the Commission could suggest that instead of 5, 10, and 15 we should have 10, 20, and 30, and then reject our ESP because they modified it. I think that's not something that's likely to happen. Actually, it's past likely.

Q. In the ESP rate using Ohio Power as an example, would Ohio Power be able to release the 5, 10, and 15 percent shown on your JCB-2 into the AEP pool?

A. The 5, 10, and 15 percent purchases would be additional resources that would go to the AEP pool.

Q. All right. And does OP receive a full energy credit in the FAC for the 5, 10, and

15 percent energy that it's released?

THE WITNESS: Can I have that question read back?

Q. Let me rephrase it. Does OP receive any credit in the FAC for the energy it's released?

A. Any energy that is used by the AEP pool either to make off-system sales or for purposes of providing primary energy to another operating company, there is a credit to the FAC.

Q. And what is the credit?

A. The credit is --

Q. Is it an energy credit?

A. It is an energy credit.

Q. Is it the full energy credit or just the fuel credit?

A. It's fuel plus half maintenance, in the case of an off-system sale, and in the case of primary energy, I believe it's the full primary energy rate.

Q. Okay. And similarly regarding capacity, would OP receive a capacity credit for those releases?

A. Those would not be capacity.

Q. I'm sorry?

A. Those would not be capacity in the pool.

Q. So there would be no capacity available
as a result of those releases to the AEP pool?

A. It's not releases. I mean, you're
getting -- energy is releases. If you're saying
would that count as primary capacity in the AEP pool
agreement, the answer is no.

Q. And for the capacity, not meaning the generating capacity, but the capacity as we've discussed it earlier, the capacity -- the PJM capacity, would there be any credit back for the ability to sell that capacity into the market? Would there be capacity equalization payments for that?

A. Capacity equalization payments are a product of the AEP pool, and as I indicated, just in the last question, this would not be treated as primary capacity in the pool.

Q. All right. Do you recall in your deposition that you had said there would be a credit -- there could not be a credit because the AEP pool does not have a provision for capacity equalization payments?

A. I would like to see the Q and A because that is a pretty cryptic answer, and I guess I'm known for cryptic answers, but I'd have to see what question I was answering.

MS. ROBERTS: If I may, your Honor.

EXAMINER BOJKO: You may.

Q. I'm talking about the section that begins with your answer here. It starts here.

EXAMINER BOJKO: Let's go off the record while Mr. Baker's reviewing.

(Discussion off the record.)

EXAMINER BOJKO: Let's go back on the record.

Go ahead.

A. On page 67 this is not related to the 5, 10, 15 percent purchases that we've been talking about. This talks about environmental expenditures.

Q. And how would the capacity equalization payments that -- how would the inability of OP to receive capacity equalization payments be affected by the environmental expenditures? How do they tie together?

A. The environmental expenditures and the cost of those are included in the capacity equalization charge for the long companies.

Q. In the capacity equalization charge for?

A. The long companies. And I believe Mr. Nelson accounted for that in his calculations.

Q. All right.

MS. ROBERTS: If I could just have a minute, I think most of these other areas have been covered.

Q. Regarding the non-FAC escalation factors of 3 and 7 percent, do you recall stating in your deposition that those escalation factors are not cost

based?
A. I don't recall, but I accept it, subject to check.
Q. All right.
MR. RESNIK: Your Honor, can I have the question and answer read back, please?
(Record read.)
MR. RESNIK: Thank you.
Q. I'm sorry, did you say you don't recall that?
A. I said I don't recall that question -- that answer in the deposition, but that --
Q. All right.
A. -- happened awhile ago.
Q. Back to my page.
A. I guess I could help clarify it even more by saying even though I may not remember it, that's the answer I would give you.
Q. That's the answer you would give me, all

right. Well, we don't have to worry about that then.

MS. ROBERTS: I have no other questions.

EXAMINER BOJKO: Let's go off the record.

(Discussion off the record.)

(Recess taken.)

EXAMINER BOJKO: Let's go back on the

record.

Mr. Bell.

MR. BELL: Thank you.

- - -

CROSS-EXAMINATION

By Mr. Bell:

Q. Directing your attention to Company Exhibit 2A, since I reference this in my brief, I want to make sure I have something on the record. You did not submit any direct testimony in Exhibit 2A on section V.E, did you, of the application?

A. Not in 2A, correct.

Q. Thank you. And I'm not going to ask you what the J stands for, for Mr. Randazzo's benefit.

Mr. Baker, beginning on page 3 and in the succeeding pages, you make a comparison of the ESP to the expected results of a market rate offer, and the market rate that you have set forth for purposes of comparison which is reflected in the charts on page

13 of your prefiled testimony is not the product of an auction, is it?

A. No, it is not.

Q. Instead, would you agree -- and please refine the terminology as you deem appropriate. Would you agree that the market rate that you have set forth in your testimony is the product of a mathematical exercise based upon a number of assumptions? And I'm trying to abbreviate my testimony, and the reason I ask that question, if I might --

EXAMINER BOJKO: Not your testimony, you mean the witness's testimony.

MR. RESNIK: Hard to tell.

Q. -- is the questions in the pages following page 3 ask about how you calculate and calculate and calculate, and, again, I'm trying to shorten the examination perhaps with an explanation of the purpose of the question.

A. If we're looking at page 13, Mr. Bell, this is AEP's estimate at the time this was filed of what the results would be if we ran an auction and asked for a slice of system.

Q. And in support of the methodology you have employed, you cite the pricing of estimating the

market price for Ormet on page 12 of your testimony;
do you not?

A. All we're saying there is that in developing it we have put in front of this Commission previously without an auction a way of evaluating what might come out of an -- what should come out of an auction.

Q. I believe in some of your previous testimony you described the market pricing established for Ormet was an administratively determined market price; is that correct?

A. I'm not sure. I remember answering a question about administratively set, but I'll -- what I'd say is that it is a price that it was intended to reflect what would result from an auction without running an auction. So for that term, if we're using that as the word "administratively," and I know I have used that word, I would agree with that.

Q. All right. Thank you. That's fair.

Would you agree that establishing such a price for Ormet, that was a unique circumstance and it is unlike the situation now at hand when you're establishing the market price for purposes of determining a standard service offer for all of the company's customers as opposed to one uniquely situated customer?

A. No, I wouldn't agree, Mr. Bell. I think the pricing elements and methodology are consistent. The characteristics of the load will come out with a different price.

Q. You also indicate or cite in your

testimony the results produced in other states, do you not, as being supportive of the reasonableness of the results that the company's methodology produced insofar as market prices, citing I believe New Jersey and Delaware?

A. The results -- I think you used the word "results," Mr. Bell.

Q. Yes.

A. The results are on page 6, and those were from New Jersey over a three-year period and says "similar results have resulted in Delaware." That's the purpose of just showing that the numbers are reflective. But what we really based this on was the methodology that others have used, Maryland, what we found in the statute and other -- and Delaware to have a group of component items that we then had to price to come up with a price.

Q. That's fair, Mr. Baker.

A. Okay.

Q. My question wasn't directed toward the components. My question was directed toward page 6 when you speak of the results. And you indicate that one would expect those prices to be higher due to both states having more transmission constraints than the AEP system. Do you see that?

A. I do see that.
Q. That's the focus of my questioning here, not the components, but the results.
A. Okay.
Q. Okay. Would you agree that there are other distinguishing characteristics between the generation in those states and the pricings produced versus the generation that might reasonably be expected to be priced for purposes of meeting your SSO customers' requirements in your service territory? And to be specific, I'm trying to speed this up again --
A. I understand.
Q. -- I apologize, but would you agree that --
EXAMINER BOJKO: Whoa, did he answer the last question?
THE WITNESS: No.
Q. Well, answer the last one if you will,

please. I'm trying to lead, to be sure, but I'm trying to speed this up.

THE WITNESS: Could I have the last question reread at this point?

(Record read.)

A. Mr. Bell, I would say that it's all

related to the transmission constraints, and by that I mean that if you assumed no transmission constraints, and PJM dispatches all the generation to meet the total load requirement, and you had a single clearing price for LMP, I would expect the prices to be exactly the same in Ohio as it would be in Jersey or Delaware.

Q. Okay. You would not attribute any difference in the resulting price to the eastern-based generation relying more heavily on fuel oil for generation than the coal-based generation of AEP.

A. And what I'm saying is they have to do that because of the constraints.

Q. Okay. Fair enough. Thank you.

Now, as I believe you reflect in your Exhibit JCB-2, in addition to the FAC component, the other major components of the rate increase requested in these proceedings is related to the incremental

environmental investments in the 2001 to 2008 period,
the POLR charges which you have proposed, as well as
the 3 and 7 percent non-FAC and annual 7 and
6.5 percent distribution increases as shown on that
exhibit, is that correct -- a correct representation
of the revenue authorization you request as part of

your ESP?
A. What I think you just gave me was the -- just what is on this sheet as to what we're asking for, and what I'm saying is the difference between what would happen in an MRO and an ESP, and in some cases there were things that would be treated the same way that I have not listed on this sheet.
Q. That was brought out I believe in Mr. Petricoff's examination with respect to the FAC; is that correct?
A. I'm just telling you what I -- I'm responding to your question.
Q. Okay. Do you recall the line of examination by Mr. Petricoff with respect to the deferrals of fuel cost so as to honor the 15 percent cap that you have put -- that the company has proposed in this proceeding on the actual increases?
A. Yes, I remember that discussion.
Q. And would you agree that that cap could

be satisfied by deferring the other components of the
increases shown under the estimated cost of the
company's ESP?
     A.   And I think I indicated to Mr. Petricoff
that I had not done that analysis as to whether or
not, A, it could be done, and B, what the impacts

would be on customers.

So, for example, if you deferred the annual 7 percent and 6.5 percent distribution increases, that would have little impact positively to industrials and large commercial customers because -- or, let's just say large industrials who don't -- aren't charged a lot for distribution.

Q. What about the POLR?

A. In the case of the POLR, again, I don't know whether we could do that or not.

Q. That's fair.

Mr. Baker, at the bottom of your JCB-2, revised, you have the estimated benefit of the company's ESP, do you not, over the MRO?

A. This is just, in my view, the financial side of it.

Q. Yes.

A. There are many other things that are listed that help describe that in the aggregate the

ESP is better than the MRO.

Q. I appreciate that, and I'm putting those aside. Those I would characterize as noneconomic bells and whistles.

MR. RESNIK: I object. For one thing it wasn't a question; second of all, I object to his characterization as bells and whistles.

MR. BELL: I withdraw the statement.

Q. Have you made any attempt, Mr. Baker, to determine the magnitude of the financial request that the company could seek in this proceeding as opposed to what it is seeking as shown in your ESP portrayal and not violate the significantly excessive earnings test advanced by Dr. Makhija?

A. Dr. Makhija is his name.

MS. GRADY: Dr. M.

Q. Dr. M, I'm sorry.

A. No, we did not in any attempt try to design this request around what might pass the significant earnings test.

Q. Moving on to the POLR charge and the Black-Scholes basis for the POLR charge, I believe you state that the object of that test is to establish the value of the right to put and call, as you characterized it, regardless of whether or not customers exercised puts or calls. Is that correct?

A.   It is the value of the optionality that is provided to customers under Senate Bill 221.

Q.   And it is an effort to value those rights to retail customers; is it not? It's to the housewife, to the grocer, to the small law firm, or

to a manufacturer of widgets, is it not, your retail
customers?
A. It is the value to any customer in my
view taking service under the ESP.
Q. Would you agree that one of the primary
uses of puts and calls is for the purpose of
advancing a hedging objective?
A. I think that's certainly one, but let me
give you an example, Mr. Bell. Let's assume that one
of your clients was asked to provide his widgets at
$40, and then in sitting down and getting ready to
write the agreement with the customer, the customer
said: "I know I committed to buy so many, but if the
price goes to 30, I want to get out of that." And
then he says -- then the customer says: "You know
what, then if the price goes back up above 40 and
goes to 50, I'd like to buy the rest that I had under
this proposal."
I believe most manufacturers would want a

premium for providing that kind of optionality. You would use this kind of model to help evaluate what that premium ought to be.

Q. Thank you, Mr. Baker, I appreciate that.

Would you accept that the use of puts and calls is generally exercised in robust large commodity markets by sophisticated traders such as AEP in the coal market?

A. I think that --

THE WITNESS: I'm sorry, could I have the question read back.

(Record read.)

A. I believe that in the stock market, in coal markets, in any number of places, you name it, people use puts and calls as a method to either hedge or to make an investment in the market, in whatever market that is, and they could be very sophisticated or they could be people who just believe they can beat the -- whatever the market is.

Q. Well, for instance, you had indicated AEP uses it; do you not?

A. Yes.

Q. And you use it with respect to the coal commodity market?

A. I don't believe we use puts and calls very much in the coal market.

Q. As referenced I believe in IEU Exhibit No. 7, the fact presentation, AEP burned some, what, 76 million tons of coal, annual?

A. I'll accept that number, subject to check.

Q. Okay.

A. Mr. Bell, what I indicated before was I didn't -- I don't think I testified around AEP doing puts and calls. I was talking about using the Black-Scholes model for other purposes.

Q. Okay. With respect to puts and calls, would you agree that -- I assume most of us invest in the stock market without getting into details or personal investments. Are you such an investor?

MR. RESNIK: Can we just make the assumption?

Q. All right.

A. I'm limited to -- I have AEP stock.

Q. The reason I inquire, it goes to my fundamental thrust, and that is, the use of the Black-Scholes model, and specifically the use of puts and calls, is generally exercised, again, by sophisticated traders in large blocks -- trading in large blocks within robust markets. Would you agree with that generalization?

A. What we're trying -- what AEP is trying to do is value the optionality. I'm using puts and calls as a descriptor and saying that the right for a customer to leave and shop, go away from tariff is, in effect, a put to AEP. And in the case of a customer who comes back, it's, in effect, a call on AEP. So I'm using it as a description of the optionality that is available down, as you described it, to the woman in the household.

MR. BELL: Could I have my last question read back? I understand the company's application of it. The question was with respect to puts and calls. Generally speaking, are they utilized by sophisticated traders trading in large blocks in robust markets as opposed to the housewife, a small law firm, a grocer, or a manufacturer in deciding whether or not to change their utility supplier.

MR. RESNIK: Your Honor, I think the witness just answered this question. I object.

EXAMINER BOJKO: Sustained.

Q. Your use of the model to value the right to switch then, as I understand it based upon your testimony, is that the right of a customer to leave presents risk to the company regardless of whether the customer ever leaves, correct?

A. The risk exists for the full period, and what you're valuing is the optionality, not whether the customer exercises the optionality.

Q. Thank you. I agree.

Would you also agree, then, that the

value, as you have valued it, stands regardless of whether or not the customer actually knows he has the right to switch?

A. The charge is there regardless of whether a customer would know.

Q. And would you agree that the charge is there irrespective of whether or not the company wants to exercise the right to switch?

A. When you use the term "company," are you now talking about a manufacturer or an industrial?

MR. RANDAZZO: Did you mean customer?

MR. BELL: Customer, I'm sorry. Thank you, Mr. Randazzo.

A. Okay. Now I'm going to have to have it read back, now that I got the clarification.

Q. I'll restate it. Would you agree that the charge applies irrespective of whether or not the customer wants the right to switch?

A. Senate Bill 221 gave customers the right.

I don't know whether they want it or not.

Q. Your response would be "Yes, then, Mr. Bell," to my question?

EXAMINER BOJKO: Actually, Mr. Bell, I think you meant to ask -- I liked your previous question better so maybe we should go back to that one because this one you asked differently, and he answered this one but I think you really want an answer to the other one.

MR. BELL: Okay.

EXAMINER BOJKO: Could you read that other one, please, Maria.

(Record read.)

A. And I would say that the customer wanting to switch will be determined around the economic value, not how they feel today.

EXAMINER BOJKO: I don't think it was "want." And this might be my fault because I thought it was whether or not they exercised the right to switch.

THE WITNESS: No, I think he said "wants to switch."

EXAMINER BOJKO: I thought that was the second.

MR. BELL: No; wants the right to switch.

EXAMINER BOJKO: Well, can you answer whether or not they exercise the right to switch?

THE WITNESS: Can you ask me a full question?

EXAMINER BOJKO: That the POLR charge, they're going to have to pay it whether or not they exercise the right to switch, the customer exercises it.

THE WITNESS: That's correct. I think I answered that -- yeah, okay.

Q. (By Mr. Bell) Would you agree that they are required to pay the charge regardless of whether they have any desire to exercise the right?

A. And to answer that, Mr. Bell, that was what I was trying to describe to you as Senate Bill 221 gave people the right. Desire to switch, in my view, will be when there's an economic advantage. I believe they don't have that desire today because there's no economic advantage.

Q. Mr. Baker, please, I'm not trying to be argumentative. Let me give you a couple of examples. My mother-in-law insists on buying a Buick because her deceased husband always bought Buicks. It had nothing to do with price. Would you agree that there are individuals that will continue to subscribe to

AEP's service without regard to the price charged by AEP standing alone or in comparison with some other competitive retail supplier?

A. Would there ever be someone who would take that position as your mother-in-law did, yeah, perhaps, but I'm not sure that your mother-in-law is representative of car buyers.

Q. Do you think that there are customers that simply desire to maintain the status quo if they're happy with the status quo and have no desire to switch for any reason?

A. I think there are some, but when it becomes economically advantageous, especially as you point out in this weakened economy where people are trying to save a dollar everywhere they can, they may very well take a different posture than they would have historically.

Q. And would that individual also have to consider the risk attendant to switching to another supplier as to whether or not that supplier would default and the issues that that would cause the customer?

A. Are we talking about governmental aggregation or --

Q. I'm not talking about any particular

form. I'm just talking about someone that has the right to switch placed before it.

A. Okay. And as I see it under Senate Bill 221 and what's provided for, to the average customer, there is no risk. That customer leaves, gets a cheaper price, supplier fails, and they come back at the same price they would have paid had they not left.

Q. That is based upon your economic analysis and does not consider the time, effort, frustration associated with dealing with an alternative supplier that defaults?

A. I believe that if an alternative supplier defaulted, it would just roll right back to us.

Q. In the final analysis, Mr. Baker, aren't you effectively taking the position that Senate Bill 221 creates a right for customers for which AEP has the right to impose a charge, regardless of whether or not the customer wants that right, exercises it, or will exercise that right? And by "customer" I mean customers plural, your customer base.

THE WITNESS: Can I have it read back? I just want to make sure that we cover -- I understand all the bases that we covered there.

(Record read.)

A. Subject to all of the caveats I gave you
before, I'd say yes.

MR. BELL: Thank you, Mr. Baker. Nothing further.

EXAMINER BOJKO: Thank you, Mr. Bell.

MR. BELL: I held true to my promise.

Close.

EXAMINER BOJKO: I believe that we've given everybody an opportunity to cross.

MR. YURICK: Your Honor, I have not.

EXAMINER BOJKO: Actually, Mr. White did yesterday.

MR. YURICK: Oh, did he?

EXAMINER BOJKO: Yeah.

MR. YURICK: I apologize.

EXAMINER BOJKO: Sorry.

MR. YURICK: That's okay.

EXAMINER BOJKO: Any redirect, Mr. Resnik?

MR. RESNIK: Yes, your Honor.

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REDIRECT EXAMINATION

By Mr. Resnik:

Q. Mr. Baker, do you have what's been marked as IEU Exhibit 7? Do you still have that up there with you?

A. Yes, I do.

Q. And I believe reference was made to page 54 of that exhibit, Regulatory Strategy.

A. Yes.

Q. Do you see that?

And in particular one of the bullets on there under Trackers, it refers to off-system sales margin sharing. Do you see that?

A. Yes.

Q. Can you explain what is meant by that bullet?

A. Yes. This bullet was intended to cover other states where AEP does business, and what we are trying to do is increase the amount of off-system sales margins that will be shared with the company and the customers, the amount that the company will retain to be increased. It was not intended in any way to reflect the position we're taking in Ohio.

Q. Okay. When you talk about increase, are you talking about increasing the amount, the dollar amount to be shared, or increase the percentage of sharing that would go to the company?

A. Increase the percentage of sharing that would go to the company.

MR. RANDAZZO: Mr. Resnik, if I may, just to make sure, we're talking about the Fact Book --

MR. RESNIK: Yes.

MR. RANDAZZO: -- page 54?

MR. RESNIK: Yes.

EXAMINER BOJKO: Mr. Baker, you're

turning your head that way. Could you move the microphone now, please?

THE WITNESS: Sure.

EXAMINER BOJKO: Thanks.

Q. (By Mr. Resnik) Staying in that exhibit taking a look at pages 132 and 133, these Debt Schedules for Columbus Southern Power on 132 and Ohio Power Company on 133; do you see that?

A. Yes, I do.

Q. And there were questions asked concerning the pollution control bonds that are shown there for each company and I think those questions were in the context of carrying charge rates. Do you recall that?

A. That was my recollection, yes.

Q. Can you indicate your assessment of the impact or the role that these pollution control bonds for each company would have in the context of an appropriate carrying charge rate?

MR. RANDAZZO: I object. The witness indicated that he did not know how much of the incremental environmental facilities were financed through the use of pollution control bonds.

MR. RESNIK: I wasn't asking for a specific amount, more conceptually.

MR. RANDAZZO: I object.

EXAMINER BOJKO: The witness can answer if he knows.

A. Okay. The couple of things I would say about that, the first is as I understand pollution control bonds, based on the tax law they can only be used for certain parts of, for example, a scrubber, and it varies, but that additionally the solid waste part of it, which you can use pollution control bonds, amounts to 20 to 30 percent of the cost of the facility. So you'd still need equity in order to cover the remaining parts.

And when I look at the rates, the floating rates today that are on these pages actually is higher than the debt rate that's embedded in the weighted average cost of capital, and the fixed rates are for financings that have been done prior to our making this filing, so the fixed rates are already built into the weighted average cost of capital.

Q. You were asked --

MR. RANDAZZO: I move to strike. That had nothing to do with concepts.

EXAMINER BOJKO: Overruled. You asked him questions on this schedule.

Q. Mr. Baker, you were asked a number of questions by several counsel concerning the company's evaluation of the market price that was used in determining the POLR rate, and I was wondering if you could indicate the -- whether or not the company had some interest in biasing that market rate either high or low.

A. We're in a position, given the fact that we -- the Commission needs to consider the ESP in relation to an MRO and our request for a POLR charge based on a market price, those work in -- against each other, so it is very important for us to get the market price as close as possible.

And let me add a little flavor to that. If we set the price for, in the market too low, that, in fact, as we talked about a number of times today, would increase the POLR. But then it would make it more difficult for the ESP to be better than the MRO.

If, in fact, we overstate the market price to bias toward the ESP being better than the

MRO, that would, in effect, reduce the charge that we would be asking for for POLR. So it's important for us to get it right because it affects both things -- both factors.

Q. Okay. You were asked a question by Ms. Roberts concerning whether the company's proposed

automatic 3 percent for Columbus Southern and
7 percent for Ohio Power Company annual increases
were cost based. Do you recall that?
A. Yes, I do.
Q. Can you indicate what those proposed
increases are based on?
A. Yeah, the companies are proposing to
increase the non-FAC portion of the standard service
offer adjusted to reflect recovery of the 2009
carrying costs associated with the 2001-2008
environmental investments --
MS. ROBERTS: Your Honor --
A. -- by 3 percent a year for CSP and by
7 percent a year for OPCO. Regarding the non-FAC
portion annual increase, which is not intended to be
a cost-of-service increase, a portion of that
increase will support the carrying costs associated
with the 2009-2011 additional environmental
investment.

The remainder of the annual automatic adjustments will support cost increases related to inflationary factors during the three-year ESP period, as well as unanticipated, nonmandated generation-related cost increases.

MS. ROBERTS: Your Honor, if I may, I

think we moved to strike this from Mr. Baker's errata. He testified just a few minutes ago in response to my question that, in fact, his testimony is -- in his deposition said these weren't cost based. Now he's trying to change the record. I don't think -- it's too late. Move to strike, again.

EXAMINER BOJKO: Go ahead.

MR. RESNIK: From what I recall from the argument yesterday and the transcript of the deposition, I think Mr. Baker's testimony here now is absolutely consistent with that. But on top of that, I understand that his testimony was stricken in the errata, but Ms. Roberts opened this up.

She specifically asked -- and I asked to have the question and answer read back -- she specifically asked if the 3 and 7 were cost based. And having asked that, I think I'm entitled to ask what is it based on.

MS. ROBERTS: His direct testimony is

that it's not based on this. His deposition is not inconsistent with this. And I'd be happy to pull the pages. And I just -- I don't think this is an appropriate way to get this information in the record. I think it needed to go in his direct case.

EXAMINER BOJKO: Although I was surprised that Mr. Baker didn't attempt to work it in his answer previously, I do think that Ms. Roberts opened the door. I'm not too keen on Mr. Baker reading this into the record at this point, but the subject matter was opened, and he can respond on redirect with regard to it.

MR. RESNIK: Thank you, your Honor.

Q. (By Mr. Resnik) I just have one other area. You were asked, and I think the general, if not the precise, words were whether the Black-Scholes model was nothing more than a mathematical calculation. Do you remember that?

A. Yes, I remember that.

Q. Do you know whether or not that mathematical calculation has won a Nobel Prize?

A. Yes, I believe it has.

MR. RESNIK: Thank you. That's all.

EXAMINER BOJKO: Recross? I know Mr. Smalz isn't here, but do you have any recross?

MR. MASKOVYAK: Give me just a second, your Honor. No recross.

EXAMINER BOJKO: Mr. O'Brien.

MR. O'BRIEN: No recross, your Honor.

THE EXAMINER: Mr. Jones.

MR. JONES: No recross, your Honor.

EXAMINER BOJKO: Mr. Petricoff.

MR. PETRICOFF: Just a couple questions.

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RECROSS-EXAMINATION

By Mr. Petricoff:

Q. Mr. Baker, can a formula win the Nobel Prize, or do you have to be a person?

A. I believe you have to be a person who sponsored something.

Q. And it's usually a body of work as opposed to a mathematical theory?

A. It's -- it is a body of work, I believe.

MR. PETRICOFF: No further questions.

EXAMINER BOJKO: Ms. Roberts?

MS. ROBERTS: I'm not sure yet. If you could -- oh, have you asked everyone else?

EXAMINER BOJKO: No.

Mr. Randazzo.

In consideration of time, we'll come back to you.

Mr. Randazzo?

MR. RANDAZZO: I will ask no questions in consideration of time. Thank you.

EXAMINER BOJKO: Mr. Bell?

MR. BELL: I'm not going to ask

Mr. Randazzo's question about Al Gore and the Nobel Peace Prize.

EXAMINER BOJKO: Mr. Yurick.

MR. YURICK: Just a couple.

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CROSS-EXAMINATION

By Mr. Yurick:

Q. On redirect, Mr. Baker, you testified about the Black-Scholes model winning a Nobel Prize. Do you recall that testimony?

A. Yes, I do.

Q. You've been up there for a while, so, you know, I think it's a fair question.

Are you aware of any other utility using that Black-Scholes model to quantify POLR risk?

A. I don't know of another utility -- distribution utility that carries the POLR risk that utilities in Ohio do.

Q. Sir, look, I'd really appreciate -- I

understand you want to explain your answer, but could
you just answer the question that I asked you first.
Are you aware of another utility that uses the
Black-Scholes model to quantify POLR risk? Just say
yes or no, and then you can say what you've got to
say.

MR. RESNIK: Your Honor, I think the witness should be given some latitude to answer the question, and if he doesn't answer it, counsel can follow up.

EXAMINER BOJKO: He can answer the question.

THE WITNESS: Thank you, your Honor.

In the broad sense of utilities, AEP as a supplier uses the Black-Scholes model, as I discussed earlier, in pricing bids for service which has a POLR responsibility. Other distribution companies don't carry the POLR risk. I don't know of another distribution company who uses Black-Scholes, but I wouldn't know why they would since they don't carry the risk.

Q. But the answer to the question is no, you don't know of any other utility that uses Black-Scholes to quantify POLR risk as you've used it in the context of your testimony; isn't that right?

A. Could the -- the differentiation, I'm not trying to get the -- make this difficult, but if you call it a distribution utility, I would agree with you. If you used the general term of "utility," I can't agree with you.

Q. Okay. So if I said you're not aware of another distribution utility that uses the Black-Scholes model to quantify POLR risk the way you've used it here, your answer would be you don't know; is that correct?

A. That's correct.

Q. And you've used this Black-Scholes model to quantify POLR risk. Would you agree with me that other than POLR risk, when a customer switches there could be costs that are incurred by the utility, actual costs? Not the cost of risk, but actual costs caused by customers switching.

A. If you exclude the costs associated with what we're trying to call and ensure against, I'm not sure there are significant costs associated with switching. We already have the systems in place as a result of the planned move to market as part of the ETP, so I'm not sure there would be a significant cost to the utility.

Q. That's not what I'm asking. Okay.

What -- your answer that you just gave me is if you
include this POLR risk cost that you've tried to
quantify, then in addition to that there may not be
costs. Assume you're not getting to collect this
Black-Scholes POLR risk cost, okay? Assume you're
not getting to collect that. If customers switch,

does the company incur costs as a result of customers switching, or are there no costs involved in that?

A. I believe there are costs.

Q. Okay. Now, the company could quantify those costs after the fact. In other words, if you weren't allowed to collect for this POLR risk, you could figure out how much cost the company incurred as a result of customers switching and, say, at the end of the year or the end of a quarter, you would know what those costs were, right? You could calculate that.

MR. RESNIK: Your Honor, I'm going to object. I think this is going beyond what the scope of redirect examination was.

EXAMINER BOJKO: I'll allow it.

A. When I think of what you're proposing --

Q. I'm just asking a question. I'm not proposing anything.

A. I'm sorry. In your question -- what I --

I believe I answered this before, perhaps when you were not in the room, and I said that if the -- if we waited until such time as customers left and we experienced the cost associated with no longer being able to serve at tariff and instead now sold in the market and achieved less, that would be stranded cost. We've been down that road. I don't think that was -- anybody thinks that was a very good model. In most of the states stranded cost turned out to be pretty much of a disaster, so that's what that is.

Q. Well, sir, with all due respect, and I do respect your position, but my question is, just is it possible for the company to compute how much costs they've incurred by customers switching? I'm not going any further than that. I would just like an answer to that question, not whether you would, you know, not how you would categorize those costs or not any system, but I'm asking you simply, the company could calculate the amount of costs it incurs by customers switching at the end of some time period; isn't that right?

A. Using your question, I believe if I were developing the cost associated with customers leaving, I could do that. I'm not sure I'd be able to calculate the cost associated with customers coming back.

Q. Fair enough.

MR. YURICK: I have no further questions of the witness.

EXAMINER BOJKO: Ms. Roberts?

MS. ROBERTS: Thank you.

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RECROSS-EXAMINATION

By Ms. Roberts:

Q. Mr. Baker, can you point to me anywhere in your direct testimony where you support that the non-FAC annual increases are related to your recent testimony of carrying costs associated with the 2009-'11 environmental and that those increases will also support costs related to inflationary factors as well as unanticipated nonmandated generation related costs? Can you point anywhere in your testimony --

A. Could I have the question reread? Only because I'm not sure you phrased what -- in exact fashion how I stated it.

Q. Where did you state it in your direct testimony?

A. You were talking about what I responded to a question from counsel. And I think you misstated what I said. If you want to say can I show you where my response to counsel appears in my direct testimony, I will tell you there is not a spot.

Q. Do you address the non-FAC increases in your testimony?

MR. RANDAZZO: I object, your Honor. This was brought up on redirect. I don't know what the question does other than take us down further in the time zone that we don't want to be in. So I object in the interest of moving on.

EXAMINER BOJKO: Well, Mr. Resnik did open the door, so she has an opportunity to cross on this.

A. I don't believe there is a reference in my testimony specifically to the non-FAC generation increases of 3 and 7 percent.

Q. And yet these are specific increases upon which you -- specific items upon which you base this increase; isn't that correct?

A. I believe what I have said in a deposition, in response to a question you made earlier, and in response to my counsel was that these are not cost-based increases.

Q. And didn't you also say in your deposition that there's no specific cost justification for these increases and that you don't think any is required?

A. That, to me, is a definition of noncost
based.

Q. All right. Thank you.

MS. ROBERTS: No further questions.

EXAMINER BOJKO: I have some questions.

THE WITNESS: Good.

EXAMINER BOJKO: You're not going to get off that easy.

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EXAMINATION

By Examiner Bojko:

Q. If you turn to page 11 of your testimony, actually I think it begins on 10 and 11, you talk about Maryland and Delaware for comparison purposes, but then on page 12 when you talk about cost components and the market price, you only give the example of the state of Connecticut in that range. Do you have a range for Delaware and Maryland?

A. Of the specific retail administration charge?

Q. Yes.

A. I don't because states do this a number of different ways, but there is a -- there are always -- or what I have found is there are adders associated with the transaction risk, the retail administration charge that may be lumped together or separated, but the premium generally runs in the 10 to 15 or 20 percent over and above what I'll call kind of the hard items, which are the energy charge adjusted for the load following and all of those.

Q. Further down on page 12 on line 13, well, it starts on line 11. You say: "For example, although certain elements, including the PJM ancillary services, were not specifically identified in the Ormet filing, the costs were handled through other mechanisms." What other mechanisms are you referencing there?

A. In that case they were included in the transmission rider.

Q. Let's turn to page 16 of your testimony, line 10. You are talking about other factors to consider in making the ESP versus MRO comparison. In line 10 you talk about "only a percentage of the costs will be reflected in an MRO-based SSO." What percentage are you referring to? Do you have a percentage?

A. That was the attempt on -- or not the attempt, but the action on JCB-2 revised where we took those various costs and reduced them by

10 percent, 20 percent, and 30 percent over the three-year time frame in the MRO.

Q. Thank you.

Some of my questions are just purely clarifying, and I'm trying to do it quickly, but if you need some foundation or background, we can --

A. As long as I can understand them, I'll answer them.

Q. Okay. Now let's look at page 20, and I want to go back to my previous question about this 15 percent cap and what's included and what's not included, and I want to be clear. I believe you answered earlier to a question I had that the up to the 15 percent could include distribution type items; is that right?

A. Yes.

Q. Because it's a 15 percent on the total bill basis.

A. Correct.

Q. And I believe in response to somebody else this afternoon you clarified that to say on a class basis.

A. It's approximately 15 percent on a class basis.

Q. Okay. So the implementation of gridSMART

and any increases associated with gridSMART would
count towards this 15 percent cap, right? I believe
in the company's application they said that there
would be automatic annual increases of 6 and -- I'm
sorry, 7 percent in CSP and 6-1/2 for Ohio Power for
gridSMART; is that right?

A. Can you point me to a spot in the application because I just want to check?

Q. Yeah. This will be easier if we just go through the application. It's page 6 in the application.

A. Page 6 in the application?

Q. Uh-huh, under the distribution rate.

A. Yes, I see it.

Q. These are all increases to the distribution rate, is my understanding.

A. The first two are covered by the annual increases of 7 percent -- increases only to the company's distribution rates, okay? So it's the unbundled distribution --

Q. Right.

A. -- of 7 percent for CSP and 6-1/2 percent for OPCO.

Q. Okay.

A. Those recover the enhanced distribution service reliability and the implementation of Phase I of gridSMART.

Q. That helps. I thought that was just for gridSMART. Regardless, both of those percentage increases, I understand it's just on the distribution rate, but those would be under the 15 percent cap and

would go towards arriving at the total bill
15 percent cap.
A. That's correct.
Q. Okay. And similarly, then, for the next
item listed on page 6, which is -- well, the provider
of last resort, obviously, that one goes toward the
15 percent, right?
A. Yes.
Q. And then next is the economic
development, which you call the EDR rider. Is
that -- does that also go -- do riders go against
this 15 percent cap?
A. I believe they do.
Q. Okay. So then you would agree with me
that that would also include the energy efficiency
rider.
A. Yes, I believe it does.
Q. What about this alternative feed service?
And I understand it would only be for specific

customers, but when you said the 15 percent was on a class basis, would that go towards that class basis 15 percent?

A. Your Honor, I'm just not sure.

Q. Okay. Then I guess I'm assuming the last two items listed, the line extension charges, as well as the Commission authorized distribution regulatory assets would also go against the cap?

A. Yes. I believe the only things that don't go against the cap are the ones that I list on page 20, which are the transmission cost recovery rider or new government mandates.

Q. Mr. Baker, you're aware that other distribution utilities currently have a -- you call it a FAC charge, but other utilities, some fuel adjustment clause.

A. Are we talking about Ohio?

Q. Sure, we'll just stick with Ohio. I mean, you're aware that Duke has what's called an FPP charge which is akin to your fuel adjustment clause?

A. There are similarities, yes, I'm aware of that.

Q. And what about FirstEnergy?

A. I know that FirstEnergy had some mechanism in dealing with the fuel increases they have incurred during the period of the RSP, but I think that they may have deferred those dollars as opposed to raised rates, but I wouldn't -- I can't be sure that that's the case.

Q. And do you know whether those companies have included any kind of fuel adjustment clause in

their ESPs?
A. I believe Duke maintains theirs. I'm loath to venture too far into FE because I just don't know the answer.
Q. Do you know of anybody else proposing a phase-in of fuel costs?
A. No. I mean, it's not a traditional approach, and except for the hoopla, I'll call it, around Senate Bill 221 and the potential for rates going up, that was what led us to think that it was appropriate to try to moderate the impact of coming off of these, what's in existing rates to new rates where we came up with the 15 percent.
We didn't do a similar thing in Virginia where you had a similar situation. We increased the rates just recently by almost 40 -- by 42 percent and didn't defer any dollars.
Q. And I think you would agree that any kind of fuel clause that are either talked about in the

RSP or any future under an ESP have been likened to the EFC proceedings that used to take place under traditional rate-making.

A. I think that's fair. There aren't always the same items that were in, but I think it's a similar-type approach. The timing might be slightly different, but if you think of it in a broad -- the broad scale of it, it would be a forecast of what the rates are expected to be for a future period. You would have periodic trueups where you would forecast forward and have an over/underrecovery from an accounting standpoint that would roll into the next case, so from that standpoint yes, I would say they're similar.

Q. And do you know whether or not AEP or any other utility under that traditional EFC-type proceeding has ever requested to phase-in fuel costs or, well, through a deferral mechanism, I guess?

A. No.

Q. Let's turn to page 22, and this is where you talk about the Ormet and Mon Power purchases.

A. The 5, 10, 15 percent purchases. And what we're saying here is that it reflects to some degree the fact that we took on these two loads, Ormet and Mon Power, that we traditionally -- that

were traditionally -- I guess the Mon Power was not
in our service territory. Ormet was, wasn't, and now
is.
Q. Well, you used the word, the phrase on
line 8, "agreement to accept," and I guess I just
want to clarify that. The company received revenues

during that whole transaction, and you, in the case of Mon Power, you did an RFP, and then any delta was recovered through the PAR rider.

And then similarly for Ormet if there was any delta from what the company's costs were versus what you charged that customer, that delta was recovered from customers as well, right?

A. In the case of Mon Power we were in an RFP, and the difference between the charge of -- or, what we paid for the power in the RFP and what we collected from those customers was socialized through the PAR for all Columbus & Southern customers.

Now, what has happened, what we did here was in developing the FAC, we credited that which is already in rates, that PAR, toward the FAC because we're now proposing this 5, 10, 15 percent purchase, okay?

Now do you want to do Ormet?

Q. Sure.

A. Okay. In the case of Ormet we came to
the Commission and said what the market price was for serving that customer, and then there was a contractual price to serve -- to serve that customer, and the difference was used to write down a regulatory liability that the company had regarding

some tax. I can't remember exactly which the tax is. I wish I could tell you exactly what it was.

But we had a regulatory liability that we were at risk for having to give back to the customers. We wrote that down, and it was only if that went to zero, then we would collect the differential and the 4 percent. And we are going to run out of that sometime in December likely.

MR. RANDAZZO: During this hearing.

Q. Well, December 31st, '08 is the termination of the Ormet contract, right?

A. Yes.

Q. And you could enter into an economic development type contract and then request if there is any delta recovery from customers through the economic development rider; isn't that right?

A. I don't think we could collect the difference between the price and market. It would only be the delta between the tariff -- or, the contract price and the tariff price.

Q. What was the load of the Mon Power customers?

A. It was in the neighborhood of 250 megawatts.

Q. And if you know, when did the Mon Power acquisition occur? Do you remember?

A. I believe it was 1/1/06, because it was the methodology to keep those customers from going to market, but it may have been a little later than that.

Q. Okay, so around '06. So it's been approximately well, I guess almost three years now, and, I mean, is it the company's position -- I'm trying to understand why the company is just not including this or treating these customers as CSP customers and why they wouldn't be charged the CSP rate and why there is still a need.

I understood the need of the RFP when you didn't expect that load to come back, but now that you've known that load to be back for three years, why wouldn't it just be determined as part of your load?

A. The rate to the customer is the tariff rate. The question is why should we be able to collect the difference between --

Q. Right.

A. -- market and that tariff rate. And quite simply, had we known that we were not going to be able to go to market in 2009, we would never have entered into those contracts. I can tell you absolutely that that is the case. It was in anticipation that we would be taking them on for two to three years and then along with all other customers would be at market.

Q. You're telling me in 2006 you didn't think there was discussion around new legislation that would change the current status of the market?

A. I was not aware of any legislation in 2006 around changing it. We were going to market.

Q. But you didn't act as if you were going to market from a corporate separation perspective, did you?

A. We would have done the corporate separation if we had gone to market.

Q. Well, you would have had to if you were going to market, right?

A. If we did the corporate separation, we would have broken up our pool before we had gone to market, and it would have had a negative impact on not customers in Ohio who had fixed rates, but it would have had a negative impact on the customers in all of the other eastern jurisdictions that didn't have fixed rates.

We didn't think that was an appropriate thing to do until we were actually at market, and then the idea was to separate the assets.

Q. I've heard a lot over the last couple days about how you don't think that -- I guess really how you don't think SB 221 is binding on the company with regard to governmental aggregators. It seemed to me earlier that you said that you would have to have a -- in response to somebody's hypothetical, you would have to have a contract in place in order to be guaranteed that the customers that promised to leave and come back at market price actually did. And I guess -- you think a contract is stronger than a law?

A. The contract one was in reference to customers who were not governmental aggregation. That's where that -- we were dealing with it in that context.

And I think I agreed earlier that if the law says no standby service, if the Commission says there's no POLR for that and parties who are in that come back at market, we'll just see how it plays out.

That would be up to the Commission to make that call.

Q. But in your testimony, your proposal, the company's proposal, is that POLR is nonbypassable, even for governmental aggregations that agree to not come back pursuant to 4928.20(J).

A. That was what we proposed. But I also indicated that if the Commission interprets the law that we are not allowed to charge a POLR charge to governmental aggregation and customers come back and they come back at market, that's what we'll do.

Q. But even if the Commission were to determine that the POLR is bypassable to governmental aggregators who agree to come back to market, isn't your POLR calculation based on those customers returning and the risk associated with those customers returning? That's how I read your testimony.

A. If it's bypassable, we don't have a POLR charge, so it doesn't matter how it was calculated for those customers.

Q. No. No. I mean your total POLR charge and the revenues associated therewith that you calculated using your Black-Scholes model and what you're seeking from all customers.

A. What we would do is if there is

governmental aggregation -- the charge is against
customer load, and that's outlined in Mr. Roush's
testimony. Our total buildup of the POLR charge is
just assuming that all load is charged POLR. If, in
fact, the Commission rules that governmental
aggregators, in fact, are not subject to that POLR

charge, then the amount of dollars we will recover for POLR will be reduced by that load leaving.

Q. And I understand you're waiting for the Commission to make that decision, but the application as it stands today includes POLR for all customers and makes it nonbypassable. And I know you've said you fear the legislative change of SB 221, if those customers dare to ever come back to market price, but wouldn't at that time, just as you did for Mon Power and Ormet, wouldn't at that time you seek recovery of any loss that may be associated to the company if those customers that come back to market are somehow put back on tariff because of a new law change or some Commission order that I guess is what you're afraid of?

A. What I'm afraid of is that we would not get the same treatment that we got in the case of Mon Power and Ormet. We might, but we would be at risk that we wouldn't.

Q. I'm not going to be the Black-Scholes police, but I do have one fundamental question I kept waiting to be asked. But I hear you say it's a great model. It won a Nobel Prize, or the people associated with it won a Nobel Prize, but I don't -- and I heard you agree with OCC's Witness Medine about

the whole -- its use in options and that it was used
for coal. But I believe she said that AEP didn't use
it for coal.

So if it is such a great model that you
stand behind, why isn't AEP using it for those coal
contracts?

A. Because we don't have -- we don't take
options on coal. We contract for it. So we have a
portfolio of contracts which are long-term, mid-term
and short-term, and so we're not buying hedges around
it. We just buy the coal.

And if you were -- if there were parties
out there today who were offering the kind of
optionality that used to be out there, okay, that
would say, for example, that you can buy a million --
using Ms. Medine's example, you can buy a million
tons, but if you want, you can reduce it and only
take 800,000, or you can increase it by the parallel
200,000 and get 1.2 million, and if, in fact, people

were offering that service, I believe we would look
at Black-Scholes to determine whether the premium
that that supplier wanted to charge relative to just
going out and buying a million tons, whether that was
a good deal or not a good deal.
Q. I guess I understand her to say that that

was available to AEP; AEP was just choosing not to do it. And you're saying that you disagree with her, that that's not available, that that was a hypothetical or under a traditional -- I'm assuming you're saying under a traditional EFC proceeding?

A. No. I'm saying in today's coal market no one is making that kind of an offer. And it's something that we miss. Those were nice options, and, unfortunately, they're not out there anymore.

Q. On page 33 you talk about the previous eight years virtually no customer switching has occurred, and I don't think you used the words "virtually no" when you responded to someone's answer yesterday or today, but your answer says that SB 221 makes clear that there should be a promotion of retail competition, and I guess didn't SB 3 promote retail competition?

A. Yes.

Q. And during that promotion of retail

competition, still in the previous eight years there
was virtually no customers switching on AEP's Ohio
system.

A. That's because the market prices went up
in the 2000-2001 period above our tariff rates, and
customers did what was economically the sound action

and chose to stay with the lower price of power. We had switching in other jurisdictions -- other companies in the state whose rates were closer to market.

Q. On page 52 you go into a history of the IGCC facility, and I guess I don't know what the point of your history lesson is here. Are you requesting any kind of recovery for an IGCC facility in this proceeding?

A. No, we're not. The purpose of this testimony is that, A, we're still supportive of doing an IGCC. We wanted to make it clear that some of -- some of what was in Senate Bill 221 make it not an option for us at this point in the state of Ohio. We wanted to make sure that the Commission understood why we were not doing it at this point, and that we were also just pointing out that we were not in this hearing dealing with the Phase I recovery.

Q. Okay. You're not expecting anything from the Commission with regard to an IGCC facility.

A. No.

EXAMINER BOJKO: Thank you. I have no further questions. Thank you, Mr. Baker.

THE WITNESS: You're welcome.

EXAMINER BOJKO: And thank you for your

long day and a half of testimony. We appreciate it.

MR. RESNIK: Your Honor, I move the admission of Companies' Exhibits 2A, B, C, and D.

EXAMINER BOJKO: Any opposition to the admission of Mr. Baker's testimony, errata sheet, and a couple interrogatories associated with his testimony?

Hearing none, Exhibits 2A, B, C, and D will all be admitted.

(EXHIBITS ADMITTED INTO EVIDENCE.)

MS. ROBERTS: Your Honor, consistent with your previous ruling on the errata?

EXAMINER BOJKO: Of course, the errata sheet portion of that will be stricken.

Mr. Randazzo.

MR. RANDAZZO: Yes, your Honor, I previously marked IEU Exhibits 3 through 8 and would move those into evidence.

EXAMINER BOJKO: Mr. Resnik.

MR. RESNIK: Your Honor, just a limited
objection, and certainly not to the authenticity or
what's in there because I think perhaps other than
the OVEC annual report, which I have no question, no
doubt what's in there, these are AEP documents. It's
just at one point I think Mr. Randazzo properly

characterized, and maybe it was the Fact Book, this Exhibit 7, that it was loaded with information, and, you know, we had questions on a lot of the pages in these documents, and I don't have any problem with those pages being admitted into the record, even though some of the questions were just "does this page address," you know, whatever the topic was.

But there is a lot in here that has nothing to do with the case, and my concern would be with no questions having been asked about the majority of the information in here, that, you know, it's just hanging out there, people using it without any opportunity for the witness to comment as to try to give context to it or what the meaning of the information is that might be used in briefs.

And so I think, as I said, no objection to any of the information that was covered in the cross-examination, those particular pages that were referred to, but to the remainder I would object to the admission.

EXAMINER BOJKO: Just with regards to the Exhibit 7, the Fact Book?

MR. RESNIK: No, actually, all of the exhibits, your Honor.

EXAMINER BOJKO: Mr. Randazzo, do you

have a response?

MR. RANDAZZO: Well, I mean, I don't know if I'm going it relieve or make worse Mr. Resnik's anxiety, but what I was trying to do is to accelerate the process of getting the information into the record. If it's useful, I tried to refer specifically to the pages that were most important to me so that everybody would have some sense of why I thought these documents had significance relative to the issues in this case.

But these are documents that have been provided to the financial community, that people in the outside world have been encouraged to rely upon by AEP for whatever the words mean, and if I interpret the words differently and choose to use that in a brief, that is a problem that I think we have as a result of AEP putting these documents into the public arena.

I respect Mr. Resnik's concern, and I

hope that he knows that we will use this information prudently and judiciously, but things like the 10-K and AEP's press releases and the financial information that's contained in IEU Exhibit 5 and 6, I just don't understand the qualification that Mr. Resnik has offered up relative to this information at this point.

But I confess to you that if the objection is sustained, I will ask to go back on the record and go page by page through the documents until we've got everything in the record to his satisfaction.

EXAMINER BOJKO: Well, that is my concern, because I did take some of the questions to be global in nature and cursory and not necessarily I thought to abbreviate, we weren't going through every page. However, I also understand the concern that Mr. Resnik's raised.

Do you have something, Mr. Bell, to add?

MR. BELL: Yes, yes, if I may. I made reference to prior use of some of these exhibits. I cross-examined Mr. Hamrock extensively utilizing the exact documents that's been identified as IEU Exhibit No. 5, and the record will so reflect, and I specifically reference specific information in that.

And if we go the route that Mr. Resnik is suggesting, then I'm deprived of the opportunity to reference specific information in these documents that was held out by AEP as being authentic and representing its position. I join with Mr. Randazzo in opposing --

And I think there's some practical

concerns. Given the time that we've got, who's going to be sorting through this to hunt up additional arguments? We're going to have problems --

EXAMINER BOJKO: That's why I asked about a couple documents to make sure they were either publicly filed or publicly available. These are AEP's documents. These aren't another party -- this isn't The Dispatch, which we did not allow such documents in of that nature. These are AEP statements. There could be exceptions to hearsay, et cetera, et cetera, so I'm going to admit all of the exhibits. I believe they all fall in that category.

MR. RANDAZZO: I may have misspoke, your Honor. Just for the record, I believe you did take administrative notice previously of the full version of the 10-K, so --

EXAMINER BOJKO: That's filed at FERC, I did.

MR. RANDAZZO: Yes.

EXAMINER BOJKO: Just so we're clear, if there's any concern or misuse, obviously, you have a reply brief opportunity, and I think that you would address it in that nature or you would do another motion to strike or something of the like, if necessary.

So we're going to admit IEU Exhibits 3, 4, 5, 6, 7, 8, and 9.

(EXHIBITS ADMITTED INTO EVIDENCE.)

EXAMINER BOJKO:

Thank you, Mr. Baker.

THE WITNESS: Thank you, your Honor.

EXAMINER BOJKO: Let's go off the record.

(Discussion off the record.)

EXAMINER BOJKO: Let's go on the record.

Mr. Randazzo, would you like to call your first --

MR. RANDAZZO: Our first witness today, your Honor. Your Honor, I'd ask that Joseph Bowser be sworn as a witness in this proceeding.

EXAMINER BOJKO: Mr. Bowser, could you please raise your right hand?

(Witness sworn.)

MR. RANDAZZO: Your Honor, I would ask

that the direct testimony of Joseph G. Bowser that was filed in this proceeding on October the 31st be marked for identification purposes as IEU Exhibit No. 10.

EXAMINER BOJKO: It will be so marked.

(EXHIBIT MARKED FOR IDENTIFICATION.)

MR. RANDAZZO: Mr. Bowser advices he's fresh as a daisy and ready to go all night

- - -

JOSEPH G. BOWSER

being first duly sworn, as prescribed by law, was examined and testified as follows:

DIRECT EXAMINATION

By Mr. Randazzo:

Q. Mr. Bowser, do you have before you what's been marked for identification purposes as IEU Exhibit No. 10?

A. Yes, I do.

Q. Am I correct that that's the testimony that you prepared for purposes of this proceeding?

A. Yes.

Q. Do you have any changes or corrections that you would like to make to that testimony?

A. No, I do not.

Q. If I were to ask you the questions that are contained in that testimony, would the answers you would give here today be the same as set forth in IEU Exhibit No. 10?

A. Yes.

MR. RANDAZZO: Your Honor, I would move the admission, subject to cross, of course, of IEU

Exhibit No. 10 and make Mr. Bowser available for appropriate cross-examination.

EXAMINER BOJKO: It will be so marked and we'll take up the admission subject to cross.

Mr. O'Brien, are you standing to --

MR. O'BRIEN: I'm sorry, I was tending to other matters.

EXAMINER BOJKO: And I was just made aware before he departed that Mr. Petricoff had no cross-examination questions for Mr. Bowser.

Mr. Bell?

MR. BELL: No questions, your Honor.

EXAMINER BOJKO: Ms. Roberts?

MS. ROBERTS: I don't know where Ms. Grady went.

EXAMINER BOJKO: Okay.

Mr. O'Brien?

MR. O'BRIEN: As tempting as it is, I have no questions.

EXAMINER BOJKO: Mr. Maskovyak?

MR. MASKOVYAK: No questions, your Honor.

EXAMINER BOJKO: Any questions, Mr. Margard?

MR. MARGARD: No, your Honor.

EXAMINER BOJKO: I'm assuming you want to wait.

MR. RESNIK: I would like to.

MS. ROBERTS: No questions, your Honor.

EXAMINER BOJKO: Mr. Resnik.

MR. RESNIK: Thank you, your Honor.

- - -

CROSS-EXAMINATION

By Mr. Resnik:

Q. Good evening, Mr. Bowser.

A. Good evening.

Q. I wanted to start at page 5 of your testimony, lines 4 through 8, and you discuss there the concept of symmetry in the treatment of taxes, and you say that: "If customers will be asked to pay for the cost of new taxes imposed" -- and I think you were talking about federally mandated carbon or energy taxes.

A. Yes, I was.

Q. Then you said they should also, the

"customers should also receive the tax benefits with the Section 199 deduction."

A. Yes, that's correct.

Q. So if in -- let's say in 2009 there are no federally mandated carbon or energy taxes imposed, would it be your suggestion that for calculating the carrying charge in that year, for symmetry, section 199 deductions should not be applied?

A. No. I would believe that the 199 deductions still should be applied.

Q. Forget about symmetry; is that it?

A. Well, the symmetry is only part of my argument. There's already Commission precedent for treating the 199 deduction as a reduction in carrying cost rates.

Q. And does the Commission's precedent that you referred to, is that the reason that you are taking the position you are?

A. That's the primary reason, correct.

Q. If that precedent did not exist, would it be your recommendation as an expert in this area that an adjustment should be made for the 199 deduction in figuring out the weighted average cost of capital?

A. Yes. I believe it does need to be reflected. In addition to the precedent that I noted in the case, which was the company's I believe GCRR proceeding, there's also precedent for Duke Energy company by way of its so-called annually adjusted component in which they've reflected this as well. It's a fairly contemporary deduction. It only started in 2005, and I think it's appropriate that it be recognized.

Q. Even if there was no precedent.

A. Yes, that's correct.

Q. Now, at lines 8 through 10 you talk about tax decreases being reflected as well as tax increases, and that that's consistent with general ratemaking principles. What general ratemaking principles are you referring to there?

A. What I'm referring to there is the fact that you reflect increases in costs as well as decreases in costs.

Q. So essentially that's sort of remnants of the cost-of-service basis for setting rates?

A. It certainly would have been used in -- it certainly would have been a cost-of-service principle, yes.

Q. Okay. And in the cost-of-service world that we used to be in, would the effects of the section 199 deduction be reflected in the company's tax expense?

A. I'm not sure. It may have.

Q. And if it were included in tax expense for rate-making purposes, would you -- if we were having a more traditional cost-of-service rate case, would you also include that deduction for purposes of

calculating the weighted average cost of capital?
A. Could you repeat the question, I'm sorry?
MR. RESNIK: Could I have it read back?
(Record read.)
A. Well, it would only be accounted for in one place, one of the two.
Q. Because otherwise you would be double counting.
A. That's correct.
Q. Okay. And are you able to indicate in these -- in the context of being consistent with general ratemaking principles that the place where that deduction would show up would be in the calculation of the company's tax expense in the overall test year expense concept?
A. It may be. It probably could have been handled either way. It could have been there.
Q. Now, if in that type of case, if no deferrals were being asked for, then several -- or

would it be your opinion that the 199 deduction would
be reflected through the computation of the company's
tax expense?
MR. RANDAZZO: I object, your Honor. To
my knowledge we have not had the company propose that
we're going to do a full rate case for purposes of

figuring out what the total cost of the non-FAC portion of the rate ought to be. I don't see how this is relevant.

MR. RESNIK: If I may, your Honor. The testimony at page 5, lines 8 through 10, talks about reflecting tax decreases as being consistent with general ratemaking principles, and so I'm exploring it in the context of that sentence.

EXAMINER BOJKO: The witness can answer if he knows.

A. When you say "deferrals," what are you referring to?

Q. Well, if there were a rate case where no deferrals were being proposed so there was nothing on which to apply a carrying charge but yet the section 199 deduction were available to the utility, would it be your understanding that that deduction would be reflected in the income tax expense?

A. Well, it would have to be reflected

somewhere because the embedded generation rates would have to -- how can I say this? I'm sorry. The deduction which applies to the generation side of the business would need to be reflected in the generation rates of the company.

Q. Okay. Now, at page 7, lines beginning at line 14 and going on to page 8, line 4, just to try and paraphrase it, and if I mischaracterize it, let me know, but are you suggesting that the total standard service offer rate has to be analyzed to determine what taxes are built into the company's generation rate?

A. Just the generation portion of that, not the entire SSO.

Q. And what else is there in the SSO as far as the rate?

A. As I understand it, there's also distribution and transmission.

Q. Okay. And so just focusing on the generation portion of the SSO, as you understand it, what you are suggesting is that some evaluations should be made by the Commission in this proceeding to see whether the generation portion reflects the costs associated with taxes?

A. You mean with the 199 deduction?

Q. Well, I thought actually that your testimony was broader than that, but we can focus on the 199 deduction.

A. Then focusing on just the 199 deduction, my answer would be yes.

Q. Okay. Are you suggesting some broader analysis also be done by the Commission, that is, look at the generation portion of the SSO and see what taxes are built into -- what tax expenses are built into that rate?

THE WITNESS: Could I have that read back, please?

(Record read.)

A. Well, I would look at it from the standpoint of the 199 deduction because that's the one that has recently changed. You know, that's the one that was recently implemented, let's say.

Q. Okay. Let's focus on the part of this answer that begins on the last line on page 7 and goes on to page 8, and there you're talking about a "closer examination of the tax costs and benefits." Now, is that the full scope of tax implications that you're talking about there, or is that also just focusing on the 199 deduction?

A. That is focusing on just the 199

deduction.

Q. Okay.

A. Yes.

Q. Now, at the top of page 7, the first four lines there, you show, if I've got this right, the carrying charge rate adjustment that you're proposing for two different periods for each company. For instance, for Ohio Power you've got an adjustment from 13.98 percent to 13.83 percent for 2007 through 2009.

A. Yes.

Q. And I was wondering why you were showing a period beginning in 2007.

A. I went back to that point because that was the -- when the 6 percent deduction for the 199 deduction went into effect.

Q. Is it --

A. As far as applicability, it might only be 2009 and thereafter.

Q. Okay. That's what I wanted to clear up. So maybe to make it clear for me, is it your understanding or do you believe that the companies are asking to recover carrying charges that they incurred prior to 2009?

A. The environmental carrying costs I

believe are for 2009, but they go back and are applied to some balances of environmental investment that the company is not already receiving carrying charges on from another case.

Q. Okay. Let's see if we can, at least for me, get a basic understanding of what this 199 deduction is about. Do you know what act created the deduction?

A. What act?

Q. And while you're looking, I might see if this refreshes your recollection. Are you familiar with the American Jobs Creation Act of 2004?

A. That was the one that created it, yes.

Q. Okay. And do you know if that act reduced the federal income tax rate for the companies?

A. Do you mean the jurisdictional federal income tax rate?

Q. Well, I'm not sure what you mean by "jurisdictional," but I'm talking about the federal income tax rate that the companies pay.

A. I don't know.

Q. Do you believe that the section 199 deduction was an adjustment to the statutory tax rate?

A. I believe that's how it has to be reflected. In rates that's how it needs to be reflected. I don't believe, though, that the IRS regulation referred to it specifically the way you are referring to it.

Q. Well, aren't there a lot of deductions that are available to any taxpayer?

A. Tax deductions?

Q. Yes.

A. Yes, there are.

Q. And do those deductions change the actual statutory tax rate?

A. They change the rate that somebody ultimately pays.

Q. Do they change the statutory tax rate?

A. The statutory rate, no, but the effective rate, yes.

Q. Okay. Thank you.

Now, are you familiar with the term "qualified production activity income"?

A. Yes. That's the basis for determining the section 199 deduction.

Q. And also the term "expanded affiliate group," are you familiar with that?

A. I know that that one's in the IRS law, but I'm not familiar with the term.

Q. Well, let me ask you this, is it your belief that the section 199 deduction is calculated separately for Columbus Southern Power standing alone and then separately for Ohio Power Company standing alone?

A. No. It would be calculated the same way that AEP corporation taxes are, which is based on a consolidated tax return for the entire corporation.

Q. And there is -- so this entire group, if you will, are those the entities that would be included in the calculation of the section 199 deduction?

A. For purposes of the calculation applied to the company's tax return, yes.

Q. Okay. And if you'll accept my terminology, certainly nothing I invented, but "expanded affiliate group," that that would be the group of AEP companies that would be looked at on a consolidated basis to determine the availability of the section 199 deduction?

A. I'm not -- again, I'm not sure what that term specifically means, but I do know that the deduction is calculated for the corporation as a whole.

Q. Okay. And then once that tax is calculated for the corporation as a whole, how is it allocated among the members?

A. I'm not sure.

Q. Okay. If we can accept for the moment the assumption that the overall deduction is allocated back on each group member's relative positive qualified production activity income, will you assume that with me?

A. Okay.

Q. So in order to know what the amount of the deduction will be for any individual member of that group, you would need to know what is going on as far as qualified production activity income for all the other members of the group, wouldn't you?

A. On the tax side, that's correct.

Q. And do you know if there are any limits on the deduction that is available?

A. Yes, there are certain limits. One of the limits is it can be no more than 50 percent of the corporation's W-2 wages paid in a particular year.

Q. And is it total wages or just wages of employees allocated to the production function?

A. I believe it's total W-2 wages.

Q. Okay. Now, do you know whether AEP
operating companies have been able to claim the 199
deduction in full for each year since the deduction
became effective?

A. I do not know that.

Q. Do you know whether Columbus Southern or

Ohio Power will receive any section 199 deduction benefit in either 2009, 2010, or 2011?
A. No, I don't know that.
Q. And would you agree that whether Columbus Southern or Ohio Power actually receive any section 199 deduction in those three years of the electric security plan will depend not only on the results related to them but also the results of the other members of the AEP group that are included in this calculation?
A. For tax purposes, that is correct.
Q. And do you know if a member of the group has a negative qualified production activity income, whether that is used to offset the positive qualified production activity income that other members might have?
A. No, I don't know that. But it's hard to imagine that somebody would have a negative QPAI because otherwise you'd be selling the generation at

a loss.

Q. So if you're not certain what, if any, section 199 deduction Columbus Southern and Ohio Power will have in years 2009, '10, and '11, I was wondering if you could take a look at your Exhibit JGB-2, and technically line 12, and tell me why you're assuming that there will be a full level of deduction available to those companies.

A. Well, again, I assume that the companies will sell their generation not at a loss, and for purposes of setting rates, you have to assume that the company is getting the deduction. How it works out on the tax return, though, may or may not be different, but that's true for any number of tax items.

Q. Well, you're talking about for purposes of setting rates. Is this going back to the general -- your understanding of general ratemaking principles?

A. Well, in this case this is in order to reflect the carrying costs used on the environmental expenditures.

Q. Right. And you're simply making the assumption that this deduction will be available in full to these two companies, Columbus Southern and

Ohio Power, in the years 2009, '10, and '11.

A. For purposes of the ratemaking, yes.

Q. Now, have you testified in other proceedings concerning the appropriate calculation of a weighted average cost of capital?

A. I don't recall, but I don't believe I have. The best I can recall is that I have not.

Q. Are you familiar with whether or not it is typical that in calculating a weighted average cost of capital that the statutory tax rate is the rate that is used?

A. Well, with -- it's hard to say what would be typical since, you know, this particular deduction has only been in effect since 2005, so no, I can't say with certainty.

Q. Okay. Do you know whether the section 199 deduction has any carry-forward or carry-back opportunities?

A. No, I don't.

Q. And I suppose maybe consistent with that you would not know whether each tax year the section 199 deduction is computed specifically for that tax year without any carry forward or carry back?

A. Correct.

Q. Correct, you would not know.

A. Yes.

Q. Now, have you reviewed the Financial Accounting Standards Board position No. FAS-109-1?

A. I believe that was what was provided in discovery, one of the discovery requests.

Q. Yes.

A. From the company to me.

Q. Right.

A. Yes, I did look at that.

Q. And is it your -- would you agree that that FASB position paper concludes that the 199 deduction does not reduce the statutory tax rate?

A. Yes, it does say that. But, you know, you also have to recognize that there can be differences in generally accepted accounting principles and what happens with utilities based on actions of the Commission.

Q. Do you know whether the FERC's chief accountant has reached the same conclusion in a FERC accounting release notice in July of 2005? That same conclusion being that the 199 deduction does not reduce the statutory tax rate.

A. And again, if I could ask, is that the information provided to me in discovery?

Q. Yes, I believe it was.

A. Could I have that in front of me,
Mr. Resnik? Could you direct me to a portion of that
or --

Q. Well, probably not, but let me try.

A. Okay.

Q. Well, I don't -- unless you have found something, I don't want to delay this any longer.

A. Yes. Just so we're on the same document, this is the guidance order on tax deduction for manufacturing activities.

Q. And that was released in July of 2005?

A. Yes.

Q. Yes.

A. Okay. Well, actually, this tax deduction which I refer to as the section 199 deduction here is referred to as the tax deduction for manufacturing activities, or TDMA, and actually on page 2, the first paragraph, the last sentence says that: The TDMA, or this tax deduction, will be the equivalent of reducing the effective federal corporate income tax rate on production activities from 35 percent to 32 percent.

Q. Right. The effective rate, not the statutory rate.

A. I don't know what it says about the

statutory rate, but that's what it says about the effective rate.

Q. All right. Now, let me see if I can find my place. On page 9, lines 13 and -- well, beginning at line 13, you make reference to -- you suggest maybe the companies have confused their ESP with the

MRO that exists under Senate Bill 221. Do you see that?

A. Yes. Now we're talking about the slice-of-system pricing, I believe.

Q. Well, no -- yes, I'm sorry. Yes.

A. Yes, I'm there.

Q. He may not be. Give me one moment, please.

MR. RESNIK: Your Honor, may I have a moment, a moment more?

EXAMINER BOJKO: You may.

Q. I should have referred you to page 5, lines 13 through 18. I apologize for that. And there you're talking about that: In an MRO, when making any adjustment to the most recent standard service offer, the Commission is to include the benefits that may be available as a result of or in connection with the costs included in the adjustment. Do you see that?

A. Yes. That's part of section 4928.142.

Q. And I think perhaps 142(D).

A. That's correct.

Q. Okay. Now, let me ask you, is the tax benefit that you're talking about, this is still the section 199 deduction, right?

A. Well, this refers to tax benefits in general. I believe section -- that section of the code.

Q. Okay. But all your testimony is focusing on is the 199 deduction.

A. For purposes of this adjustment, correct.

Q. Yes. Now, the benefits you're talking about in division (D) of 4928.142 are enumerated. There are four different benefits in that section. Is that what you had in mind? Excuse me, the adjustments, rather.

A. No. Actually, Mr. Resnik, it's below that section. It's the first full paragraph under those four items about the fourth line down.

Q. Right. But that is talking about in the context of making the adjustments, and aren't the adjustments the four categories listed just above that paragraph? Is that your understanding?

A. I see what you mean now. Yes, that's

right.

Q. Okay. So we can look at each of these four categories and see if this section 199 deduction would relate to any of them and then determine whether that's a benefit that you're saying would need to be used as an offset in the context of an

MRO?

A. Well, I'm saying this more as, you know, reflecting these types of benefits is also something that the MRO anticipates would happen, and the four items that are listed there, you know, it says that those are items that can be adjusted upward or downward, but below those four items there's language that talks about the utility's receipt of tax benefits or other benefits.

And so what I'm trying to do here is indicate that, you know, the MRO also contemplates that benefits would be reflected as well as costs.

Q. And that's what I want to test. And you sort of cut short, not that I was asking you to read the whole --

A. Excuse me.

Q. Did I interrupt you?

A. No. No. Excuse me if I interrupted you.

Q. No. I was going to say you cut short

your paraphrasing or characterization of what was in this paragraph after the four --

MR. RANDAZZO: Both of you are being too nice.

MS. GRADY: Yeah, really.

MR. RESNIK: Especially at this hour.

Q. It goes on to talk about including benefits that may become available to the utility in connection with the costs that are included in the adjustments; is that right?
A. Can you refer to me where you're looking at?
Q. I'm in that paragraph in division (D) that you were talking about, in the third line saying that the Commission should include the benefits that may become available.
A. Yes, I see that.
Q. I was just going down a little further. It's not simply "become available," but "may become available as a result of or in connection with the costs that are included in the adjustment."
MR. RANDAZZO: I object, your Honor. Mr. Bowser has cited this as an example of where benefits need to follow costs, and he very clearly indicates that on line 17 of his testimony.

MR. RESNIK: Right. And I think he was
suggesting that, your Honor, in the context of the
199 deduction, and I'm trying to find out if the
witness thinks that the section 199 deduction would
be a benefit that would essentially be an offset to
these costs that are permissible or the adjustments

in the MRO.

EXAMINER BOJKO: I think the witness can answer if he knows, but I don't think -- well, ask him if he knows exactly what you said. We don't need to read the law into the record.

MR. RESNIK: I agree. I apologize, your Honor.

Q. (By Mr. Resnik) Is it your belief that the section 199 deduction would be a benefit that would be used as an offset in the context of an MRO to any adjustments that are referenced here among these four adjustments in section 142(D)?

A. No. Again, I was citing this merely to show that the MRO anticipates that there would be benefits reflected.

Q. But not necessarily the 199 benefits.

A. That's correct.

Q. Okay. Great.

Now, do you also suggest applying this

199 deduction to the carrying charge rate for the fuel deferrals?

A. Yes, that's correct.

Q. And the fuel, is that something that qualifies as production related? Is it covered by this section 199 deduction?

A. Yes, because the qualified production activities income is basically the revenue from the sale of generation minus the cost of goods sold, which for generation is primarily fuel and then other allocated costs. So yes, in my opinion fuel would be part of that function.

Q. Purchased power costs also?

A. I'm not sure on purchased power costs.

Q. Okay.

A. But fuel, yes.

Q. Pardon me?

A. Fuel, definitely.

Q. Okay. What about the cost of renewables or energy efficiency?

EXAMINER BOJKO: Go ahead.

(Discussion off the record.)

EXAMINER BOJKO: I'm sorry, let's go back on the record.

And could you reread the last question,

please?

MR. RESNIK: Thank you.

(Record read.)

Q. And the rest of that question would be, would the section 199 deduction apply to renewable energy that is purchased?

A. I don't know.

Q. And what about costs of complying with environmental laws, would that be covered by the section 199 deduction?

MR. RANDAZZO: Marv, if I can, are we talking about a carrying cost?

MR. RESNIK: Yes.

MR. RANDAZZO: Okay.

A. What was the last question again?

Q. Would that be covered, the carrying costs associated with prior environmental investments, would that be covered by the 199 deduction?

A. Not directly, but that's how you capture the ratemaking effect of the 199 deduction, is one of the ways of doing that is in the carrying charges, and that's why I proposed what I did for the environmental and for the carrying charges on the deferred fuel.

Q. So are you saying that as far as

environmental investment that was made, incremental investment made between 2001 and 2008, that at least for some of those years, you mentioned beginning in 2005, section 199 deduction would have applied to those environmental investments?

A. I'm not sure that it necessarily applies to those investments. I don't know that that's part of the determination of the qualified production activities income for tax purposes, but for purposes of setting rates, yes, that's something that you would expect to recognize.

Q. If you're not certain if the 199 deduction would encompass investment in capital -- in environmental investments, and as I understand it you're not certain if it would apply to purchased power or purchased renewable power, why would there be a deduction inflicted into the weighted average cost calculation for the deferrals associated with those items?

A. Because it's part of the generation. It's part of the generation function, and that's what you're getting the deduction on.

Q. Even if the deduction doesn't apply to those particular components, you're saying.

MR. RANDAZZO: I object. The deduction

as Mr. Bowser has applied it is to a carrying charge
calculation.

MR. RESNIK: And I understand that, your
Honor. But it's a carrying charge calculation on
dollars that I think the witness has said he doesn't
know if the deduction would apply to those dollars.

That's all I'm trying to get straight in my mind and on the record.

EXAMINER BOJKO: Okay, he can answer if he knows. But I thought we were working under that assumption.

THE WITNESS: Well, basically what you're doing with this deduction is you take the statutory tax rate of 35 percent, and in years where the section 199 deduction is 6 percent, you multiply 6 percent times the 35, and then that result you subtract from the 35 percent giving you, in effect, an effective federal income tax rate.

And so to reflect that in rates, one of the ways of doing that is then you adjust the federal income tax rate to that lower rate in the gross revenue conversion factor, and you apply that to the carrying charges. So that's practically -- that's the ratemaking you need to do in order to reflect this.

Q. Okay. And I think you've described how the calculation would be done. What I was just trying to get at is you would do that calculation for a carrying charge rate even if it was being applied to expenses or investment that was not covered by the 199 deduction.

A. It's got to be applied to the generation function because any of the costs that are generation related, that's what generates the section 199 deductions, the generation side of the business.

Q. Looking at page 9 of your testimony, lines 18 through 20, is it your understanding of the electric security plan provisions in Senate Bill 221 that purchased power is precluded from being included along with fuel cost recovery?

A. Well, I think the issue here is the blending, the blending of the slice of system into the ESP. And under my understanding of the legislation, it's only section 4928.142 which is the MRO section that addresses the blending.

Q. But do you have an understanding of whether or not under an ESP, if there is a recovery mechanism for fuel or fuel-related costs, that that can include purchased power?

MR. RANDAZZO: To move this along, we'll

stipulate that it can include purchased power to the extent it's prudently incurred.

MR. RESNIK: Okay.

Q. Now, moving on to the distribution increases, I think you begin discussing those at page 10. And I'm taking a look at page 11, your recommendation, as I understand it, is that what I'll call the gridSMART and the enhanced service reliability plan proposals should be looked at in a future distribution rate case?

A. Correct.

Q. Okay. Is it your recommendation that in such a rate case, that the company would need to, in order to recover costs or investment or return on investments made in those regards, that those costs would have had to have been incurred during a test year, and that the investment would have to be in rate base at a date certain as already being used and useful?

A. Correct.

Q. So you're saying that your view is the company needs to just go ahead with these and then come to the Commission and ask for a cost recovery.

A. If you thought it was appropriate to go ahead with those, yes. I just don't think that

increases of this magnitude in a distribution rate
should be addressed here.

Q. Okay. Now, next you discuss the
company's proposal to sell or transfer certain
generating assets. Did you review in preparation of
this part of your testimony section 4928.17(E), which

deals with the Commission's authority to approve such a sale or transfer?

A. I believe I did, and I believe my recollection of that section is that the company has to have Commission approval in order to sell or transfer generating assets that it fully or partially owns.

Q. And if you remember when you reviewed that paragraph, did you find anything in there that would tell you, you know, what the Commission should be considering in approving or disapproving such a request?

A. I don't recall.

Q. Now, if I understand it correctly, you're saying that because CSP is one of the owners of OVEC, it has ownership in OVEC generating facilities?

A. Yes. Because CSP has an equity ownership in OVEC, then to me that means that they have ownership.

Q. Now, do you know who owns CSP's stock?

A. I assume AEP, Inc.

Q. Okay. Good assumption.

Would it then be your view that AEP, Inc. has an ownership interest in OVEC generating assets?

A. I know from looking at the OVEC Annual

Report that AEP, Inc. and Columbus Southern Power are both listed separately as having equity ownerships.

Q. In?

A. In OVEC.

Q. In OVEC.

A. Correct.

Q. Right. I was asking whether under your view that started with CSP, but now AEP has ownership interest, that that -- in OVEC, that that also means they have an ownership interest in specific generating assets.

MR. RANDAZZO: I object. The section of the law that we're referring to here is a restriction on electric distribution utilities' ability to transfer. I'm not sure what AEP's ownership interest in OVEC has to do with this.

MR. RESNIK: If I may, your Honor, I'm trying to test the theory that because someone owns stock in a company, that they actually have an ownership interest in particular assets of that company. So I'm just trying to see how far up the chain that goes.

EXAMINER BOJKO: If the witness knows, he can answer. But I thought he already answered your question once.

A. Yeah. Again, both AEP, Inc. and Columbus Southern are listed separately with equity ownerships. So to me both of them own -- have partial ownership in OVEC.

Q. Okay. Do you know whether the Darby or Waterford units owned by Columbus Southern Power have been the basis or used as the basis for setting Columbus Southern Power's generation rates under either the electric transition plan proceeding or the rate stabilization plan proceeding?

A. I don't believe they have.

Q. Okay. And let's assume for the moment that they have not. If the Commission rejects Columbus Southern's proposal in this regard for the reasons you provide and would not allow the sale or transfer of Darby or Waterford, would it be your recommendation that the company should be able to achieve some level of rate recovery associated with those two units?

A. I'm not really testifying to that. I'm just testifying to the fact that I think Commission authority is needed to do this.

Q. I understand that. But now I'm asking you to think about it, and if you don't have an opinion, you can say that. But whether or not, if the Commission precludes the sale or transfer of those units, whether you think it would be appropriate for Columbus Southern to get some rate recovery associated with either-or both of those units.

A. I don't have an opinion on that right now.

Q. Okay. That takes us to the discussion on the Gavin scrubber. If I understand correctly, your testimony at page 17, also on 16, the bottom line is that the Commission should not leave open the door for the company to come back during the ESP period for cost recovery that might be associated with the expiration of the Gavin scrubber lease?

A. Yes, that's right.

Q. And why do you take that position?

A. In the Commission's order of June 4th, 2008, in a financing case, which was 08-498, the Commission had indicated in there that the company should provide in its ESP details of how it intends to incorporate the Gavin scrubber project, so in my mind it seems like the company came up short in saying, you know, we're not ready to address this right now; we want to reserve the right to do that later.

In my mind the Commission was looking for a specific proposal, and because now the company is saying "we'd like to reserve this right," it seems like it's a single-issue rate-making type of issue in terms of, "well, down the road when we know what this is, you know, we'd like to make an adjustment for this."

Q. And is it at least conceivable, as you sit there on the stand, that given when the company was asked to address this and given that it was filing an application in July and we had a lease expiring in 2010, that the company may not have had all of the facts upon which it could reach a conclusion as to what was the best course of action to follow?

A. Yes, it may not have had all the facts.

Q. Okay. And so if that were the case, then again, I would characterize your testimony, and correct me if I have it wrong, the effect is that because of the timing of when the lease expires in comparison to when the ESP application was being filed, that if the company just couldn't address it with specificity at this time, the company gets locked out until the end of its ESP?

A. Yes, that is what I'm saying.

Q. And I know the word "fair" has been used a few times in this hearing. Do you think that's fair?

A. Well, there would be other, you know, ways that the company could seek recovery in the future. They could certainly seek potential deferral once they knew what the costs were. But it's --

Q. I bet I know what carrying charge rate you'd want to do.

A. But it seems to me that it's sort of picking and choosing of "let's address this item down the road," and I know that one of the tests, I didn't study the tests thoroughly, but I know Mr. Baker was cross-examined a little bit earlier today on it, was the MRO versus ESP evaluation, and, you know, to the extent that there's a cost allowed into the ESP, let's say in 2010, that could affect that comparison.

Q. I understand that point that you made, and I would suspect that if the company were

permitted to come back to the Commission with the
results of its proposal for dealing with the
expiration of the lease, the Commission could look at
that in 2010 and consider whether that tipped the
scale as to the comparison that it was looking at at
this point in time. But what you're really saying is

the company just can't come in at all; is that right?

A. Yes, that's right.

Q. Okay. And if we were back in pre-Senate Bill 3 ratemaking, the company would have the opportunity, if it thought it was necessary, to come back for a rate case to recover those costs and other cost changes that might have occurred in relation to its generation business, right? Or even its total business.

A. Yes, you would.

Q. And do you have an understanding as to once an ESP plan is in place, for whatever its term might be, as to whether the company can come back in outside of that ESP and ask for additional standard service offer rate treatment?

MR. RANDAZZO: For generation, Mr. Resnik?

MR. RESNIK: Yes.

A. I don't believe it can.

MR. RESNIK: Okay. That's all I have, your Honor. Thank you, Mr. Bowser.

EXAMINER BOJKO: Thank you.

Any redirect, Mr. Randazzo?

MR. RANDAZZO: Just one, what I think is a clarifying question and we can do it, hopefully, unless I get an answer I'm not expecting, we don't need to take a moment.

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REDIRECT EXAMINATION

By Mr. Randazzo:

Q. Mr. Bowser, on the top of page 7 Mr. Resnik asked you about the numerical values that appear on the top of that page. Do you recall that?

A. Yes, I do.

Q. And what you're -- and I apologize, I'm going to ask some leading questions. If there's an objection, I'll break it down.

What you're illustrating there is the effect of your adjustment; you're not necessarily recommending a carrying cost rate there, correct?

A. That's correct. That's the effect of my adjustment on the carrying cost rates, but I'm not saying that is the carrying cost rate that should be applied to the environmental expenditures.

Q. Right.

A. Correct.

MR. RANDAZZO: That's all I have, your Honor.

EXAMINER BOJKO: Any recross?

MR. RESNIK: No.

EXAMINER BOJKO: Mr. Bowser, one quick question. What's the magnitude of the rate impact of your adjustment for the 199 deduction; do you know?

THE WITNESS: No, I don't know offhand.

EXAMINER BOJKO: Okay. Thank you.

Mr. Randazzo.

MR. RANDAZZO: Your Honor, I would move IEU Exhibit No. --

EXAMINER BOJKO: 10.

MR. RANDAZZO: 10, thank you.

EXAMINER BOJKO: Any objection to the admission of IEU Exhibit 10, Mr. Bowser's testimony?

MR. RESNIK: No.

EXAMINER BOJKO: Hearing none, it will be admitted.

(EXHIBIT ADMITTED INTO EVIDENCE.)

EXAMINER BOJKO: We are adjourned until 9 a.m. tomorrow. Let's go off the record.

(The hearing adjourned at 7:36 p.m.)

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CERTIFICATE

I do hereby certify that the foregoing is a true and correct transcript of the proceedings taken by me in this matter on Wednesday, December 3, 2008, and carefully compared with my original stenographic notes.

Maria DiPaolo Jones, Registered Diplomate Reporter, CRR and Notary Public in and for the State of Ohio.

(3308-MDJ)

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