

BEFORE THE PUBLIC UTILITIES COMMISSION OF OHIO

- - -

In the Matter of the :  
 Application of Columbus :  
 Southern Power Company for:  
 Approval of an 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. :

- - -

# PROCEEDINGS

before Ms. Greta See and Ms. Sarah Parrot, Attorney  
 Examiners, at the Public Utilities Commission of  
 Ohio, 180 East Broad Street, Room 11-A, Columbus,  
 Ohio, called at 10 a.m. on Friday, July 15, 2011.

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# VOLUME I

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8 Porter, Wright, Morris & Arthur, LLP  
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12 On behalf of the Applicants.

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22 Power Company.

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On behalf of IEU-Ohio.

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11 On behalf of the Staff of the PUCO.

12 Ohio Partners for Affordable Energy  
13 By Mr. David C. Rinebolt  
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17 On behalf of the Ohio Partners for  
18 Affordable Energy.

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On behalf of The Kroger Company.

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3 By Mr. David F. Boehm  
4 and Mr. Michael Kurtz  
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6 Cincinnati, Ohio 45202

7 On behalf of the Ohio Energy Consumers  
8 Group.

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13 On behalf of the Ohio Manufacturers  
14 Association.

15 Bricker & Eckler, LLP  
16 By Mr. Matthew W. Warnock  
17 and Mr. Thomas J. O'Brien  
18 100 South Third Street  
19 Columbus, Ohio 43215-4291

20 and

21 Ohio Hospital Association  
22 By Mr. Richard L. Sites  
23 155 East Broad Street, 15th Floor  
24 Columbus, Ohio 43215

25 On behalf of the Ohio Hospital  
Association.

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1 Friday Morning Session,  
2 July 15, 2011.

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4 EXAMINER PARROT: The Public Utilities  
5 Commission of Ohio has called for hearing at this  
6 time and place Case No. 08-917-EL-SSO, being in the  
7 Matter of the Application of Columbus Southern Power  
8 Company for Approval of an Electric Security Plan, an  
9 Amendment to its Corporate Separation Plan and the  
10 Sale or Transfer of Certain Generating Assets, and  
11 Case No. 08-918-EL-SSO, being in the Matter of the  
12 Application of Ohio Power Company for Approval of its  
13 Electric Security Plan and an Amendment to its  
14 Corporate Separation Plan.

15 My name is Sarah Parrot. With me today  
16 is Greta See, and we are the Attorney Examiners  
17 assigned by the Commission to hear these cases. At  
18 this time let's begin with the appearances of the  
19 parties and let's start with companies.

20 MR. NOURSE: Thank you, your Honor. On  
21 behalf of Columbus Southern Power Company and Ohio  
22 Power Company, Stephen T. Nourse and Matthew J.  
23 Satterwhite, 1 Riverside Plaza, Columbus, Ohio,  
24 43215. And, Dan.

25 MR. CONWAY: Also on behalf of the

1 companies, your Honor, Daniel R. Conway, Porter,  
2 Wright, Morris & Arthur, 41 South High Street,  
3 Columbus, Ohio, 43215.

4 EXAMINER PARROT: Let's just continue  
5 around the table, please.

6 MS. GRADY: Yes, on behalf of the Ohio  
7 Office of Consumers' Counsel representing the  
8 residential customers of the companies, Maureen R.  
9 Grady and Jeffrey L. Small, 10 West Broad Street,  
10 Suite 1800, Columbus, Ohio, 43215.

11 MS. MOONEY: On behalf of Ohio Partners  
12 for Affordable Energy, David C. Rinebolt and Colleen  
13 L. Mooney, 231 West Lima Street, Findlay, Ohio.

14 MR. BOEHM: On behalf of the Ohio Energy  
15 Group, David Boehm and Michael Kurtz of the law firm  
16 of Boehm, Kurtz & Lowry, 36 East Seventh Street,  
17 Cincinnati, Ohio, 45202.

18 MR. DARR: On behalf of the Industrial  
19 Energy Users, Frank Darr and Sam Randazzo, McNees,  
20 Wallace & Nurick, 21 East State Street, Columbus,  
21 Ohio.

22 MR. MARGARD: On behalf of the staff of  
23 the Public Utilities Commission, Mike DeWine, Ohio  
24 Attorney General, by Assistant Attorneys General  
25 Werner Margard, John Jones, and William Wright, 180

1 East Broad Street, 6th Floor, Columbus, Ohio.

2 MR. WARNOCK: On behalf of the Ohio  
3 Manufacturers Association, Matthew W. Warnock, the  
4 law firm of Bricker & Eckler, LLP, 100 South Third  
5 Street, Columbus, Ohio, and on behalf of the Ohio  
6 Hospital Association, Thomas J. O'Brien and Matthew  
7 W. Warnock, Bricker & Eckler, LLP, and Richard L.  
8 Sites, 155 East Broad Street, 15th floor, Columbus,  
9 Ohio.

10 MS. HAND: On behalf of Ormet Primary  
11 Aluminum Corporation, Emma F. Hand, Clinton A. Vince,  
12 and Presley R. Reed with SNR Denton, 1301 K Street  
13 NW, Suite 600 East Tower, Washington, DC 20005.

14 MR. PETRICOFF: On behalf of  
15 Constellation NewEnergy and Constellation Energy  
16 Commodities Group, Howard Petricoff and Lija  
17 Kaleps-Clark, of the law firm, Vorys, Sater, Seymour  
18 & Pease, 52 East Gay Street, Columbus, Ohio.

19 MR. YURICK: On behalf of the Kroger  
20 Company, your Honor, John W. Bentine, Mark Yurick,  
21 and Zach Kravitz, the law firm of Chester, Willcox &  
22 Saxbe, 65 East State Street, Suite 1000, Columbus,  
23 Ohio, 43215.

24 EXAMINER PARROT: Any other parties  
25 present today?



1 All right. Seeing none, the Bench has a  
2 few preliminary matters that it would like to address  
3 this morning before we call our first witness, the  
4 first of which concerns motions for protective orders  
5 that were filed in these cases. Specifically, on  
6 June 30th, 2011, IEU-Ohio filed a motion for  
7 protective order seeking to protect the  
8 confidentiality of Exhibit KMM-3 which is contained  
9 in the direct testimony of Kevin Murray, and that  
10 testimony was filed on behalf of IEU-Ohio on June  
11 30th, 2011. No memoranda contra were filed to the  
12 motion.

13 Subsequently on July 8th, 2011, AEP-Ohio  
14 filed a motion for protective order with respect to  
15 that same exhibit. Under the procedural schedule  
16 that we have in place memoranda contra AEP's motion  
17 are due today, and I would like to know at this time  
18 whether any of the parties object to either of these  
19 motions or plan on filing a response today to AEP's  
20 motion.

21 All right. Seeing none, the motions for  
22 protective order filed by IEU-Ohio and AEP-Ohio on  
23 June 30th, 2011, and July 8th, 2011, respectively are  
24 granted. Exhibit KMM-3 contained in the direct  
25 testimony of Kevin Murray which was filed on behalf

1 of IEU-Ohio on June 30th, 2011, shall be maintained  
2 under seal and protected for a period of 18 months  
3 ending on January 15th, 2013.

4 MR. NOURSE: Your Honor?

5 EXAMINER PARROT: Yes.

6 MR. NOURSE: I don't want to interrupt  
7 you. If you're done with that item, I wanted to  
8 chime in on confidentiality. First of all, are you  
9 going to be putting that in an entry, I presume, or  
10 not?

11 EXAMINER PARROT: No.

12 MR. NOURSE: Okay. So I need to make  
13 note of that date again.

14 EXAMINER PARROT: That's right. It's  
15 January 15th, 2013.

16 MR. NOURSE: Okay. Thank you.

17 And I just wanted to add as well for the  
18 record that the parties have been provided various  
19 confidential documents in the course of discovery and  
20 the parties have voluntarily reached agreements with  
21 the company regarding protection of that material, so  
22 parties and there are certain additional authorized  
23 representatives that are cleared under those  
24 agreements to access and to view the confidential  
25 materials.

1           To the extent we need to get into that,  
2           and hopefully not, on the record, I would just ask  
3           counsel to advise in advance so we can make sure the  
4           people present are authorized representatives under  
5           those agreements.

6           EXAMINER PARROT: Thank you for that,  
7           Mr. Nourse.

8           Any other comments with respect to  
9           confidentiality?

10          (No response.)

11          EXAMINER PARROT: Our second issue, then,  
12          to address this morning, on July 12th, 2011, AEP-Ohio  
13          filed a motion to strike of the testimony of IEU  
14          Witness Bowser and OCC Witnesses Duann and Thompson.  
15          Apparently, IEU-Ohio and OCC have both filed or will  
16          shortly be filing today memoranda contra to  
17          AEP-Ohio's motion. The parties, I believe, are in  
18          agreement that we will proceed today as best we can,  
19          and if it's necessary for the Bench to rule on the  
20          motion at any point this morning or, I suppose, this  
21          afternoon, we will do so as necessary. Otherwise,  
22          the Bench will take some time and issue a ruling on  
23          Tuesday.

24          MR. DARR: Your Honor, a question to  
25          clarify. The motion specifically goes to striking

1 particular testimony, obviously it's premised on  
2 issues of scope. I just note for the record that  
3 there's a distinction between those two things. And  
4 I'm sure that Mr. Nourse and Mr. Conway will advise  
5 us when they think that we've drifted into an area  
6 that they are concerned about, but I would just note  
7 for the record that substantively these two issues  
8 may be distinct, while one may be premised on the  
9 other.

10 MR. NOURSE: Yeah, and I would agree,  
11 your Honor, with what Mr. Darr said and that's  
12 exactly why I wanted to try to get the whole matter  
13 resolved before we started. But we can proceed in  
14 the way he described and to the extent that  
15 cross-examination portion that we -- those issues  
16 arise, we'll object and, of course, our testimony  
17 didn't address any of those flow-through claims and  
18 those are being presented by the intervenors.

19 EXAMINER PARROT: Thank you, Mr. Nourse.

20 And finally I have one last matter to  
21 clarify on the record. On June 23rd, 2011, the  
22 attorney examiner granted Commission staff's motion  
23 to continue and begin the hearing today, July 15th,  
24 beginning with the testimony of AEP-Ohio Witness  
25 Makhija and then to continue the hearing until

1 Tuesday, July 19th, following Dr. Makhija's  
2 testimony.

3 For the record, I would just like to note  
4 that at the prehearing conference on July 8th, 2011,  
5 at the examiners' request AEP-Ohio determined that it  
6 could possibly make Witness Nelson available for  
7 testimony this afternoon or following the conclusion  
8 of Dr. Makhija's testimony, and I believe that's the  
9 plan for today. Is that correct?

10 MR. NOURSE: Yes, your Honor.

11 EXAMINER PARROT: Mr. Nelson is  
12 available.

13 We appreciate that cooperation in making  
14 the hearing as efficient as possible, and then our  
15 order of witnesses today will be Dr. Makhija and  
16 we'll follow with Mr. Nelson.

17 Do any of the parties have any other  
18 preliminary matters to address on the record before  
19 we call our first witness?

20 (No response.)

21 EXAMINER PARROT: All right. Seeing  
22 none, you may proceed, Mr. Conway.

23 MR. CONWAY: Thank you, your Honor. At  
24 this time the companies call Dr. Anil Makhija.

25 EXAMINER PARROT: Please raise your right

1 hand.

2 (Witness sworn.)

3 EXAMINER PARROT: Please be seated.

4 - - -

5 DR. ANIL MAKHIJA

6 being first duly sworn, as prescribed by law, was  
7 examined and testified as follows:

8 DIRECT EXAMINATION

9 By Mr. Conway:

10 Q. Dr. Makhija, would you please state your  
11 full name for the record.

12 A. My name is Anil Kumar Makhija.

13 Q. And by whom are you employed,  
14 Dr. Makhija?

15 A. I'm employed by the Fisher College of  
16 Business at The Ohio State University.

17 Q. And what is your position at the Fisher  
18 College of Business?

19 A. I'm a tenured full professor and I hold a  
20 distinguished -- dean's distinguished professorship.

21 Q. And are you the same Anil Kumar Makhija  
22 that presented testimony in these cases previously in  
23 the fall of 2008?

24 A. Yes, sir.

25 Q. And did you then prepare additional

1 direct testimony which the companies submitted in  
2 this phase of the proceeding, the remand phase, on  
3 July 6th, 2011?

4 A. Yes, I did.

5 MR. CONWAY: Your Honor, at this time I'd  
6 like to mark as Companies' Exhibit No. 1  
7 Dr. Makhija's direct testimony that was prefiled  
8 on -- I might have said July 6th, I think I meant to  
9 say June 6th, 2011.

10 EXAMINER PARROT: And for purposes of  
11 clarity of the record, we would appreciate it if all  
12 exhibits could be specifically marked as remand  
13 exhibits so this would, therefore, be marked as  
14 Companies' Remand Exhibit No. 1.

15 (EXHIBIT MARKED FOR IDENTIFICATION.)

16 Q. Dr. Makhija, do you have before you, with  
17 you a copy of what has been marked as the Companies'  
18 Remand Exhibit No. 1, your prefiled direct testimony  
19 that was filed on June 6th?

20 A. Yes, I do.

21 MR. CONWAY: And just for the record,  
22 your Honor, I would just note that on the cover sheet  
23 for Dr. Makhija's remand testimony, Companies' Remand  
24 Exhibit No. 1, the suffix for the case numbers  
25 indicates that it's EL-UNC. In fact, it's EL-SSO.

1                   EXAMINER PARROT: Thank you for that  
2 clarification, Mr. Conway.

3                   Q. Dr. Makhija, directing your attention  
4 back to Companies' Remand Exhibit No. 1, that is your  
5 direct testimony in this proceeding on remand,  
6 correct?

7                   A. Yes, it is.

8                   Q. And you prepared that testimony?

9                   A. Yes, I did.

10                  Q. And do you have any corrections or  
11 modifications to make to that testimony at this time?

12                  A. None that I'm aware of at this time.

13                  Q. And if I were to ask you the questions  
14 contained in Companies' Remand Exhibit No. 1 at this  
15 time, would your answers be as they appear in that  
16 document?

17                  A. Yes, I believe so.

18                  MR. CONWAY: At this time, your Honor, I  
19 would move for the admission of Companies' Remand  
20 Exhibit No. 1 into the record and make Dr. Makhija  
21 available for cross-examination.

22                  EXAMINER PARROT: Thank you, Mr. Conway.

23                  Let's proceed around the table. OCC?

24                  MS. GRADY: Thank you, your Honor.

25                                 - - -



## CROSS-EXAMINATION

By Ms. Grady:

Q. Good morning, Dr. Makhija.

A. Good morning.

Q. Now, in your direct or your presentation by your counsel, counsel indicated that you filed -- or you responded that you had filed testimony in the fall of 2008 in this proceeding; is that correct?

MR. CONWAY: Actually, let me correct that. The hearings were in the fall. The testimony may have been prefiled before that point in time.

MS. GRADY: Thank you for that clarification.

A. In the context of the SEET, yes.

Q. That was my question. It was not in the context of calculating POLR as this proceeding --

A. Correct.

Q. -- is. Thank you. Now, Dr. Makhija, in the course of this proceeding you have not examined the out-of-pocket cost of POLR, have you?

A. Strictly on the issue of out-of-pocket costs, no. But on the issue of costs, yes.

Q. And you have not identified any out-of-pocket costs of POLR, have you?

1           A.    I have not because my testimony is not  
2 directed at out-of-pocket costs.

3           Q.    And, Dr. Makhija, you have not performed  
4 any quantitative analysis of the cost to the  
5 companies to provide POLR service, have you?

6           A.    That's correct, I have only sponsored the  
7 principles of such evaluation and the implementation  
8 of that has been carried out, I believe, by the  
9 Company Witness Thomas.

10          Q.    Dr. Makhija, you have not conducted an  
11 empirical study to test the statement that you make  
12 on page 2, line -- starting on line 17 and carrying  
13 over to page 3. And let me rephrase that.

14                Dr. Makhija, you make the statement in  
15 your testimony on page 2 carrying over to line 3 that  
16 the obligations of the companies to be the provider  
17 of last resort to customers imposes substantial risks  
18 on the companies and those risks in turn create real  
19 and significant costs for the companies.

20                Do you see that testimony?

21          A.    Yes, I do.

22          Q.    You have not conducted an empirical study  
23 to test that statement, have you?

24          A.    I have not done an empirical test of that  
25 statement. Nevertheless, given the order of

1 magnitude of the issue we are dealing with this is a  
2 reasonable claim to make.

3 MS. GRADY: Your Honor, I would move to  
4 strike the sentence beginning "nevertheless."

5 MR. CONWAY: Your Honor, he's simply  
6 explaining his answer which I think he's entitled to  
7 do. He's entitled to give the context so there's not  
8 an inaccurate impression left on the record.

9 EXAMINER PARROT: The motion is denied.

10 MS. GRADY: Thank you, your Honor.

11 Q. Dr. Makhija, you have not provided any  
12 quantitative amount for the differential between the  
13 standard service offer and the market price that must  
14 exist in order for a customer to act on that, have  
15 you?

16 A. My arguments are based on the existence  
17 of a differential irrespective of the magnitude.

18 Q. Dr. Makhija, you have not provided any  
19 quantitative amount for the differential between the  
20 SSO and market that must exist in order for a  
21 customer to act; is that correct?

22 A. Yes, that is correct.

23 Q. And, Dr. Makhija, you are not familiar  
24 with the details of how the Black model measures the  
25 value of the optionality, are you?

1           A.    I'm not familiar with the implementation  
2 details.   I am familiar with the model itself.

3           Q.    And you did not review the ingenuities,  
4 the optionality model, or how the model was  
5 implemented, did you?

6           A.    That's correct.

7           Q.    And you did not review the model utilized  
8 by Mr. Baker, the unconstrained model, which is the  
9 basis for the current POLR charge; is that correct?

10          A.    Again, not the implementation.

11          Q.    And you do not have empirical evidence,  
12 do you, Dr. Makhija, that the POLR risk, if not  
13 recovered, will result in a diminution in equity?

14          A.    I provided the principles that lead to  
15 that outcome, but I have not empirically ascertained  
16 that.

17          Q.    And you are not aware of any empirical  
18 evidence that confirms that the loss to shareholders  
19 equals the benefit given to customers through the  
20 POLR provisions, correct?

21          A.    I'm not saying that such a study is  
22 feasible and I am not aware of one.

23          Q.    And the financial theories that you  
24 present in your testimony have not been empirically  
25 tested, have they, Dr. Makhija?

1           A.     These theories have long considerable  
2     usage in finance and consequently they are called  
3     theories. But they have not been implemented  
4     necessarily in this text as a test. However, Company  
5     Witness Thomas does provide empirical estimation for.

6           Q.     Dr. Makhija, do you recall being deposed  
7     by OCC on June 20th, 2011?

8           A.     Yes.

9           MS. GRADY: May I approach the witness,  
10    your Honor?

11          EXAMINER PARROT: You may.

12          Q.     Dr. Makhija, if you could turn to page 40  
13    of the deposition.

14          MR. CONWAY: Your Honor, the witness has  
15    a copy of his deposition with him, and it's not  
16    necessary for OCC to approach the witness.

17          Counsel, you referred him to page 40?

18          MS. GRADY: That's correct.

19          MR. CONWAY: Could you refer him to a  
20    particular line on page 40?

21          MS. GRADY: I wanted to make sure he had  
22    it in context so I would allow him to read the entire  
23    page.

24          A.     Yes, I have read the page.

25          Q.     Now, I'm going to direct your attention

1 to the question that begins on line 1 and I'm going  
2 to read that question, Dr. Makhija, and I'm going to  
3 ask you if I read it correctly. "Question: With  
4 respect to the financial theories that you present in  
5 your testimony, did you vet these within the academic  
6 community as you suggest?"

7 Is that a correct reading of that  
8 question?

9 A. Yes, it is.

10 Q. And your answer, again, I'm going to ask  
11 you if I correctly read your answer, "As I mentioned  
12 early on, I have applied the principles of finance  
13 here, but I have not conducted an empirical study."  
14 Did I read that correctly?

15 A. Yes, you did.

16 Q. Thank you.

17 Let's turn to your testimony at page 2 --  
18 or 3 and you indicate, and I'm looking at the very  
19 bottom where you talk about the purpose of your  
20 testimony on remand. You state that the purpose of  
21 your testimony is to provide or to support the  
22 proposition that POLR obligations impose substantial  
23 risks on the company and those risks create real and  
24 significant costs for the company. Is that a correct  
25 reading of your testimony?

1           A.    Yes, it is.

2           Q.    Is it also your testimony that unless the  
3 costs are compensated, the POLR causes a  
4 corresponding reduction to the companies' equity?

5           A.    Yes.

6           Q.    Now, the real and significant costs that  
7 you mention are not out-of-pocket costs for providing  
8 POLR service; is that correct?

9           A.    Yes.

10          Q.    And by "out-of-pocket costs" I mean an  
11 expenditure that was made in the form of cash or a  
12 deferred expenditure. Is that your understanding of  
13 the term "out-of-pocket costs"?

14          A.    And I did not examine those costs.  
15 Instead I am speaking about the liability that is  
16 created by the POLR obligation.

17          Q.    Now, on page 3 at lines 10 through 11 you  
18 testify that the option that customers have to shop  
19 and depart and to return are valuable to the  
20 customers of utility A. Do you see that reference?

21          A.    Yes, I do.

22          Q.    The value you define, Dr. Makhija, is  
23 that customers may possibly have an economic benefit  
24 to migrate to a cheaper option; is that correct?

25          A.    Yes.

1           Q.    And that possible economic benefit is  
2 dependent upon the relationship between the standard  
3 service offer and market price; is it not?

4           A.    Yes.

5           Q.    For instance, if the standard service  
6 offer price is higher than market price, customers  
7 can shop or have an incentive to shop.

8           A.    Correct.

9           Q.    Or if the SSO price happens to be lower  
10 than the market price, customers may return.

11          A.    Correct.

12          Q.    If the customers of utility A cannot  
13 shop, you are taking away the option or not providing  
14 the option, then there's no value being provided to  
15 those customers; is that correct?

16          A.    In the eventuality where the POLR  
17 optionality has been negated completely, obviously  
18 then there is no corresponding value of that  
19 optionality.

20          Q.    And if there is no value being provided  
21 under your theory, there is no cost to utility A; is  
22 that correct?

23          A.    If we can be certain that there is no  
24 optionality, then no liability is created, and if  
25 there is no liability, there is no corresponding



1 cost.

2 Q. I want you to assume the following  
3 hypothetical: A customer of utility A signs a  
4 contract with utility A and utility A is to be the  
5 exclusive provider of service to that customer for a  
6 ten-year period of time. During that time the  
7 customer has no right to shop.

8 Would you agree with me that under that  
9 hypothetical utility A does not have to provide a  
10 POLR benefit?

11 A. Because you have removed the optionality,  
12 there is obviously no value available under that  
13 hypothetical.

14 Q. Thank you.

15 On page 3, lines 11 through 12, you state  
16 that "it is reasonable to assume that customers are  
17 likely to depart from Utility A's SSO and gain by it  
18 when the market prices are less than the regulated  
19 SSO price." Do you see that reference?

20 A. Yes.

21 Q. So there you are saying that when the  
22 relationship between market and regulated -- and the  
23 regulated SSO is such that the market falls below the  
24 SSO, it creates an economic incentive on which  
25 customers could act creating the potential for

1 shopping, correct?

2 A. Correct.

3 Q. Does the likelihood that a customer will  
4 depart depend on how great the differential is  
5 between market and SSO price?

6 A. The incentive exists irrespective of the  
7 magnitude; however, customers may take into account  
8 considerations such as how stable that differential  
9 is as they have. So consequently in practice we may  
10 not see a full swing of customers moving for every  
11 differential, but the -- from the point of view of  
12 the utility, nevertheless, the liability did get  
13 created because customers did have the opportunity to  
14 now act on it.

15 Q. And perhaps I wasn't very clear in my  
16 question, but I was asking you about the likelihood.  
17 Does the likelihood that a customer will depart  
18 depend on how great the differential is between the  
19 SSO price and the market?

20 A. The greater the economic incentive,  
21 perhaps greater is the likelihood, but that does not  
22 negate the fact that the liability begins the moment  
23 a differential begins to appear.

24 Q. Now, does the likelihood that a customer  
25 will depart depend on other factors besides price?

1           A.     To assume that would negate the economic  
2     incentive created by the price differential. To the  
3     extent that the price differential is not seen as a  
4     stable differential I'm claiming that perhaps they  
5     don't see the ongoing benefit, but as long as there  
6     is a price differential, I see the potential  
7     liability.

8           MS. GRADY: Your Honor, I would move to  
9     strike that entire answer. It was not responsive to  
10    my question. He did not answer my question.

11          MR. CONWAY: Your Honor, he did answer  
12    the question. She asked if it was likely that  
13    customers would switch if there's any differential,  
14    and he answered it the best he could. He said that  
15    they would -- the liability exists as soon as there  
16    is a differential, customers may appreciate that  
17    there's some variability in whether the differential  
18    would be maintained which might affect their  
19    likelihood of their shopping, but that the liability  
20    is created immediately. I think it provides context  
21    to the question that she asked. So I think it's  
22    perfectly appropriate.

23          EXAMINER PARROT: I'm going to allow the  
24    answer to stand. If you wish to follow up with that.

25          Q.     (By Ms. Grady) Dr. Makhija, does the

1     likelihood -- I'm going to ask my question again.

2     Does the likelihood that a customer will depart  
3     depend on other factors besides price?

4             A.     If you consider price stability and  
5     differential as a factor alternative from the price  
6     per se, that is an alternative factor.

7             Q.     Are there no other factors that influence  
8     the likelihood that the customer will depart from the  
9     SSO and take advantage of the market?

10            A.     Several reasons are often offered for  
11     such behavior, but they are not necessarily reasons  
12     that I subscribe to, such as confusion on account of  
13     customers' lethargy, et cetera. To me it seems like  
14     such reasons speak to individuals not pursuing their  
15     economic interests -- self-interests.

16            Q.     What about transaction costs,  
17     Dr. Makhija? The fact that customers may have  
18     transaction costs incurred with the switching.

19            A.     Yes. So the differential I'm speaking  
20     of, it's net of transaction costs. Yes, transaction  
21     costs could be a rational economic reason that may  
22     prevent individuals from acting on observed price  
23     differentials.

24            Q.     Dr. Makhija, do you believe that the  
25     incentive to shop exists at a penny per megawatt-hour

1 price differential?

2 A. Absent a calculation of what the  
3 transaction costs are, this does create a liability  
4 upon which customers could act.

5 Q. Whether a customer acts on every  
6 differential is an empirical issue, is it not.

7 A. Yes, because as I suggested myself, not  
8 all differentials may be perceived as stable enough  
9 to act on.

10 Q. Would you agree with me that the  
11 potential liability to the company is less if the  
12 differential between the market and the standard  
13 service offer is smaller?

14 A. The presumption here is that we know how  
15 differentials will emerge in the market, and that is  
16 not known a priori.

17 Q. Would you agree with me, Dr. Makhija,  
18 that the potential liability to the company is less  
19 if the differential between the market and the  
20 standard service offer price is smaller?

21 A. There is a difference between ex ante and  
22 ex post. You are describing to me what happens after  
23 the ex post. It will then in those circumstances, if  
24 their differential turns out to be small, then  
25 obviously the company will have suffered less loss on

1 account of the liability, but a priori how can we  
2 know that this is the situation we will fall into.

3 Q. Now, on page 3, line 15, you refer to the  
4 fact that "Utility A has provided its customers  
5 potential benefits that Utility B has not," correct?

6 A. Yes.

7 Q. And those potential -- those are  
8 potential benefits, are they not, because you don't  
9 know what the price differential may be or whether  
10 the SSO price will be above or below market, correct?

11 A. Correct.

12 Q. Would you agree that there's a  
13 possibility that the potential benefits that utility  
14 A has provided to its customers will not be realized?

15 A. It is quite possible that because of the  
16 nature of volatility some realized outcomes may be  
17 favorable to customers and other outcomes may be  
18 favorable to the company. The option-pricing model,  
19 therefore, takes one utility into account and is a  
20 forward-looking estimation because such winners and  
21 losers would emerge naturally as quality plays itself  
22 out.

23 Q. Now, going to page 3, lines 16 through  
24 18, you state that the benefits to customers  
25 constitute a potential liability to utility A. Do

1 you see that reference?

2 A. Yes, I do.

3 Q. You are speaking there of the migration  
4 risk, the customers leaving, and the return risk as  
5 that potential liability; is that correct?

6 A. Yes. I'm speaking about the emergence of  
7 those risks as a result of possible differences in  
8 prices that may emerge.

9 Q. And these are liabilities that the  
10 utility may have to cover in the future; is that  
11 correct?

12 A. Correct.

13 Q. And by covering, you mean that, for  
14 instance, on the migration risk, and then the utility  
15 may have generation which they have to dispose of at  
16 a lower price than the SSO price?

17 A. Yes.

18 Q. And that would be lost revenue that they  
19 would have because they would have to sell that  
20 generation at market prices lower than the SSO price?

21 A. Correct. Lost revenues which will then  
22 turn into lost earnings creating potential risk for  
23 equity holders.

24 Q. And would you agree with me that there's  
25 a possibility that that liability will not be

1 realized?

2 A. That is the nature of volatility, it  
3 could also emerge to be a larger liability as it  
4 plays itself out.

5 Q. For POLR, Dr. Makhija, couldn't the  
6 Commission do an ex post review looking at what  
7 occurred, looking at the benefit that was actually  
8 provided and the liability that the company incurred?

9 A. Isn't that precisely what the  
10 option-pricing model does exactly, because it looks  
11 at the volatility and the notion is to estimate  
12 volatility going forward with the best data available  
13 which will speak to the risks that are being taken  
14 upon at the time when you sign on to POLR?

15 Q. Perhaps you misunderstood. My question  
16 was with an ex post review versus an ex-ante review?

17 A. That would be equating the ex ante to  
18 ex post; they're not the same.

19 Q. Correct, and I guess I was confused in  
20 that you talk about the optionality model at least in  
21 your response as an ex post review and I believe  
22 that --

23 A. Not a --

24 Q. In your response today.

25 A. Not at all. Even today we were speaking



1 of how volatility may play out so that, as I use this  
2 expression multiple times, there could be winners or  
3 losers applied to customers, et cetera. That's how  
4 it might play out. But at the time the liability's  
5 taken on, as I've mentioned before, the volatility as  
6 used in the option-pricing model is making a  
7 forward-looking attempt to find that potential  
8 liability that might come upon us.

9 Q. So it's an ex ante review.

10 A. Correct.

11 Q. And not an ex post review.

12 A. Yes.

13 Q. And so my question was couldn't the  
14 Commission to do an ex post review looking at what's  
15 occurred, looking at the benefits that are actually  
16 applied to customers, and looking at the liability  
17 the company actually incurred?

18 A. But that would not answer the question of  
19 the liability that got imposed on the company because  
20 that's a forward-looking concept of the risks taken  
21 on, the liability taken on.

22 Q. But at this point, after two-and-a-half  
23 years of the ESP having occurred, couldn't the  
24 Commission do an ex post review of what actually  
25 occurred looking at the benefits provided and the

1 liability the company incurred?

2 A. The two-and-a-half years' experience that  
3 you referred to in fact might point us in just the  
4 other direction because during this period I  
5 understand more shopping has occurred so that looking  
6 at the past behavior may not have recognized what has  
7 actually come to be.

8 Q. Now, on page 3, line 20, you state that  
9 since the benefits of the POLR obligation represents  
10 costs that the utility bears, that the value of the  
11 options given to customers equal the POLR cost to the  
12 utility. Do you see that?

13 A. Yes.

14 Q. And by "costs" do you mean that the  
15 utility incurs a potential loss if it is not  
16 recovered through some recovery process and,  
17 therefore, it is a cost?

18 A. Give me a moment. I think I'm referring  
19 to the liability that the company incurs.

20 Q. And that reference is page 3, line 20.

21 A. I'm referring here to the liability  
22 imposed on the company when it takes on a POLR  
23 obligation.

24 Q. Are you referring to the potential value  
25 diminution for equity there or are you not?

1           A.    Yes.  But that is a consequence of taking  
2   on the POLR obligation.

3           Q.    And when I say "potential value  
4   diminution in equity," do you understand that to be  
5   what you termed a shareholder diminution?

6           A.    Yes.

7           Q.    And we talked a little bit before about  
8   the cost that the utility bears, and you link that to  
9   the liability of the company.  Do you also agree that  
10   when you use the term that the costs, that the other  
11   costs the POLR obligation represents, are potential  
12   hedging costs?

13          A.    The hedging refers to a slightly  
14   different notion here and the notion is that the  
15   liability could be transferred to someone else  
16   through hedges, but it is still tied to the notion  
17   that the liability was the cost and the question is  
18   whether we bear it directly to a diminution in equity  
19   value.  Do we bear it to passing the risks on to  
20   someone who would provide the hedge.

21          Q.    On page 4, lines 8 through 9 you state  
22   that "cost recovery is not provided for the POLR  
23   obligation, Utility A's shareholders will see a  
24   diminution in their equity value."  Do you see that?

25          A.    Yes, I do.

1           Q.    If cost recovery is provided for the  
2 POLR, then the shareholders will not see a diminution  
3 in their equity value, correct?

4           A.    That's correct.

5           Q.    Now, on page 4, lines 20 through 22, and  
6 it carries over to page 5, you discuss the  
7 option-pricing model used by Witness Thomas. Do you  
8 see that reference.

9           A.    Yes.

10          Q.    And you further testify that the  
11 potential for future shopping is what is important to  
12 valuing the cost to the utility of providing the  
13 optionality. Do you see that reference?

14               MR. CONWAY: Could I have that question  
15 reread, please?

16               (Record read.)

17          A.    Are you referring to line 19 on page 4?

18          Q.    I believe it carries over from page 4,  
19 line 22 onto page 5, line 1 and 2. Specifically on  
20 page 4.

21          A.    Correct.

22          Q.    Would you agree with me that the  
23 potential for shopping is what is valued in the  
24 optionality model and not the actual cost of  
25 shopping?

1           A.     That is correct, because it is the  
2     poten -- the possible future shopping which creates  
3     the liability.

4           Q.     Now, on page 4, line 18, you refer to the  
5     Black model. Do you see that reference?

6           A.     Yes, I do.

7           Q.     And you are generally familiar, are you  
8     not, Dr. Makhija, with the Black model?

9           A.     Broadly, yes.

10          Q.     And the value of POLR to customers is  
11     what the Black model purports to show?

12          A.     The Black model has been applied to value  
13     that optionality.

14          Q.     And that model does not measure the cost  
15     to AEP of POLR, does it?

16          A.     The model estimates the liability created  
17     because that is the benefit provided to customers  
18     and, therefore, gives us an estimate of liability for  
19     AEP-Ohio.

20          Q.     Dr. Makhija, just so that I'm clear, the  
21     Black model purports to show the value of POLR to  
22     customers; is that right?

23          A.     Yes, it estimates the value of the  
24     optionality given to customers.

25          Q.     Would you agree with me that the model

1 does not measure the out-of-pocket costs to AEP of  
2 POLR?

3 A. That's correct. The model is designed to  
4 ultimately value the liability created by giving the  
5 rate optionality.

6 Q. And from your perspective the value to  
7 the customer is the same as the cost to AEP?

8 A. This is what I have sponsored as a  
9 principle here that when the liability is created,  
10 that presents a cost to the company. This is not an  
11 alien concept for us because, you know, there are not  
12 many out-of-pocket costs that we recognize as costs  
13 such as cost of equity capital routinely in rate of  
14 return proceedings.

15 Q. Would you agree with me, Dr. Makhija,  
16 that there's a need to keep inputs into the Black  
17 model internally consistent?

18 A. I presume that's a desirable property for  
19 applying any -- data to any model.

20 Q. Is that a "yes"?

21 A. Yes.

22 Q. Now, in your testimony, Dr. Makhija,  
23 you're simply offering your opinion that an  
24 optionality model appropriately applied would capture  
25 the value of optionality; is that right?

1           A.    Yes.  Looking at the circumstances I  
2 believe the model is applicable.

3           Q.    And you have not done an analysis to  
4 determine if the optionality model used by the  
5 company has been appropriately applied here, correct?

6           A.    I have not examined the implementation  
7 details.

8           Q.    And would you agree that if there's a  
9 mechanism that provides for the recovery of POLR  
10 costs in some form, then the POLR obligation is  
11 addressed and the diminution of shareholders' equity  
12 would be limited?

13          A.    That's correct.

14               MS. GRADY:  Your Honor, that's all the  
15 questions I have for Dr. Makhija.

16               Thank you, Dr. Makhija.

17               THE WITNESS:  Thank you.

18               EXAMINER PARROT:  Thank you,  
19 Ms. Grady.OPAE.

20               MS. MOONEY:  No questions.

21               MR. BOEHM:  No questions, your Honor.

22               EXAMINER PARROT:  Mr. Darr.  Thank you,  
23 ma'am.

24                       - - -

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CROSS-EXAMINATION

By Mr. Darr:

Q. Good morning, Doctor.

A. Good morning.

Q. Would you turn to page 3 of your testimony, please. On page 3 of your testimony starting at I believe line 9 you indicate that the POLR obligation contains two pieces. Am I describing that correctly?

A. Correct.

Q. And the first piece is the option or, excuse me, the first piece is that a customer can shop and depart if the price differential is, as you discussed with Ms. Grady, appropriate for that customer to take advantage of.

A. Correct.

Q. And the second piece is the possibility that that customer might return.

A. Correct.

Q. In your calculation of the value or in your sponsoring of the value you identify both of those as the value drivers; is that correct?

A. Both options are provided to customers, correct.



1           Q.    That's not exactly what I asked, sir.  
2   The terms of driving the liability that you've  
3   described, it's both pieces.  Am I correct in that?

4           A.    Correct.

5           Q.    So regardless of whether a customer  
6   returned or not to the AEP system, there would be a  
7   cost, in your model, or some value for that customer  
8   leaving.

9           A.    I'm sorry, I didn't follow the question.

10          Q.    Let me rephrase it.  In the manner in  
11   which you are valuing POLR or suggesting that the  
12   Commission value POLR, part of that is associated  
13   with the customer's ability to leave.

14          A.    To depart.

15          Q.    And that is true regardless of that  
16   customer returning to the utility.

17          A.    Unfortunately, the two are tied  
18   together --

19          Q.    Well, unfortunate or not, sir, isn't  
20   it -- and I apologize, I stepped on your answer.  Go  
21   ahead, finish up your answer.

22          A.    That the POLR obligation connects both  
23   migration and return risk.

24          Q.    Right.  You can't return if you haven't  
25   left, correct?

1           A.     Also the fact that you can return at the  
2     SSO price that is provided through the POLR affects  
3     your return behavior.

4           Q.     Go back to my question and see if I can  
5     get a "yes" or "no." You can't return unless you've  
6     left, correct?

7           A.     Correct.

8           Q.     Some of those customers that leave may  
9     not return, also correct?

10          A.     Correct.

11          Q.     Previously you have indicated, and I'm  
12     speaking now of when we had an opportunity to take  
13     your deposition a few weeks ago, and if you need, you  
14     can refer to, to refresh your recollection, it will  
15     be page 43 of your deposition.

16                 I believe at that time you indicated that  
17     there were three alternatives for calculating the  
18     cost to the company, one was the one that you  
19     sponsored, the diminution in the equity value. Do  
20     you see that at lines 7 through 12 in case you need  
21     to refresh your recollection?

22          A.     Please give me a moment, I'll reread  
23     this.

24          Q.     Certainly.

25                 MR. CONWAY: Perhaps, Mr. Darr, you could

1 simply ask him your question and see if he gives you  
2 the answer you're looking for rather than reading  
3 into the record his deposition. He's here to  
4 testify.

5 MR. DARR: I appreciate that, Mr. Conway.  
6 Why don't we allow me to ask the questions the way I  
7 want to and then we can go from there.

8 MR. CONWAY: Your Honor.

9 EXAMINER PARROT: The witness is reading  
10 his testimony from the deposition, let's allow him to  
11 do that.

12 A. I have reread that portion.

13 Q. Does that refresh your recollection?

14 A. Yes.

15 Q. Now, there were -- you have identified  
16 three potential ways of valuing this obligation; is  
17 that correct?

18 A. I believe that's not so because what I'm  
19 referring to here is how this cost may be borne and  
20 you asked me whether I'm speaking of alternative ways  
21 of valuing it.

22 Q. I misunderstood, then. You valued -- you  
23 have stated that the POLR obligation is a value to  
24 customers and you've equated that value to the costs  
25 to the company.

1           A.     That's true.

2           Q.     Okay. And when you were asked during the  
3 deposition with regard to what were the costs, did  
4 you understand at that time that you were answering a  
5 question as to the costs of the company or estimating  
6 the costs of the company as to this obligation?

7           A.     Correct. And what this is showing here  
8 is how that cost may be borne either through the  
9 diminution of equity or through hedging or through  
10 contracts made by potential CRES providers that would  
11 pick up the POLR. But in none of these the liability  
12 disappears and, consequently, these are alternative  
13 ways of allocating that liability in different forms  
14 of cost.

15          Q.     Thank you, I understand what you're  
16 saying.

17                   And one would be explicitly looking at a  
18 change in equity value.

19          A.     Correct.

20          Q.     A second would be looking at the cost of  
21 hedging, that is transferring that risk to a third  
22 party.

23          A.     Correct.

24          Q.     When you speak about a hedge, you're  
25 talking about a contract with a third party that

1 would have an explicit price in it, correct?

2 A. And they will pick up the POLR liability  
3 and so the price would reflect that presumably.

4 Q. And we could go out and we could see in a  
5 contract the price that the company incurred or the  
6 cost that the company incurred to purchase that  
7 hedge.

8 A. Providing we could also observe the price  
9 in the absence of them picking up the hedge.

10 Q. Again, we could look at the contract and  
11 determine a cost, a price, that the company paid to  
12 secure that hedge; is that correct?

13 A. It would be embedded in that contract.

14 Q. And finally with regard to a transfer to  
15 a third party, that would operate in a similar way,  
16 correct?

17 A. The third party we presume will reflect  
18 in its pricing the extra liability that POLR  
19 presents.

20 Q. The obligation to provide service.

21 A. Correct.

22 Q. Now, with regard to the work that you  
23 have done on behalf of AEP in this case, you have not  
24 calculated for AEP what that potential diminution of  
25 value is, correct?

1           A.    Correct.

2           Q.    You have not attempted to empirically  
3 verify what the hedge would cost.

4           A.    Correct.

5           Q.    And you have not attempted to empirically  
6 verify what the transfer to a third party would cost.

7           A.    Correct.

8           Q.    Are you aware, based on the work that  
9 you've, of any hedging or third party transfers that  
10 AEP has done?

11          A.    I've not examined that aspect.

12          Q.    Did you ever ask?

13          A.    Sorry?

14          Q.    Did you ever ask for that information?

15          A.    No.

16          Q.    One last question because that's all I've  
17 got for the day, does the POLR risk that you discuss  
18 in your testimony exist in the case where the  
19 companies, in this case Ohio Power and Columbus  
20 Southern Power, satisfy their SSO obligation under a  
21 market rate offer or MRO?

22          A.    So if the -- can you please repeat the  
23 question?

24          Q.    Certainly.  Would the POLR risk that you  
25 discuss in your testimony exist in a case where the

1 two utilities here, Ohio Power and CSP, satisfy their  
2 standard service offer obligations under a market  
3 rate offer?

4 A. Yes. It would -- the obligation would  
5 still exist, the question is whether the price  
6 differential would be market price versus the MRO  
7 price or in the current situation between the ESP  
8 price and the market price.

9 MR. DARR: Thank you.

10 EXAMINER PARROT: Thank you, Mr. Darr.  
11 Staff?

12 MR. MARGARD: No questions, thank you,  
13 your Honor.

14 EXAMINER PARROT: Mr. Warnock?

15 MR. WARNOCK: No questions, your Honor.

16 EXAMINER PARROT: Ms. Hand?

17 MS. HAND: No questions, your Honor.

18 EXAMINER PARROT: Mr. Petricoff.

19 MR. PETRICOFF: Thank you, your Honor,  
20 yes.

21 - - -

22 CROSS-EXAMINATION

23 By Mr. Petricoff:

24 Q. Good morning, Dr. Makhija.

25 A. Good morning.

1           Q.    A couple of questions for you.  First, I  
2   looked on page 1 of your credentials and I see that  
3   you have a doctorate in finance and an MBA, but I  
4   didn't see any reference to advanced degrees in  
5   economics.  Are you an economist?

6           A.    Financial economist.

7           Q.    Financial economist.  And what's the  
8   difference between an economist and a financial  
9   economist?  What's the differentiation?

10          A.    Economics, as you know, is a broad field.  
11   There are labor economists, there are economists that  
12   study trade, and you might say that finance is a  
13   subfield of economics that looks at financial aspects  
14   of economics.

15          Q.    Thank you.

16                Now, do you have any experience either in  
17   the wholesale or retail energy market?

18          A.    No, I do not.

19          Q.    Now, if you could, I'd like you to turn  
20   to your testimony at page 3, it's the answer to  
21   questions 5 and 6, and this is -- actually, your  
22   answer starts on line 7 and goes to 17.  I see we  
23   don't have numbers on them, on questions.

24          A.    Are you referring to page 4 now?

25          Q.    No, page 3.



1           A.    Page 3.

2           Q.    Page 3.

3                   MR. CONWAY:  Mr. Petricoff, are you  
4 referring to the answer that starts on line 7 and  
5 ends on line 18?

6                   MR. PETRICOFF:  That's correct.

7           Q.    We're examining here whether it's a cost  
8 and we have the A and B utility comparison.  There  
9 may be a difference in -- is that page 3 on yours?

10          A.    Yes, it is.  And the question reads "Why  
11 does serving as a Provider of Last Resort constitute  
12 a cost to a utility."

13          Q.    That's correct.  Sometimes when you run  
14 these out, the paginations change on the computers.  
15 I want to make sure we're on the same page.

16                   Is it a fair summary to say that  
17 basically what you are gauging here is the lost  
18 opportunity for AEP-Ohio between what they would have  
19 sold the power under the standard service offer and  
20 what they will get for the power in the market?

21          A.    Correct.

22          Q.    And is it possible that basically the  
23 fact that a customer has shopped could be beneficial  
24 for the company?

25          A.    Could you explain that hypothetical for

1 me?

2 Q. Yes, let me give you a hypothetical. The  
3 customer signs a contract with a CRES and so,  
4 therefore, the power that would have gone to that  
5 customer -- first of all, are you familiar with the  
6 acronym CRES?

7 A. Correct.

8 Q. Okay. Has gone to a CRES, so the power  
9 that has gone to a CRES is now being sold in the  
10 market. But market price has now gone to a level  
11 that is higher than the standard service offer. In  
12 that case wouldn't AEP-Ohio actually benefit by the  
13 customers migrating to the CRES?

14 A. Unless those customers now return to AEP.

15 Q. But if they return to AEP, then wouldn't  
16 the differential that -- wouldn't the revenue that  
17 AEP would be getting would be the SSO, standard  
18 service offer, revenue?

19 A. Well, this is a situation that you  
20 describe where the company loses twice, once they  
21 lost because the customer left because the price was  
22 favorable relative to SSO, now that it's become  
23 unfavorable to SSO and they return, so now whereas  
24 the company would have had the opportunity to  
25 discourage its generation at better prices, they now

1 have to provide the same service again to the  
2 customer at a lower price.

3 So going and coming presents lost  
4 opportunities relative to market prices.

5 Q. And I want to explore that one step  
6 further because I want to try to get the measure of  
7 what this lost opportunity amounts to. So in our  
8 example where the customer has left AEP-Ohio, gone to  
9 a CRES, and AEP-Ohio -- let's say for the first year  
10 and a half of the three years of the ESP, left for a  
11 year and a half and the price was actually higher in  
12 the market. So AEP actually got more money than they  
13 would have gotten in the SSO.

14 A. So in the first half what is the market  
15 price and what is the SSO price?

16 Q. Let's say in the first half, the first 18  
17 months, the market price was \$100 a megawatt-hour and  
18 the SSO price was \$70 a megawatt hour. In that case  
19 wouldn't you agree with me that for the first 18  
20 months AEP-Ohio actually benefited by the migration  
21 by \$30 a megawatt-hour?

22 A. But why would anyone migrate to instead  
23 of getting power at 70, why would they migrate to pay  
24 100?

25 Q. At the beginning. Well, let's see. The

1 reason that -- well, assume that they signed a  
2 contract on day one and when they signed the  
3 contract, "they" being the retail customer, their  
4 forecast of prices showed that that would be  
5 attractive. It would be an attractive price.

6 A. Please explain that. I mean, you're  
7 telling me that CRES provider offers a contract at  
8 100, they are sitting at an SSO of 70. Why would  
9 anyone sign a contract to want to pay more?

10 Q. You indicated before that you are not  
11 familiar with the way that contracts work. Let's  
12 assume that the contract -- that the contract that  
13 they signed was, you know, based on a price indices.  
14 Are you familiar with contracts based on price  
15 indices in industries other than the electric  
16 industry?

17 MR. CONWAY: Your Honor, just a second.  
18 I'll object to the initial characterization of his  
19 prior testimony. I don't think he said he was  
20 unfamiliar with the contracts.

21 Q. Let's go back. Are you familiar with the  
22 way in which retail power is sold in Ohio by  
23 competitive retail electric suppliers?

24 A. Somewhat.

25 Q. And is it your understanding that

1 sometimes contracts are sold based on price indices  
2 that change over time?

3 A. Yes.

4 Q. And isn't it possible, then, if someone  
5 signed a contract based on a price indices,  
6 forecasting that the industry would be -- the indices  
7 would be at a certain price but markets, being as  
8 they are, it is higher --

9 A. Okay.

10 Q. -- that they could end up paying more  
11 than they expected?

12 A. Yeah. So this is referring to the issue  
13 of winners and losers in the ex post market and I  
14 have already agreed that winners and losers do emerge  
15 subsequently, but at the time the liability is  
16 created everyone acts rationally in terms of the  
17 expected price. So no one would sign an expected  
18 prevailing price of 100 when they could get an SSO at  
19 zero. They could have an expectation of market price  
20 less than 70 in the contract to have signed on, in  
21 your example.

22 Now, subsequently, yes, winners and  
23 losers do emerge, as indices change, would change the  
24 value of what you pay under the contract, but in  
25 terms of the liability that was created by rational

1 players, that would have been a serious liability for  
2 AEP that -- AEP-Ohio that people would leave whenever  
3 the market price is below the SSO.

4 MR. CONWAY: Your Honor, could I have the  
5 answer reread, please?

6 (Record read.)

7 Q. Within that example where the customer  
8 has signed a contract and the contract was for a year  
9 and a half, then they couldn't return to the SSO  
10 until the end of their contract without breaching  
11 their contract.

12 A. Okay.

13 Q. So in the model, the Black-Scholes model  
14 that you looked at, doesn't the model assume that all  
15 of the load will change based on changes in the  
16 differential in price?

17 A. Not quite because, as I mentioned, that  
18 customers will have a sense of the stability of their  
19 differential on which they will act. So the moment  
20 they see a market price below the SSO, they may want  
21 to affirm that this is a prevailing price that will  
22 be stable, that their differential is a reliable  
23 differential, but once that is ascertained, they have  
24 an economic incentive to act upon it.

25 Q. They may have an economic incentive, but

1 they may be barred contractually from completing that  
2 transaction going back to SSO.

3 A. That is possible.

4 Q. Right. And that contingency is not  
5 covered in the Black-Scholes model.

6 A. This is an implementation detail that can  
7 be accommodated in how the Black-Scholes is applied.  
8 As you know, that the Black-Scholes is a formula, but  
9 its actual calculation is done through a binomial  
10 estimation procedure and in those estimation  
11 procedures various constraints can be accommodated.

12 I don't know the exact implementation  
13 details of how AEP-Ohio has implemented it, but such  
14 constraints can be accommodated in the model.

15 Q. So don't know whether that accommodation  
16 has been made in the Black-Scholes that has been  
17 applied and used in setting the rates in ESP I case.

18 A. I do not know the implementation.

19 Q. All right. Mr. Darr asked you questions  
20 about going out and buying either hedges or  
21 contracts -- let me rephrase that.

22 Mr. Darr examined the ability of AEP-Ohio  
23 to go out and buy either financial hedges or  
24 contracts to transfer the POLR risk; do you recall  
25 that conversation?

1           A.     Correct.

2           Q.     And am I correct in assuming that you  
3     indicate that that was a possibility, that either  
4     financially or physically the risk of the POLR could  
5     be transferred from AEP-Ohio to a third party?

6           A.     That's a managerial choice that the  
7     company can assert, as to how it will bear the  
8     liability created by the POLR obligation.

9           Q.     And do you know whether those type of  
10    financial hedges or bilateral contracts exist in the  
11    market today that AEP-Ohio could take advantage of if  
12    they wanted to?

13          A.     I believe some CRES providers may be  
14    willing to take on such obligations and incorporate  
15    it in their contracts.

16          Q.     If that's the case, couldn't AEP-Ohio  
17    have surveyed those offers and presented those as a  
18    market evaluation as to what the value, going  
19    forward, of the POLR liability is?

20          A.     Again, it's a managerial choice on how  
21    best to manage your liabilities. So I'm not going to  
22    second guess the company's ability to optimize its  
23    carrying of liabilities.

24          Q.     Well, I'll join you, I won't second guess  
25    their decision either. I was looking to see whether



1     there were comparable services at comparable prices  
2     that the Commission could look at to see whether or  
3     not the amount that's being charged for the POLR  
4     truly reflects the cost of providing the POLR  
5     service.

6           A.     It's a hypothetical exercise, a bit of a  
7     daunting one because the benchmark would be the  
8     counterfactual circumstances of the same situation  
9     except no POLR. You can imagine empirically how  
10    difficult that is. But it's a hypothetical that  
11    could be entertained.

12          Q.     Let me switch subjects for you. Let me  
13    ask you if you know this: When a customer, going  
14    back to our lost opportunity analysis, when a  
15    customer leaves the SSO service and goes to the CRES,  
16    do you know whether the CRES has to make a capacity  
17    payment to AEP-Ohio?

18          A.     I believe it does so but this is not an  
19    aspect that I've explored, nor have I sponsored these  
20    aspects of POLR in my testimony.

21          Q.     Okay. Let's assume that that payment is  
22    required. Wouldn't that reduce the lost opportunity  
23    of a customer migrating if, in fact, AEP-Ohio is  
24    going to get the capacity payment from the CRES?

25          A.     Well, there are two reactions that I have

1 to that claim, one is that if you can demonstrate an  
2 alternative mechanism where POLR has been -- has been  
3 compensated for, POLR obligation, then clearly, you  
4 know, the company has already been compensated.

5 But in the circumstances that you suggest  
6 I'm not sure that that's necessarily correct because  
7 I don't know whether the capacity charges were  
8 already part of the SSO and, therefore, POLR is a  
9 completely unrelated risk to the compensation for  
10 capacity. But as I said, I have not examined this  
11 issue and, therefore, I will not offer a definitive  
12 opinion on it.

13 Q. And likewise I take it that if, in fact,  
14 compensation was being paid for capacity when a  
15 commissioner migrated, that is a factor that should  
16 be considered in the Black-Scholes model in  
17 determining the optionality.

18 A. I don't think so, because the optionality  
19 is centered on the value from exploiting the price  
20 differential, and that's what the Black-Scholes model  
21 estimates. Now, there are other mechanisms by which  
22 the liability created through the optionality has  
23 been compensated for, those are not part of the  
24 consideration of evaluating the liability of the  
25 price differential, which is what the Fisher model --

1       sorry, the Black model does.

2               EXAMINER SEE: Mr. Petricoff, I think you  
3       said "when a commissioner migrates." Did you mean a  
4       customer?

5               MR. PETRICOFF: Yes, when a customer  
6       migrates. Thank you, your Honor.

7               Q. To the best of your knowledge, then, was  
8       the model that was used to set the POLR price in the  
9       ESP I, did it contain any adjustment for the fact of  
10      a capacity payment by the CRES to AEP-Ohio?

11              MR. CONWAY: Objection. He's already  
12      answered the question a couple of times. He  
13      explained that he's not a model implementer. He also  
14      explained that the model looks at the difference  
15      between the market price and the SSO price, and he's  
16      also indicated that he doesn't think some capacity  
17      charges that CRES providers pay is relevant to that  
18      analysis. He's explained it two or three times at  
19      this point.

20              MR. PETRICOFF: Your Honor, counsel is  
21      testifying.

22              MR. CONWAY: No, I'm not.

23              EXAMINER PARROT: Dr. Makhija may answer  
24      the question if he knows.

25              THE WITNESS: Could you please repeat the

1 question?

2 (Record read.)

3 A. I do not think it was incorporated in the  
4 application of the Fisher model, and I believe that's  
5 appropriate because the Fisher model is only  
6 evaluating the effects of the price differentials.

7 Q. Dr. Makhija, can anyone other than -- in  
8 your understanding can anyone other than AEP-Ohio  
9 offer the POLR service in the AEP-Ohio service  
10 territory?

11 A. The question is whether anyone can offer  
12 service or --

13 Q. POLR service.

14 A. -- POLR service? To the best of my  
15 understanding, only AEP-Ohio in its service area  
16 takes on the POLR obligation.

17 Q. So we can fairly say that AEP-Ohio has a  
18 monopoly on providing the POLR service.

19 A. Monopoly on having that liability, yes.

20 Q. And a monopoly also on charging for that  
21 service.

22 A. Since it's the only one that provides  
23 that obligation, it would be the only one that would  
24 be compensated for it appropriately.

25 Q. Okay. And if AEP-Ohio wanted to maximize

1 the profitability on that service, being a  
2 monopolist, if left unconstrained, would it charge a  
3 price that contained monopolistic rents?

4 A. In the absence of regulation?

5 Q. Yes.

6 A. Yes.

7 Q. Okay. And so it is important for the  
8 Commission, then, in this case to establish a price  
9 that would remove or assure the public that they  
10 would not be paying any monopolist price.

11 A. Please understand you are referring to  
12 classical theory of the behavior of a monopolist  
13 which is to produce lower quantities and charge  
14 higher prices. Those principles, if those are what  
15 you are asking me to invoke, is what I did. How AEP  
16 itself behaves would look at the long-term interest  
17 of the company and they may not charge neoclassical  
18 rates, but perhaps because they are good citizens or  
19 other considerations that may be material to them.

20 MR. PETRICOFF: ,Thank you, Dr. Makhija.  
21 I have no further questions.

22 THE WITNESS: Thank you.

23 EXAMINER PARROT: Mr. Yurick?

24 MR. YURICK: No questions at this time,  
25 your Honor.

1 EXAMINER PARROT: Redirect, Mr. Conway?

2 THE WITNESS: Could I take just a  
3 five-minute break, your Honor?

4 EXAMINER PARROT: You may. Let's go off  
5 the record.

6 (Recess taken.)

7 EXAMINER PARROT: Let's go back on the  
8 record.

9 Mr. Conway.

10 MR. CONWAY: Thank you, your Honor, just  
11 a few questions.

12 - - -

13 REDIRECT EXAMINATION

14 By Mr. Conway:

15 Q. Dr. Makhija, at several times during,  
16 maybe twice, during your cross-examination from  
17 Mr. Petricoff and maybe one of the other lawyers I  
18 heard you refer to the Fisher model. Maybe I  
19 misunderstood or didn't hear correctly. Generally  
20 we've been talking about the Black or the  
21 Black-Scholes model. Is the Fisher model the same  
22 model or is it different?

23 A. Sorry, I must have misspoken because it's  
24 Mr. Fisher Black, so I was always referring to the  
25 Black model and this refers to the 1976 paper in the

1 Journal of National Economics which does the  
2 application for the commodity options.

3 Q. During the cross-examination by Ms. Grady  
4 there was some line of questions that dealt with the  
5 nature of the liability created by the POLR  
6 obligation. Do you recall that line of questioning?

7 A. Yes.

8 Q. Does the POLR obligation that Ohio law  
9 imposes on AEP-Ohio create an actual liability at the  
10 time that the obligation is assumed?

11 A. Yes, it does, because for the period of  
12 the ESP the company's obligated to provide service at  
13 the SSO rate for any customer that is paying the POLR  
14 charge.

15 Q. And that liability starts at day one and  
16 lasts for the term of the ESP?

17 A. Yes.

18 Q. And that liability creates an actual cost  
19 starting day one which lasts for the term of the ESP?

20 A. Yes.

21 MR. CONWAY: Thank you, your Honor.  
22 That's all I have.

23 EXAMINER PARROT: Thank you, Mr. Conway.  
24 Recross-examination, Ms. Grady?

25 MS. GRADY: No, your Honor.

1 EXAMINER PARROT: Mr. Boehm?

2 MR. BOEHM: Just one question.

3 - - -

4 CROSS-EXAMINATION

5 By Mr. Boehm:

6 Q. Out of curiosity, when you say it creates  
7 a cost, from an accounting point of view is this  
8 actually booked?

9 A. From an accounting point of view it will  
10 not show up just as the cost of equity does not show  
11 up. But, you know, several -- not all costs are  
12 necessarily booked costs.

13 Q. Is there any fund created to take care of  
14 this?

15 A. Yes, in that sense if we were to create  
16 an income and balance sheet which looked at the  
17 assets and liabilities in a market-based income and  
18 balance sheet, this is how it would work out. On the  
19 one hand you have a set of assets, there were perhaps  
20 some liabilities and equities to begin with, now you  
21 add a liability, given that the asset side is fixed,  
22 then correspondingly some other element on the  
23 right-hand side has to take a hit. And since the  
24 obligation is taken over by the -- ultimately by the  
25 shareholders of AEP-Ohio, adding the POLR obligation



1 would translate into a diminution in equity value.

2 Q. I don't want to take this too much  
3 further, but if we looked at the books, if we looked  
4 at the books of the company, could you find evidence  
5 in the books of this liability?

6 A. No.

7 Q. Could you point to a line or lines and  
8 say "There it is?"

9 A. No, because it would not show up as  
10 out-of-pocket costs. However, in terms of the market  
11 value of equity, that's why I was drawing for you the  
12 market value balance sheet on both sides. Equity  
13 would take a hit because the additional liability  
14 showed up but the asset sheet was unchanged.

15 MR. BOEHM: Thank you.

16 EXAMINER PARROT: Mr. Darr?

17 MR. DARR: Thank you.

18 - - -

19 RECROSS-EXAMINATION

20 By Mr. Darr:

21 Q. Again, Doctor, the liability that you  
22 just described as a function of the ESP, in the  
23 response to Mr. Conway's redirect, that would assume  
24 that the company accepted the ESP, correct?

25 A. When they accepted the ESP, they accepted

1     this additional liability.

2             Q.     And you've already indicated that this  
3     same liability would exist in the MRO context?

4             A.     Yes, in the sense that customers have a  
5     right to return to the SSO which could be determined  
6     either under the ESP or MRO.

7             MR. DARR:   Thank you.   Nothing further.

8             MR. MARGARD:   No questions, thank you.

9             EXAMINER PARROT:   Mr. Warnock?

10            MR. WARNOCK:   No questions, your Honor.

11            EXAMINER PARROT:   Ms. Hand?

12            MS. HAND:   No questions, your Honor.

13            EXAMINER PARROT:   Mr. Petricoff?

14            MR. PETRICOFF:   No questions, your Honor.

15            EXAMINER PARROT:   And Mr. Yurick.

16            MR. YURICK:   Nothing, your Honor, thank  
17     you.

18            EXAMINER PARROT:   Thank you very much,  
19     Dr. Makhiya.   You're excused.

20            THE WITNESS:   Thank you, your Honor.

21            MR. CONWAY:   At this time, your Honor, if  
22     I may, I would move for the admission of Companies'  
23     Remand Exhibit No. 1 into the record.

24            EXAMINER PARROT:   Are there any  
25     objections to the admission of Companies' Remand

1 Exhibit No. 1?

2 (No response.)

3 EXAMINER PARROT: Seeing none, it shall  
4 be admitted.

5 (EXHIBIT ADMITTED INTO EVIDENCE.)

6 EXAMINER PARROT: Let's go off the  
7 record.

8 (Discussion off the record.)

9 EXAMINER PARROT: Let's go back on the  
10 record.

11 MR. NOURSE: The company calls Philip J.  
12 Nelson.

13 EXAMINER PARROT: Please raise your right  
14 hand.

15 (Witness sworn.)

16 EXAMINER PARROT: Please be seated.

17 - - -

18 PHILIP J. NELSON

19 being first duly sworn, as prescribed by law, was  
20 examined and testified as follows:

21 DIRECT EXAMINATION

22 By Mr. Nourse:

23 Q. Good morning, Mr. Nelson.

24 A. Good morning.

25 Q. Can you state and spell your full name

1 for the record.

2 A. Philip J. Nelson, P-H-I-L-I-P J.  
3 N-E-L-S-O-N.

4 Q. Thank you. By whom are you employed and  
5 in what capacity?

6 A. I'm employed by American Electric Power  
7 Service Corporation, managing director of regulatory  
8 pricing and analysis.

9 Q. You're the same Philip J. Nelson that  
10 testified earlier in this proceeding a couple years  
11 ago?

12 A. I am.

13 Q. Do you have the document that is the  
14 direct testimony of Philip J. Nelson that was filed  
15 in this record on June 6th this year?

16 A. Yes, I do.

17 Q. Okay.

18 MR. NOURSE: Your Honor, I'd like to mark  
19 that as Companies' Remand Exhibit No. 2.

20 EXAMINER PARROT: So marked.

21 (EXHIBIT MARKED FOR IDENTIFICATION.)

22 Q. Mr. Nelson, did you prepare this  
23 testimony, or was it prepared under your direction?

24 A. Yes.

25 Q. Do you have any changes, additions, or

1 corrections to make this morning?

2 A. No, I do not.

3 Q. If I were to ask you these questions, the  
4 same questions under oath today, would your answers  
5 be the same?

6 A. They would.

7 MR. NOURSE: Your Honor, I would move the  
8 admission of Companies' Remand Exhibit No. 2 subject  
9 to cross-examination.

10 EXAMINER PARROT: Thank you, Mr. Nourse.  
11 OCC?

12 MR. SMALL: Thank you, your Honor. The  
13 OCC has motions to strike based on two problems with  
14 the testimony, and they will encompass four sections  
15 of his testimony.

16 The first portion of his testimony that  
17 should be stricken are page 4, line 1, through page  
18 4, line 16, and I'll put these together because it's  
19 basically one argument, as well as page 5, line 3, to  
20 page 5, line 10.

21 In both instances the witness states  
22 legal opinions for which he's not qualified. Rule  
23 702, testimony of experts, provides and I quote "A  
24 witness may testify as an expert if, B, the witness  
25 is qualified as an expert by specialized knowledge,

1 skill, experience, or education, regarding the  
2 subject matter of the testimony."

3 The subject matter of these portions of  
4 his testimony is the interpretation of Ohio law for  
5 which the witness is not qualified. The witness does  
6 not reflect that he has any legal training.

7 Regarding the material on page 4, the  
8 witness repeats portions of a statute and opines  
9 that, and I quote, it supports recovery of  
10 incremental environmental investment; on page 4, line  
11 7.

12 This is testimony on the ultimate issue  
13 of these cases that will be argued on brief by the  
14 attorneys, but it's not within Mr. Nelson's area of  
15 expertise.

16 Mr. Nelson states on line 6 that his  
17 understanding is derived from his counsel, not from  
18 his expertise. The matter should be left to his  
19 counsel to brief the matter where AEP certainly can  
20 state its opinions and the OCC as well as other  
21 parties will do likewise.

22 If it is -- for the convenience of the  
23 Bench, I'll continue with the portions on page 5.

24 EXAMINER PARROT: Can we have those two  
25 references again, though? We want to make sure

1 everyone got them before we move on.

2 MR. SMALL: Page 4, line 1, through page  
3 4, line 16. That's the portion that I just referred  
4 to. The second portion which I will address now is  
5 page 5, line 3, through page 5, line 10.

6 Regarding the material on page 5, the  
7 witness opines about the applicability of the  
8 Administrative Code Section 4901:1-17-05 to the issue  
9 -- of the interest rate on refunds. He also  
10 interprets that rule stating that it results in a  
11 3 percent interest rate as found on page 5, line 10.

12 AEP, again, can argue the matter in its  
13 briefs as far as the applicability of that particular  
14 portion of Ohio law. OCC and other parties will do  
15 likewise. But it's not within the expertise of  
16 Mr. Nelson.

17 I have additional portions to strike, but  
18 those are the two that are based on legal opinions.

19 EXAMINER PARROT: Response?

20 MR. NOURSE: Thank you, your Honor.  
21 First of all, the material on page 4, this testimony  
22 is very brief and this brief answer here is  
23 contextual, it's all premised very clearly based on  
24 the advice of counsel, and Mr. Nelson is not  
25 asserting the legal positions of the company. It's

1 merely a reference.

2           These same references have been made in  
3 other filings in this docket by counsel and it really  
4 just gives context for his next Q and A. So I think  
5 with that understanding I don't see -- I think it's  
6 helpful and it doesn't provide any legal conclusions  
7 or assertions and Mr. Nelson is not going to attempt  
8 to do that on cross either.

9           With respect to the second item on page  
10 5, you know, I think that's of a different character.  
11 The rule, administrative rule provision that's  
12 referenced there is essentially an example, you know,  
13 it's part of the Commission's regulations that's  
14 being referred to, and I don't think, there again,  
15 that that's trying to assert any ultimate legal issue  
16 or assert any legal opinion, just referring to the  
17 fact that that exists and explaining or discussing it  
18 in the context of the issue in this case about  
19 interest rate.

20           EXAMINER PARROT: Mr. Small.

21           MR. SMALL: Your Honor, with respect to  
22 the first portion on page 4, I understood counsel to  
23 say that the matter is brief, that it's upon the  
24 advice of counsel, and it repeats matters that were  
25 stated by counsel in pleadings. None of that



1 addresses whether he's qualified to state opinions on  
2 legal matters. It basically reinforces the fact that  
3 his counsel is making these arguments and has made  
4 these arguments elsewhere. And as I said, the  
5 counsel can make their arguments on brief.

6 To the extent that he's not opining on  
7 the ultimate applicability of the statute, it states  
8 on lines 6 and 7 there are at least three bases in  
9 the ESP statute to support recovery of incremental  
10 environmental investment. That is an opinion and  
11 that is not just contextual, that is an opinion of  
12 the applicability of the statute in this instance and  
13 it should be stricken.

14 MR. NOURSE: Your Honor, just briefly.  
15 You know, Mr. Small quoted the portion and he  
16 excluded the key statement in that sentence that the  
17 whole thing was based on the advice of counsel. It  
18 is contextual, and I didn't state that it had no  
19 meaning, it's simply a context and it's a very brief  
20 answer. He's not asserting any legal opinions, so,  
21 you know, either it's helpful or it's not, it doesn't  
22 add to the legal debate. It's merely a reference to  
23 what's already been advanced by the company through  
24 counsel.

25 EXAMINER PARROT: And the remainder of

1 your motion, Mr. Small?

2 MR. SMALL: You're referring to page 5?

3 EXAMINER PARROT: Was that the extent of  
4 it? I thought you had other --

5 MR. SMALL: No, I thought you might want  
6 to rule on that, but I'll continue.

7 EXAMINER PARROT: No, the Bench is going  
8 to take this under advisement and we will address it  
9 after we break for lunch.

10 MR. SMALL: Very well, your Honor.

11 The second portion of the testimony that  
12 should be stricken are page 2, line 11, through page  
13 3, line 4, as well as page 4, line 17, through page  
14 5, line 2

15 EXAMINER SEE: Mr. Small, could you  
16 repeat those, please?

17 MR. SMALL: Certainly. Page 2, line 11,  
18 through page 3, line 4, and page 4, line 17, through  
19 page 5, line 2.

20 And I appreciate, I've been on the other  
21 end of this, that it's difficult to follow with  
22 people. I know where I'm going and nobody else in  
23 the room does. I think we have that.

24 In both instances the witness merely  
25 repeats earlier testimony, PUCO Rule 27(E) states in

1 part that the presiding officers shall regulate the  
2 course of the hearing and may, according to 7(B) of  
3 that administrative rule, prevent the presentation of  
4 cumulative evidence. The material on pages 2 and 3  
5 is the witness's own statements in the witness's own  
6 words a recap of his July 31st, 2008, testimony on  
7 pages 15 to 20.

8 The witness simply says that he's  
9 repeating testimony that was previously submitted.  
10 The reference to page 15 to 20 is on page 2, line 14.

11 The material on page 4 through 5 also  
12 states that it appears in the witness's testimony,  
13 and I quote, "filed on July 31st, 2008." That's on  
14 page 5.

15 This material has already appeared. The  
16 witness by his own words, his own citation is just  
17 saying he's repeating his previous testimony.

18 EXAMINER PARROT: Mr. Nourse.

19 MR. NOURSE: Yes, your Honor. The  
20 witness in the testimony here talks about recapping,  
21 not repeating, and I think in light of the events  
22 that transpired since the time of the original  
23 testimony this, again, is intended to be helpful,  
24 provide context, and to, you know, avoid repeating  
25 all the content of those prior exhibits or current

1 exhibits.

2 Certainly, they're open for  
3 cross-examination and further discussion by counsel,  
4 but, again, Mr. Small in his motions to strike  
5 basically would take the entirety of the testimony  
6 out and so it's already very brief testimony and very  
7 efficient testimony, I think that it's intended to be  
8 helpful and so striking the entirety of the testimony  
9 is inappropriate.

10 MR. SMALL: I do agree that the  
11 consequence of granting OCC's motion would  
12 essentially be that this testimony would not exist,  
13 and it is the OCC's position that this testimony is  
14 of no consequence to this remand proceeding, it  
15 either repeats material that the witness stated  
16 previously or states legal opinions which the company  
17 can place into its brief and argue elsewhere.

18 And in that light, and dependent upon the  
19 Bench's ruling, the portions of the testimony on page  
20 2, lines 3 through 8, would be stricken in accordance  
21 with the Bench's ruling, that is the material on  
22 lines 3 through 6 deals with a cumulative or the  
23 repeating of evidence, and the portions on 6 through  
24 8 of page 2 is a statement that the witness is going  
25 to testify about matters that the OCC consider to be

1 legal opinions.

2 So those portions would be stricken also  
3 according to -- in agreement with the Bench's ruling.  
4 Again, I agree with AEP that if the OCC's motions are  
5 granted, that this would essentially eliminate the  
6 witness's testimony and there would be no need for  
7 cross-examination this afternoon.

8 EXAMINER PARROT: Thank you both. At  
9 this point let's take a one-hour or so recess for  
10 lunch. We'll reconvene at 1 o'clock, and we're off  
11 the record.

12 (At 11:55 a.m., a lunch recess was taken  
13 until 1 p.m.)

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1 Friday Afternoon Session,

2 July 15, 2011.

3 - - -

4 EXAMINER PARROT: Let's go back on the  
5 record. After consideration of the arguments raised  
6 by OCC and the companies in response during the lunch  
7 recess, the decision has been made to deny the motion  
8 to strike.

9 Mr. Small, you may proceed with your  
10 questions.

11 MR. SMALL: Thank you, your Honor.

12 - - -

13 CROSS-EXAMINATION

14 By Mr. Small:

15 Q. Mr. Nelson, I know you were in the room  
16 when the motions to strike were submitted. You don't  
17 hold yourself out as having expertise in legal  
18 matters, do you?

19 A. No, I do not.

20 Q. I'd ask you to turn your attention to  
21 page 5 of your testimony. Are you there?

22 A. Yes.

23 Q. Okay. There you mention on line 9  
24 Chapter 4901:1-17-05 of the Ohio Administrative Code.  
25 Do you see that?

1           A.    Yes, I do.

2           Q.    Is it the companies' position that that  
3   portion of the Ohio Administrative Code applies in  
4   the circumstances of refunds to customers if such  
5   refunds are ordered as a result of this proceeding?

6           A.    No, I don't believe that's the companies'  
7   position. We are using it as an appropriate rate in  
8   this instance, but it is really just specifically for  
9   deposits.

10          Q.    Okay. But you did arrive at the  
11   3 percent that's shown on line 10 of page 5 from that  
12   Ohio Administrative provision; is that correct?

13          A.    I based my recommendation on review of  
14   that statute and thought it was a fair rate for the  
15   customer. The statute itself says that, you know,  
16   deposits of a shorter duration get zero percent  
17   interest and I would expect that, you know, this will  
18   be a -- if we do have a refund, it will be a shorter  
19   duration, but we went ahead and decided that the  
20   3 percent would be an appropriate rate in this  
21   instance.

22          Q.    All right. You've referred to a portion  
23   of that provision that talks about the duration of  
24   the customer deposit, but is it your position that  
25   any of the other portions of that part of the Ohio

1 Administrative Code applies to these circumstances of  
2 the refunds?

3 A. Yeah. I didn't rely on any other  
4 provisions of the section of the Ohio Administrative  
5 Code.

6 Q. Okay. And I think, I'm not sure I  
7 received the answer to my other question which was  
8 but the 3 percent that you state on line 10, page 5  
9 of your testimony, that was the result of reviewing  
10 that provision in the Ohio Administrative Code; is  
11 that correct?

12 A. Yes. But I would like to point out that  
13 I reviewed a lot of different options for the  
14 company. You know, I went and looked at 26-week  
15 Treasury Bills and looked at the rate of those and,  
16 you know, 26-week Treasury Bills, the high rate for  
17 the 182-day bill auction most recently was  
18 0.065 percent. So I took that into account. I also  
19 looked at what the CD rates were running. Again, the  
20 CD rates would be much lower than the 3 percent.  
21 Six-month CD rate 0.59 percent. This is from  
22 bankrate.com. The 12-month CD is 0.93 percent. So  
23 those are the types of things I reviewed. And based  
24 on a review of those things we came up with this  
25 recommendation.



1           You know, one of the theories is that  
2     here the Commission has given a standard for when we  
3     hold customers' money for deposit and it's held -- if  
4     it's held for a certain period of time, it should be  
5     3 percent, so we thought that was a good basis for  
6     our recommendation.

7           MR. SMALL: Your Honor, I move to strike  
8     all but the first portion of that answer that said,  
9     that essentially agreed that the 3 percent came from  
10    and the very last portion of this statement that said  
11    that he arrived at the 3 percent by reviewing the  
12    Ohio Administrative Code. The rest of that response  
13    was not responsive to my question.

14           My question was: Did the 3 percent come  
15    from a review of the Ohio Administrative Code, and I  
16    didn't ask him for all the things that he would have  
17    considered. I move to strike that portion of his  
18    response.

19           MR. NOURSE: Your Honor, this question  
20    and the line of questioning was clearly asking  
21    Mr. Nelson if he relied solely on this rule. He  
22    indicated he had not, that he had taken it into  
23    account, and he indicated the other things that he  
24    looked at and was -- it was clearly responsive and  
25    helpful. I don't think it should be stricken.

1 EXAMINER PARROT: The motion to strike is  
2 denied.

3 Please continue, Mr. Small.

4 Q. Mr. Nelson, do the companies believe that  
5 the interest rate on any refund should not be less  
6 than a rate specified for customer deposits that are  
7 stated in the companies' tariffs?

8 A. Do I believe that they should not be less  
9 than the 3 percent proposed here?

10 Q. That's not my question.

11 MR. SMALL: If I could have the question  
12 reread for you.

13 (Record read.)

14 MR. NOURSE: Your Honor, could I inquire  
15 as to what specific tariff Mr. Small's referring to,  
16 and if he can direct the witness to that.

17 MR. SMALL: Let's -- I think this could  
18 be clarified a little bit for you, Mr. Nelson.

19 Q. If the tariffs, and I'm referring to the  
20 tariffs of the companies, that would be Columbus  
21 Southern and Ohio Power Company, all right, the filed  
22 tariffs of the companies at the Commission for these  
23 two companies, if those tariffs specified a higher  
24 interest rate for customer deposits than is stated in  
25 the Ohio Administrative Code that you cite in your

1 testimony, should that higher rate be applied?

2 MR. NOURSE: Your Honor, I object. The  
3 companies' tariffs are a multitude of pages.  
4 Mr. Small is making a generic reference to tariffs  
5 and hasn't had any specific tariff provision  
6 referenced or, for that matter, Mr. Nelson's  
7 knowledge about those tariffs.

8 MR. SMALL: So far it's a hypothetical.

9 EXAMINER PARROT: I was going to say, if  
10 you know, Mr. Nelson, please answer the question.

11 Q. I will pose it as a hypothetical. Let's  
12 suppose that the tariff provisions of Ohio Power and  
13 Columbus Southern had higher interest rates for  
14 customer deposits than stated in the Ohio  
15 Administrative Code that you cite in your testimony.  
16 Should the higher rate that is stated in the tariffs  
17 prevail?

18 A. Well, again, this isn't really a deposit.  
19 It's a unique situation. So I'm not sure the  
20 applicability of those tariffs applies here. But let  
21 me state that, you know, those tariffs would also  
22 reflect the fact that there should be no interest  
23 rate paid for the first 180 days, so even if it was a  
24 higher rate, I think the customer's advantaged by  
25 using our proposal which pays the 3 percent based on

1 the start of the refund.

2 Q. All right.

3 A. And I could read to you the section in  
4 the code that says that. "A utility should not be  
5 required to pay interest on deposits it holds for  
6 less than 180 days. No utility shall be required to  
7 pay additional interest on a deposit after it  
8 discontinues the service." So I'm not sure this is  
9 really an apples-to-apples comparison.

10 So I just relied on, you know, I was  
11 looking at the appropriate interest rate. I reviewed  
12 a lot of things. I decided that 3 percent would be  
13 the recommendation the company makes. I could see  
14 that the Commission might say, well, that's too high  
15 in these circumstances because they have, you know,  
16 they don't force any sort of interest for the first  
17 180 days, and of course with what I quoted around the  
18 current short-term interest rates it would be much  
19 lower than 3, but the companies make that  
20 recommendation.

21 Q. I thought we agreed that you were not  
22 applying the other portions of that Ohio  
23 Administrative Code section, that you were just  
24 getting the interest rate from it and you were not  
25 saying that that Ohio Administrative Code provision

1 applied to these circumstances.

2 A. Well, and that's why I was confirming I  
3 believe by saying the tariff wouldn't apply either.

4 Q. All right. I will agree with you on  
5 that, but the hypothetical was if there's a similar  
6 provision in the tariff having to do with customer  
7 deposits, I'm saying similar to the Ohio  
8 Administrative Code provision that you have, only it  
9 stated a different and higher interest rate, and that  
10 was my hypothetical, would it be the companies'  
11 position that should apply rather than the Ohio  
12 Administrative Code provision?

13 A. No, that shouldn't apply.

14 Q. And why is that? The Ohio -- let me put  
15 it another way. The Ohio Administrative Code  
16 provision, as you said, I believe you said is not  
17 strictly applicable but has an interest rate stated  
18 in it.

19 A. Right.

20 Q. The same thing is true of the tariff. It  
21 wouldn't be strictly applicable, but it has an  
22 interest rate in it. Why shouldn't we apply the  
23 higher rate that in the hypothetical is stated in the  
24 companies' tariffs?

25 A. Well, I think what we're trying to do

1 here is recommend an appropriate interest rate, not  
2 necessarily tied to any particular thing. You know,  
3 whether it is the code or the tariff. What I've done  
4 is reviewed several interest rates that apply to a  
5 shorter term hold of money and, you know, so I've  
6 based it on 3 percent. In fact, I think our proposal  
7 in our current tariff pending before the Commission  
8 is to move our deposit interest rates down to  
9 3 percent which is permitted by the Ohio  
10 Administrative Code.

11 Q. And so you're aware that the interest  
12 rate stated in the tariffs is actually higher than  
13 3 percent; is that correct?

14 A. I believe it is.

15 Q. Would you agree with me, subject to  
16 check, that it is at least 5 percent?

17 A. I believe one of the companies is  
18 5 percent, yes.

19 Q. Would that be Columbus Southern that's  
20 5 percent?

21 A. I know one of the companies is 5 percent.  
22 I'll accept that it's Columbus Southern.

23 Q. And would you also accept, subject to  
24 check, that the provision that prevailed or the  
25 tariff provision that prevailed for a customer

1 deposit interest over the period of the ESP for Ohio  
2 Power is 5.25 percent?

3 A. That sounds correct to me.

4 MR. SMALL: Your Honor, I have no further  
5 questions.

6 EXAMINER PARROT: Thank you, Mr. Small.

7 Mr. Randazzo?

8 MR. RANDAZZO: Yes, your Honors, thank  
9 you.

10 - - -

11 CROSS-EXAMINATION

12 By Mr. Randazzo:

13 Q. Good afternoon, Mr. Nelson.

14 A. Good afternoon.

15 Q. Just a few questions. First of all, with  
16 regard to the interest rate portion of your  
17 testimony, you have not -- you've addressed the  
18 interest rate on refunds but you have not chosen in  
19 your testimony to address any flow-through  
20 implications associated with the refund; is that  
21 correct?

22 A. Could you define "flow-through" for me?

23 Q. I'd prefer not to.

24 MR. NOURSE: Your Honor, I object. It's  
25 a vague question that's -- undefined terms are being

1 used.

2 MR. RANDAZZO: I was trying to avoid an  
3 argument over what "flow-through" meant. I'm happy  
4 to define it.

5 Q. If, for example, there was a reduction in  
6 the revenues that are collectible by Ohio Power,  
7 there would be a corresponding reduction in the  
8 amounts that would be eligible for deferral, correct?

9 A. Going forward --

10 Q. Right.

11 A. -- correct.

12 Q. Correct. Okay. So you have not  
13 addressed -- if I were to call that a flow-through  
14 implication, you have not addressed any of those  
15 flow-through implications in your testimony, correct?

16 A. No, I haven't addressed flow-through  
17 implications.

18 Q. Now, with regard to the interest rate on  
19 a refund, is it fair to say that you agree that an  
20 interest rate should attach to a refund?

21 A. Yeah, I believe that's a fair assessment.  
22 I would think that, you know, in this instance it's  
23 appropriate.

24 Q. Right.

25 A. I would say that most likely it would be



1 a very low interest rate below what I proposed here.

2 Q. Well, I expected that that would be your  
3 view on it, but why should there be an interest rate?

4 A. Why? Time value of money.

5 Q. And it's the customer's money we're  
6 talking about here, right?

7 A. It could be depending on how the case is  
8 finally decided.

9 Q. If there's a refund --

10 A. If there's a refund.

11 Q. -- it's the customer's money, right?

12 A. That's right.

13 Q. So the time value of money computation  
14 should be calculated from a customer's perspective,  
15 right?

16 A. Time value of money I think can be  
17 independent of that.

18 Q. In what circumstance?

19 A. I'm not sure every customer, for example,  
20 would have the same time value of money. So when you  
21 say from the customer's perspective, are you saying  
22 an industrial customer which may have one cost of  
23 funds, you may have a residential customer who has  
24 another, et cetera, so I'm not sure. It's kind of a  
25 broad statement.

1 Q. Yes, it is a broad statement.

2 A. And I think the way you get around that  
3 is look at a proxy, you know, customers do have bank  
4 investments, they buy CDs and so forth, so that's  
5 kind of the way I look at it from a customer  
6 perspective. You know, what are the current short  
7 term kind of riskless type investments, and then you  
8 look at, you know, you can look at things like the  
9 26-week bank or the Treasury Bills and so forth.

10 Q. I heard that testimony previously. In  
11 the case of a bank deposit, is that a voluntary thing  
12 on the part of the customer?

13 A. Yeah, I would think so.

14 Q. Right. Customers aren't compelled to  
15 make deposits in a savings account, right?

16 A. I wouldn't think so.

17 Q. And they would do that only if they had  
18 funds available to make a deposit in a savings  
19 account, right?

20 A. Well, yes. I mean, they have to have  
21 funds to have a -- did you say make a deposit?

22 Q. Right. A customer may have other value  
23 opportunities associated with the cash that's  
24 available to the customer rather than placing the  
25 funds in a savings account at a bank or savings

1 institution, right?

2 A. The customer may have other return  
3 opportunities.

4 Q. So do you think it would be appropriate  
5 to look at the value that the customer may derive  
6 from having had the money as a basis for computing  
7 the magnitude of the interest charge that should  
8 attach to the refund?

9 A. I don't know how I'd do that for all the  
10 customers but --

11 Q. Could you --

12 A. -- what I did is I looked at, you know,  
13 bank CDs, I've looked at, you know, the Treasury Bill  
14 rates and so forth and that's generally what's  
15 available for this type of risk-free investment. So  
16 I did review those. Again, they were below a tenth  
17 of a percent in the --

18 Q. Could you use the Black-Scholes model to  
19 look at the optionality value associated with having  
20 and not having the cash on the part of the customer?

21 A. I certainly wouldn't.

22 Q. Why not?

23 A. I'm not that familiar with the  
24 Black-Scholes model.

25 Q. Did you ask about other valuation models

1 that might apply to determine the appropriate  
2 interest rate that would attach to a refund?

3 A. No, I didn't because I don't think this  
4 is quite that complex. You know, FERC has a refund  
5 interest rate as well, there's other, you know,  
6 people have addressed this. I think this is the  
7 appropriate, as I said, it's probably on the high  
8 side, but it's a reasonable interest rate for this  
9 purpose. And it's supported by public information.

10 Q. Okay, but you didn't look at any other  
11 valuation techniques.

12 A. No. I looked at the ones I mentioned. I  
13 thought that was sufficient for this purpose.

14 Q. Okay. Now, you mentioned in your, what  
15 is Remand Exhibit No. 2, your prior testimony in this  
16 proceeding, and your prior testimony consisted of  
17 both direct testimony and rebuttal testimony,  
18 correct?

19 A. It did.

20 Q. Did you review that testimony for  
21 purposes of preparing your testimony for the remand  
22 proceeding?

23 A. I did.

24 Q. Is it correct that in neither your  
25 original direct testimony nor your original rebuttal

1 testimony -- is it correct that you did not mention  
2 any provision of 4928:143(B) (2) for purposes of  
3 discussing the proposal to recover environmental  
4 related carrying charges?

5 A. I only have a limited piece of my  
6 testimony before me from my direct testimony, but I  
7 didn't see a particular provision of the statute  
8 mentioned in that as part of the testimony.

9 Q. Right. Would you accept, subject to  
10 check, that neither your original direct testimony  
11 nor your rebuttal testimony previously filed in this  
12 proceeding contained any reference to a provision of  
13 section 4928:143(B) (2)? Would you accept that  
14 subject to check?

15 A. Yes.

16 Q. Now, is it also true that in addition to  
17 the environmental related carrying costs -- cost  
18 charges that were previously included in rates that  
19 there were some operation and maintenance expense  
20 associated with environmental facilities that was  
21 allowed to be recovered through the fuel adjustment  
22 mechanism? And I'm speaking principally of what were  
23 referred to as consumables. Is that correct?

24 A. Yes, consumables were part of the fuel  
25 cost.

1           Q.    And that would be the chemicals that were  
2    used in the environmental facilities that process the  
3    emissions as you produce electricity, right?

4           A.    That's correct.

5           Q.    So to be clear, you say that the, in your  
6    testimony, to be clear here, in addition to the  
7    carrying cost charges, the revenue that is available  
8    from those charges, in addition to that there are  
9    environmental related expenses that are flowing  
10   through the fuel adjustment clause.

11          A.    I'm sorry, Mr. Randazzo. What piece of  
12   testimony are you referring to?

13          Q.    Strike the question.

14                Now, on page 3 of your testimony in line  
15   7 you have the word "environmental investment" or the  
16   words "environmental investment." Do you see that?

17          A.    Yes.

18          Q.    And that environmental investment there,  
19   that's the capital expenditure that occurred between  
20   2001 and 2008, correct?

21          A.    That's a portion of it, yes.

22          Q.    Well, in the sentence that begins on line  
23   5 of that page you say that the capital carrying cost  
24   charges for 2001 through 2008 are associated with  
25   incremental environmental expenditures that were made

1 during that period, correct?

2 A. Yes. Incremental.

3 Q. Now, you say on page 3 at the bottom,  
4 speaking about the remand decision -- by the way, did  
5 you read the Supreme Court's decision reversing the  
6 Commission?

7 A. Yes.

8 Q. Is it correct that the court did not  
9 agree with AEP's interpretation of the phrase  
10 "without limitation"?

11 MR. NOURSE: I object, your Honor. The  
12 issue before the court was the Commission's  
13 interpretation of the statute. Furthermore, the  
14 answer calls for a legal conclusion.

15 MR. SMALL: Well, your Honor, I guess I  
16 have to object or argue against that. We've been all  
17 through we're not going to grant the OCC's motion to  
18 strike based on a legal opinion, the witness has to  
19 be subject to cross-examination on those portions of  
20 the testimony where he brings legal matters into the  
21 testimony.

22 MR. NOURSE: Your Honor, just briefly.  
23 What the discussion was earlier was that Mr. Nelson's  
24 not offering legal opinions about the statute let  
25 alone the court's opinion.

1 MR. RANDAZZO: If I may.

2 EXAMINER PARROT: I think the record's  
3 clear that Mr. Nelson is not offering legal  
4 testimony.

5 MR. RANDAZZO: Yeah, I think it is too,  
6 but his testimony is on line 16 of page 3 that the  
7 court did not agree with the Commission's  
8 interpretation of the phrase "without limitation."  
9 The question I've asked the witness is, is it also  
10 true that the court did not agree with AEP's  
11 interpretation of the same phrase.

12 EXAMINER PARROT: Mr. Nelson, you may  
13 answer the question if you know.

14 A. I believe that's the case. I think we  
15 had to -- we were in line with the Commission's  
16 position, but I can't swear to that.

17 Q. Oh, you're on the stand.

18 A. I know.

19 (Laughter.)

20 Q. I appreciate your reservation there, but  
21 it's an awkward one.

22 A. Did that help me at all?

23 Q. And you say on page 3 here, in the last  
24 sentence on page 3, there you're interpreting what  
25 the court said in sending the case back to the



1 Commission. Right?

2 MR. NOURSE: Your Honor, I would just  
3 note that, again, this whole paragraph is premised by  
4 the phrase "Based on the advice of counsel, it is my  
5 understanding." So Mr. Randazzo's trying to press  
6 further into these contextual background statements.

7 EXAMINER PARROT: The objection is  
8 overruled. Please answer the question.

9 THE WITNESS: Could I have that read back  
10 to me.

11 (Record read.)

12 A. Yes. And since we put some language in  
13 quotes I assume that was a quote of the court's  
14 decision.

15 Q. Yeah. I was going to ask you about that  
16 next. Is the quote that you have there a complete  
17 quote from what the court said or a partial quote?

18 A. I don't have the court's opinion in front  
19 of me.

20 Q. You don't know whether that's a complete  
21 indication of what the court said; is that correct?

22 A. Well, I can tell from the fact that the  
23 first letter of "determine" is not capitalized, it's  
24 probably not a full sentence.

25 Q. And who made the decision to selectively

1 quote the Supreme Court?

2 MR. NOURSE: I object. Your Honor,  
3 there's no basis to say this was selectively quoted  
4 and it's not even clear what Mr. Randazzo means by  
5 "the complete meaning" to begin with.

6 MR. RANDAZZO: Well, here, I'll withdraw  
7 the question.

8 Q. Mr. Nelson, did the court require the  
9 Commission to determine whether any of the listed  
10 categories of (B)(2) authorized recovery of  
11 environmental carrying charges or did the court say  
12 that the Commission may consider that question?

13 A. I don't have the court's opinion in front  
14 of me, so I'm not positive one way or the other.

15 Q. So you don't know without referring to  
16 the court decision, you don't know whether or not the  
17 court said the Commission may consider that issue.  
18 Is that correct?

19 A. Yes.

20 Q. Now, on page 4 of your testimony in the  
21 lines 6 through 16 you have some additional partial  
22 quotes of statutory provisions, right?

23 A. That's correct.

24 Q. Did you make the choice to include a  
25 portion of the statutory language or it was the

1 choice -- was the choice made by somebody else?

2 A. I would have been involved in the choice  
3 of it.

4 Q. I would hope so.

5 A. And I would have felt that those were the  
6 appropriate parts of the statute to quote for  
7 purposes of this remand testimony.

8 Q. And why -- let's take division (B) (2) (b).  
9 Is it your understanding that a charge approved under  
10 (B) (2) (b) must be nonbypassable?

11 Mr. Nelson, I see you have some papers in  
12 front of you. Are you referring to the statutory  
13 language?

14 A. Yes, I am.

15 Q. All right.

16 A. It doesn't have to be nonbypassable. I  
17 think I'd refer to the discretion of the Commission  
18 on that one.

19 Q. Did you read the statutory language?

20 A. Yes.

21 Q. Do you see the words "nonbypassable" in  
22 the statutory language?

23 A. I do.

24 Q. Do you understand the significance of  
25 "nonbypassable"?

1           A.     Yes.

2           Q.     I'll ask you again, not a legal opinion,  
3     a lay opinion based upon your understanding of the  
4     word "nonbypassable," does a charge approved under  
5     (B) (2) (b) have to be nonbypassable?

6           MR. NOURSE: Your Honor, I object. He  
7     called it a lay opinion but he's asking if the  
8     statute requires something, and Mr. Nelson has  
9     already indicated, as have I, that this -- he's not  
10    here to testify on legal issues. This paragraph was  
11    inserted as background. It reflects the legal  
12    position the companies already advanced in pleadings  
13    filed by counsel. These matters can be further  
14    debated and elaborated on in brief.

15          EXAMINER PARROT: The objection -- I'm  
16    sorry, did you have a --

17          MR. RANDAZZO: I'm sorry. Your Honor, I  
18    think it would be -- I would ask, regardless of what  
19    I think would be helpful, I think it would be -- I  
20    would ask if counsel for the applicants has an  
21    objection to a question, that they state the  
22    objection, and if the Bench requires an explanation  
23    as to the basis of the objection, that that proceed  
24    rather than having this series of argument and  
25    testimony come in through counsel. Thank you.

1 EXAMINER PARROT: The objection is  
2 sustained. Please continue, Mr. Randazzo.

3 Q. Mr. Nelson, with regard to division  
4 (B) (2) (d) that you referred to in your testimony,  
5 briefly and concisely, on page 4, were you aware that  
6 the words "retail electric service" are a defined  
7 term under Ohio law?

8 A. No, I'll say I am not aware of that.

9 Q. So for purposes of your testimony you did  
10 not consider the meaning -- the defined meaning of  
11 "retail electric service"; is that correct?

12 A. No, I didn't. If it is a defined term, I  
13 didn't review that.

14 Q. Did you inquire of counsel as to whether  
15 or not the words "retail electric service" involved a  
16 term that was defined by Ohio law?

17 MR. NOURSE: Objection.

18 EXAMINER PARROT: Overruled. Please  
19 answer.

20 A. I don't believe I asked the attorney --  
21 my attorney that question.

22 Q. Now, with regard to (B) (2) (d) and the  
23 whole subject of environmental carrying charges, am I  
24 correct that in the original case presented by the  
25 applicants in this proceeding, that it was the

1 applicants' view that under either the ESP or the MRO  
2 that customers would pay environmental carrying  
3 charges?

4 A. I don't recall that we talked about the  
5 MRO in the original case.

6 MR. RANDAZZO: May I approach the  
7 witness, your Honor?

8 EXAMINER PARROT: You may.

9 Q. Mr. Nelson, I'm going to lay before you a  
10 book that I assembled that contains some testimony  
11 from the original case and I'll direct you to the  
12 direct testimony of Craig Baker. Do you remember  
13 Mr. Baker?

14 A. Yes, I do.

15 Q. Yeah. His legend lives on.

16 And direct you to Exhibit JCB-2 that was  
17 at the end of that testimony which is in the record  
18 and ask you to take a look at that and see if that  
19 refreshes your recollection about whether the  
20 applicants compared the ESP to the MRO.

21 A. Yes, they did a comparison. I didn't  
22 think that was your question.

23 Q. And you have reviewed the testimony that  
24 has been filed by the applicants in the remand phase  
25 of this proceeding, right?

1           A.    The testimony that was filed in the  
2 remand phase --

3           Q.    Right.

4           A.    Have I --

5           Q.    Dr. Makhija, your testimony, and the  
6 other two witnesses.

7           A.    I'm not sure I reviewed all the testimony  
8 in this remand phase.

9           Q.    Okay. Are you aware of any of the  
10 applicants' witnesses that have identified update to  
11 the ESP versus MRO comparison?

12          A.    In the remand case?

13          Q.    Yes.

14          A.    If there was a witness that did that  
15 comparison, it would be Witness Thomas.

16          Q.    Okay. And you're not aware if she  
17 addressed that subject.

18          A.    I suspect she did, but I just don't  
19 recall. The cases are running together a bit.

20          Q.    All right. And based upon the document  
21 that I've placed in front of you, and more  
22 specifically the exhibit to Mr. Baker's testimony, am  
23 I correct that the applicants attributed  
24 environmental carrying charges to both the MRO and  
25 the ESP scenarios?

1           A.    It's included in the schedule under both  
2 titles.

3           Q.    So "yes" would be the answer?

4           A.    Yes.

5           Q.    So from the applicants' perspective,  
6 whether there was an ESP or an MRO, customers were  
7 going to be carrying environmental carrying charges  
8 one way or the other, right?

9           THE WITNESS:   Could I have that question  
10 read back?

11          Q.    I can restate it.  So from the  
12 applicants' perspective, customers were going to be  
13 paying environmental carrying charges through the ESP  
14 or the MRO regardless, right?

15          A.    Regardless -- it's, again, kind of a  
16 broad statement.  The MRO provision does have a  
17 provision in it that would allow adjustment for  
18 environmental --

19          Q.    Right.

20          A.    -- costs.

21          Q.    But as the applicants presented their  
22 case, they evaluated the MRO versus ESP based upon an  
23 assumption that the customers would pay environmental  
24 carrying charges regardless of whether the Commission  
25 approved an ESP or you went to the MRO option,



1 correct?

2 A. Well, the MRO is a blending process so  
3 that there would be a component in there for the SSO  
4 rate which would include the environmental.

5 Q. Now, these charges, these environmental  
6 carrying charges, generate revenue for the companies,  
7 right?

8 A. Yes.

9 Q. How is the revenue booked?

10 A. It's booked as revenue in the appropriate  
11 category of revenue, whether it's residential,  
12 commercial, industrial.

13 Q. Is it on the generation ledger or the  
14 distribution ledger?

15 A. It would be on -- it could be on both in  
16 the sense that there is sometimes an offsetting  
17 expense booked. So I'm not positive how it's booked.  
18 I really just reviewed the total consolidated  
19 statements of the company.

20 Q. Well, did you -- was there any offsetting  
21 expense that you identified associated with the  
22 environmental carrying charge revenues?

23 A. As I said, I don't recall, but there  
24 could be.

25 Q. You don't know --

1           A.    For example, you know, to put that in  
2 context, if --

3           Q.    But I'm not asking you to speculate.

4           A.    Okay.

5           Q.    I'm asking you if you know. Do you know  
6 if there is an expense associated with the  
7 environmental charge revenues?

8           A.    No, I'm not certain.

9           Q.    All right. If there were no expenses  
10 associated with the environmental charge revenues,  
11 then the revenues would flow directly to earnings,  
12 dollar for dollar, correct?

13           MR. NOURSE: Your Honor, I object. He's  
14 getting further into the accounting material and he  
15 already said he didn't know how it was booked in the  
16 answer to the prior question.

17           MR. RANDAZZO: I'll withdraw the  
18 question.

19           THE WITNESS: Well, you --

20           MR. RANDAZZO: I'll withdraw the  
21 question.

22           THE WITNESS: You clarified for me one  
23 thing, of course there are expenses associated with  
24 the --

25           MR. RANDAZZO: Mr. Nelson, I withdrew the

1 question. If you have something you want to say, the  
2 appropriate opportunity for that is when counsel and  
3 you get an opportunity to do redirect. I withdrew  
4 the question.

5 Q. Now, within the calculation of the  
6 carrying charge there is a return on the 2001-2008  
7 environmental expenditures, right?

8 A. Yes.

9 Q. And the return on is -- includes both an  
10 equity and a debt component correct?

11 A. Yes.

12 Q. Now, with regard to the return on equity  
13 component, that would flow -- that is earnings for  
14 the shareholders, right?

15 A. That's correct.

16 Q. And there is a depreciation component  
17 associated with the computation of the carrying  
18 charge, correct?

19 A. Yes.

20 Q. Once the carrying charges were approved  
21 by the Commission and charged by the companies, did  
22 you alter your depreciation accrual rates for the  
23 environmental plant?

24 A. I'm sorry. Did you say depreciation pool  
25 rates?

1 Q. Accrual rates.

2 A. Accrual, yes.

3 Q. Do you know what depreciation accrual  
4 rates are?

5 A. Yes.

6 Q. Okay. Let's do it by the numbers. The  
7 depreciation accrual rates are generally expressed as  
8 a percentage that drive the depreciation expense that  
9 is associated with a particular asset relative to the  
10 original book cost of the asset in a straight line  
11 depreciation context, correct?

12 A. Yes.

13 Q. Once the Commission approved this charge  
14 containing a component for depreciation, did you  
15 modify your depreciation accrual rates associated  
16 with the environmental plant?

17 A. No, we wouldn't have any basis to modify  
18 the accrual rates.

19 Q. So if you didn't modify the depreciation  
20 accrual rates, you, therefore, did not modify the  
21 depreciation expense associated with that plant,  
22 correct?

23 A. The booked depreciation expense was not  
24 modified as a result of the carrying costs.

25 Q. Okay. So the component in the

1 environmental carrying charge that is associated with  
2 depreciation, the revenue associated with that  
3 component would have also flowed to earnings, right?

4 A. No. That doesn't make any sense to me.  
5 You still have the depreciation expense that you're  
6 booking.

7 Q. Okay.

8 A. And earlier we were talking about which  
9 ledger it was booked on. That's what I told you I  
10 didn't understand. Certainly, I understand the fact  
11 that these costs are costs on the companies' books,  
12 depreciation being one of the major components of the  
13 costs.

14 Q. But you did not change your depreciation  
15 expense as a result of the Commission authorizing you  
16 to collect revenues for these environmental carrying  
17 charges, right?

18 A. It wasn't a subject of that case. We  
19 didn't ask to change the depreciation rates, and the  
20 Commission --

21 Q. And you didn't, correct?

22 A. -- didn't order us to and there wouldn't  
23 have been any reason to change those depreciation  
24 rates.

25 Q. So you didn't change your depreciation

1 expense as a result of getting this incremental  
2 revenue for depreciation through the environmental  
3 carrying charges, right?

4 A. That's correct. The depreciation expense  
5 would be on the companies' books regardless of  
6 whether we got the revenue, but it's an expense that  
7 the company incurs so I'm not sure where you're  
8 headed with this.

9 Q. Just trying to provide some context.

10 Just one last question. Again, with  
11 regard to page 4 and the statutory provisions that  
12 you partially quote on page 4, you do not in your  
13 testimony address any of the limitations that may  
14 exist on the ability to establish environmental  
15 carrying charges; is that correct?

16 A. Can you give me an example of the  
17 limitations?

18 Q. I gave you one earlier, nonbypassable  
19 charge.

20 A. No, with respect to the remand proceeding  
21 there's -- we didn't ask for a nonbypassable charge  
22 on these carrying costs and so that was not a subject  
23 of the remand.

24 Q. But if there are other limitations on the  
25 ability to establish an environmental carrying

1 charge, they're not a subject that you've addressed  
2 for purposes of this proceeding, correct?

3 A. I certainly don't think that the  
4 Commission is limited to granting the remand that the  
5 company is asking. We believe that there aren't  
6 limitations that would prevent the Commission from  
7 granting our request to continue the carrying costs  
8 that were approved in the original ESP order.

9 MR. RANDAZZO: Mr. Nelson, I'm going to  
10 quit in the interest of moving on. Thank you very  
11 much for your time.

12 Thank you, your Honors.

13 EXAMINER PARROT: Staff?

14 MR. MARGARD: No questions, thank you,  
15 your Honor.

16 EXAMINER PARROT: Mr. O'Brien?

17 MR. O'BRIEN: No questions, your Honor.

18 EXAMINER PARROT: Ms. Hand?

19 MS. HAND: No questions, your Honor.

20 EXAMINER PARROT: Mr. Petricoff?

21 MR. PETRICOFF: No questions, your Honor.

22 EXAMINER PARROT: And Mr. Yurick?

23 MR. YURICK: Nothing at this time, your  
24 Honor, thank you.

25 EXAMINER PARROT: Redirect?

1 MR. NOURSE: Just a very brief recess  
2 please, your Honor.

3 EXAMINER PARROT: Let's go off the record  
4 and reconvene in five minutes. Thank you.

5 MR. NOURSE: Thank you.

6 (Recess taken.)

7 EXAMINER PARROT: Let's go back on the  
8 record.

9 Mr. Nourse.

10 MR. NOURSE: Thank you, your Honor. Just  
11 a few questions.

12 - - -

13 REDIRECT EXAMINATION

14 By Mr. Nourse:

15 Q. Mr. Nelson, Mr. Randazzo had asked you  
16 some questions about carrying charges, environmental  
17 carrying charges, and depreciation, and do you recall  
18 that line of questioning?

19 A. Yes.

20 Q. And do the environmental carrying charges  
21 include a depreciation component?

22 A. Yes, they do.

23 Q. And how is that component related to the  
24 expenses that are booked?

25 A. Well, the depreciation component is one



1 driven by the -- how long the plant's life is, so you  
2 have a depreciation rate that would coincide with the  
3 25-year life, you could have one that would coincide  
4 with a lesser life, 20 years, et cetera.

5 Q. Is there any difference in the  
6 methodology of how the depreciation expense is  
7 calculated?

8 A. Well, for purposes of the carrying cost  
9 rate we use a levelized methodology as opposed to  
10 book depreciation rate. The levelized methodology  
11 uses the same revenue requirement over the life of  
12 the asset on a net-present-value basis as would a  
13 traditional cost-of-service calculation using booked  
14 depreciation rates.

15 Q. And the levelized methodology you're  
16 referring to is the same one you presented in  
17 testimony and it was adopted by the Commission?

18 A. Yes, that's correct.

19 MR. NOURSE: Thank you. That's all I  
20 have, your Honor.

21 EXAMINER PARROT: Any  
22 recross-examination, Mr. Small?

23 MR. SMALL: No questions, your Honor.

24 EXAMINER PARROT: Mr. Randazzo?

25 MR. RANDAZZO: No.

1 EXAMINER PARROT: Staff?

2 MR. MARGARD: No.

3 EXAMINER PARROT: Mr. O'Brien?

4 MR. O'BRIEN: No.

5 EXAMINER PRICE: Ms. Hand?

6 MS. HAND: No.

7 EXAMINER PARROT: Mr. Petricoff?

8 MR. PETRICOFF: No.

9 EXAMINER PARROT: And Mr. Yurick?

10 MR. YURICK: No questions, your Honor.

11 EXAMINER PARROT: Thank you very much,  
12 Mr. Nelson. You're excused.

13 MR. NOURSE: Thank you, your Honor. I  
14 would renew my motion for admission of Companies'  
15 Remand Exhibit No. 2.

16 EXAMINER PARROT: Are there any  
17 objections?

18 MR. SMALL: Your Honor, none other than  
19 the ones previously stated in OCC's motions, we  
20 understand that the Bench has ruled on those  
21 portions.

22 EXAMINER PARROT: Thank you, Mr. Small.  
23 Companies' Exhibit No. 2 shall be admitted.

24 (EXHIBIT ADMITTED INTO EVIDENCE.)

25 EXAMINER PARROT: Are there any other

1 matters to be addressed today?

2 MR. NOURSE: Your Honor, can I just  
3 inquire -- we can do this off the record, I'm sorry.  
4 Nothing further, your Honor.

5 EXAMINER PARROT: With that, the hearing  
6 is adjourned for today. We will pick up again on  
7 Tuesday, July 19th, at 10 o'clock in the morning, and  
8 we will be in this room again, Room 11-A.

9 (Thereupon, the hearing was adjourned at  
10 2:03 p.m.)

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## 1 CERTIFICATE

2 I do hereby certify that the foregoing is a  
3 true and correct transcript of the proceedings taken  
4 by me in this matter on Friday, July 15, 2011, and  
5 carefully compared with my original stenographic  
6 notes.

7  
8 Maria DiPaolo Jones, Registered  
9 Diplomate Reporter and CRR and  
Notary Public in and for the  
State of Ohio.

10 My commission expires June 19, 2016.

11 (MDJ-3870)

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Summary: Transcript Transcript of Columbus Southern Power Company and Ohio Power Company hearing held on 07/15/11 - Volume I electronically filed by Mrs. Jennifer Duffer on behalf of Armstrong & Okey, Inc. and Jones, Maria DiPaolo Mrs.