

FILE

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

120

Page 1

RECEIVED-DOCKETING DIV.

2007 MAR 16 PM 4:18

PLUCO

1

BEFORE

2

THE PUBLIC UTILITIES COMMISSION OF OHIO

3

- - -

4

Consolidated Duke Energy) Case Nos.

5

Ohio, Inc. Rate) 03-93-EL-ATA

6

Stabilization Plan Remand) 03-2079-EL-AAM

7

and Rider Adjustment) 03-2080-EL-ATA

8

Cases.) 03-2081-EL-AAM

9

05-724-EL-UNC

10

05-725-EL-UNC

11

06-1068-EL-UNC

12

06-1069-EL-UNC

13

06-1085-EL-UNC

14

15

Deposition of Neil H. Talbot, a witness

16

herein, called by Duke Energy Ohio, Inc. for

17

cross-examination under the statute, taken before

18

me, Deborah J. Holmberg, Registered Merit Reporter

19

and Notary Public in and for the State of Ohio,

20

pursuant to notice and stipulations of counsel

21

hereinafter set forth, at the offices of Ohio

22

Consumers' Counsel, 10 West Broad Street, Suite

23

1800, Columbus, Ohio, on Wednesday, March 14,

24

2007, beginning at 10:10 o'clock a.m. and

25

concluding on the same day.

This is to certify that the images appearing are an
accurate and complete reproduction of the original
document delivered in the regular course of business
Technician 2 Date Processed 3.14.07

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

1 APPEARANCES:

2

3 ON BEHALF OF DUKE ENERGY OHIO, INC.:

4 John J. Finnigan, Jr., Esq.

5 Associate General Counsel

6 Duke Energy Shared Services, Inc.

7 Duke Energy Corporation

8 221 East Fourth Street

9 Room 2500, Atrium II

10 Post Office Box 960

11 Cincinnati, Ohio 45201-0960

12 (513) 287-3601 Fax (513) 287-3810

13 john.finnigan@duke-energy.com

14

15 Paul A. Colbert, Esq.

16 Associate General Counsel

17 Duke Energy Ohio

18 Duke Energy Corporation

19 155 East Broad Street - 21st Floor

20 Columbus, Ohio 43215

21 (614) 221-7551 Fax (614) 221-7556

22 paul.colbert@duke-energy.com

23

24

25

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

1 APPEARANCES (continued):

2

3 ON BEHALF OF THE RESIDENTIAL CONSUMERS OF DUKE
4 ENERGY OHIO, INC.:

5 Janine Migden-Ostrander, Esq.

6 Ohio Consumers' Counsel

7 BY: Ann M. Hotz, Esq.

8 Assistant Consumers' Counsel

9 10 West Broad Street - Suite 1800

10 Columbus, Ohio 43215-3485

11 (614) 466-8574 Fax (614) 466-9475

12 hotz@occ.state.oh.us

13

14 ON BEHALF OF OHIO PARTNERS FOR AFFORDABLE ENERGY:

15 Colleen Mooney, Esq.

16 337 South Main Street - Fourth Floor

17 Suite 5

18 Post Office Box 1793

19 Findlay, Ohio 45839-1793

20 - - -

21

22 ALSO PRESENT:

23 Don Wathen, Director - Revenue Requirements

24 - - -

25

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

S T I P U L A T I O N S

- - -

1
2
3 It is stipulated by and among counsel for
4 the respective parties herein that the deposition
5 of Neil H. Talbot, a witness herein, called by
6 Duke Energy Ohio, Inc. for cross-examination under
7 the statute, may be taken at this time and reduced
8 to writing in stenotype by the Notary, whose notes
9 may thereafter be transcribed out of the presence
10 of the witness; that proof of the official
11 character and qualification of the Notary is
12 waived; that the witness may sign the transcript
13 of his deposition before a Notary other than the
14 Notary taking his deposition; said deposition to
15 have the same force and effect as though the
16 witness had signed the transcript of his
17 deposition before the Notary taking it.

- - -

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

I N D E X

1

2

3

WITNESS

PAGE

4

Neil H. Talbot

5

Cross-examination by Mr. Finnigan

6

6

Cross-examination (cont'd.) by Mr. Finnigan

68

7

8

EXHIBITS

MARKED

9

Talbot Exhibit No. 1 -

46

10

Percent of 2006 Generation Revenue

11

that is Bypassable for Residential

12

Consumers

13

14

15

16

17

18

19

20

21

22

23

24

25

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

1 NEIL H. TALBOT

2 of lawful age, being by me first duly placed under
3 oath, as prescribed by law, was examined and
4 testified as follows:

5 CROSS-EXAMINATION

6 BY MR. FINNIGAN:

7 Q. Good morning, Mr. Talbot.

8 A. Good morning, Mr. Finnigan.

9 Q. I'm the attorney representing Duke Energy
10 Ohio in the deposition today.

11 As we proceed during today's deposition,
12 if at any time you don't understand any question I
13 ask you, please let me know and I'll be happy to
14 withdraw or rephrase the question. Will you agree
15 to do that?

16 A. Sure.

17 Q. Okay. And, of course, any time you want
18 to take a break, just say so and we'll be happy to
19 take a brief recess.

20 A. Thank you.

21 Q. Mr. Talbot, did you review any documents
22 in preparation for preparing your filed testimony
23 or for today's deposition?

24 A. Yes. I reviewed quite a large proportion
25 of the filings in this docket and the related

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

1 dockets. I guess the second set of documents that
2 I would have reviewed would have been the
3 responses to data requests that the company
4 provided. So those would be the two main sources.

5 Q. Anything else besides those two
6 categories of documents?

7 A. I reviewed or scanned, let's say, some
8 other documents, what some other states might be
9 doing about the standard offer.

10 Q. Okay. Anything else?

11 A. That's all that comes to mind.

12 Q. Okay. And where did you get documents on
13 what other states are doing with respect to their
14 standard service offers?

15 A. Mostly off their web sites.

16 Q. Okay. And is that something that you do
17 in your day-to-day practice as a consultant, is
18 you generally try to keep up-to-date with
19 developments in other states that have deregulated
20 retail generation service?

21 A. Generally, yes.

22 Q. And is going to those state commission
23 web sites a valuable tool for you to be able to do
24 that?

25 A. It is, yes.

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

1 Q. Okay. And do you find that the
2 information on the state utility commission
3 web sites is generally reliable?

4 A. Yes.

5 Q. Okay. Are there any other resources that
6 you use to keep informed about developments in
7 restructured electric markets, generally, without
8 regard to whether you reviewed those to prepare
9 your testimony in this case?

10 A. I talk with colleagues and I subscribe to
11 at this point just one journal, which is the
12 "Public Utilities Fortnightly".

13 Q. Okay. Is that also a generally reliable
14 source of information about developments in the
15 electric industry?

16 A. It is. It's a reliable trade journal.

17 Q. Okay. What about "Megawatt Daily", are
18 you familiar with that?

19 A. I'm familiar with it, but I don't follow
20 it.

21 Q. Okay. Have you prepared any testimony or
22 reports relating to deregulated retail electric
23 generation markets since 2004?

24 A. I don't think so.

25 Q. What has been the focus of your

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

1 consulting practice since 2004?

2 A. I actually took a year off to write
3 fiction.

4 Q. Good for you.

5 A. Well, not actually that good for me, not
6 financially.

7 So I did not -- have done not much
8 consulting in the last year. I'm back in business
9 this year.

10 Q. Okay. It's good to see you back.

11 A. Thank you.

12 Q. Now, during today's deposition, and in
13 your testimony, and in the testimony of other
14 witnesses, there's a term that was used, and that
15 term is "approved MBSSO".

16 A. Yes.

17 Q. And I just want to make sure that we're
18 on the same page with that term and that we both
19 understand that when we use that term in today's
20 deposition, that what we mean is the MBSSO that
21 was approved by the Public Utilities Commission in
22 2004 in its entry on rehearing and also was
23 involved in the Supreme Court of Ohio's decision
24 and remand order. That is the purpose of today's
25 deposition or the focus of today's deposition.

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

1 So do you understand if I use that term,
2 "approved MBSSO", that that's what I'm referring
3 to?

4 A. I do. I refer to it as the current MBSSO
5 or the current standard service offer.

6 Q. Okay. But with regard to either term,
7 we'll mean the same thing; that is, the plan --

8 A. Yes.

9 Q. -- that's currently in effect.

10 A. Yes.

11 Q. Now, in your opinion, is this current
12 MBSSO or the approved MBSSO a pure market rate?

13 A. No.

14 Q. And why not?

15 A. As I've said, really, in a number of
16 places in my testimony, the current standard
17 service offer or approved standard service offer
18 is a hybrid construct, which -- which has
19 cost-based elements, other elements that are
20 related to historical costs, and certain current
21 costs of the company in acquiring assets from the
22 marketplace. So that all those three components
23 are present in this approved MBSSO.

24 Q. Okay. Now, would you agree with me that
25 it's common that market prices in various other

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

1 industries or other settings have components that
2 recover the producer's or the manufacturer's costs
3 plus a margin for profit built into the price and
4 it's still considered to be a market price?

5 A. I think the way I would look at it is
6 that over time market prices have to cover costs
7 plus a reasonable rate of return for that line of
8 business.

9 Q. That's true of any market price.

10 A. It's pretty well true of any -- any
11 market in the long run.

12 Q. Okay. And the approved MBSSO is
13 consistent with that, isn't it, in the sense that
14 it recovers the costs and the margin?

15 A. No. It's -- It's a hybrid. It has a
16 number of different features in it.

17 Q. But those features include costs plus
18 margin; right?

19 A. Well, if I could revisit my previous
20 answer. There were current costs, market costs,
21 in the sense that they're acquired by the company
22 in the marketplace for capacity, for example, or
23 fuel; historical costs in the form of legacy
24 generation costs; and the third element is certain
25 estimates which the company has justified in terms

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

1 of building up what it regards as a reasonable
2 market price, but I do not.

3 I don't think there's a basis for
4 concluding that it is either a reasonable market
5 price or, in fact, a well-based cost- --
6 cost-based item. So there's certain items that
7 cannot really be categorized. They're really
8 rather pure estimates, rather subjective
9 estimates.

10 Q. But what you've told me is you've told me
11 that there are different types of costs that the
12 company has embedded into its approved MBSSO. And
13 you've mentioned historic costs, current costs,
14 estimates of costs, but at the end of the day,
15 those are all different types of cost components,
16 aren't they?

17 MS. HOTZ: Well, John, could you explain
18 how your question is different than the last one
19 that you asked?

20 BY MR. FINNIGAN:

21 Q. If you could just answer the question,
22 Mr. Talbot.

23 MS. HOTZ: If you can.

24 THE WITNESS: Well, I think the answer
25 I'd give is the same: Namely, that there's some

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

1 elements which you can't really call costs.

2 BY MR. FINNIGAN:

3 Q. And what are those elements? Are those
4 the estimates?

5 A. The estimates.

6 Q. Okay. But they're estimates of costs;
7 correct?

8 A. I think the company's presentation of
9 those items is so vague -- if I may use that
10 word -- that I wouldn't call them cost-based.

11 Q. Well, I accept that you wouldn't call
12 them cost-based, but in the company's rationale
13 for the approved MBSSO where it presents estimated
14 components of the MBSSO, the company's
15 presentation or rationale is that those components
16 are estimated costs; correct?

17 A. Yes, but I think the costs or elements
18 that they're covering they regard as compensation
19 for risk-taking.

20 Q. Okay. Now, the approved MBSSO
21 incorporates a rate cap; isn't that correct?

22 A. Yes.

23 MS. HOTZ: Do you want to see a document?

24 Could you refer to a document in which
25 you're talking about the previous MBSSO?

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

1 MR. FINNIGAN: Sure. I'll get to that.

2 THE WITNESS: Let me answer that a little
3 more fully.

4 There are a number of cost items that I
5 don't think are capped, in fact.

6 BY MR. FINNIGAN:

7 Q. Right. But some are.

8 A. Fuel, for example.

9 Q. Some are.

10 A. Some are fixed numbers, yes.

11 Q. And so some elements of the approved
12 MBSSO feature a cap, other elements do not. Can
13 we agree on that?

14 A. Yes.

15 Q. Now, I want to change the focus a bit now
16 and I want to talk about the developments in
17 deregulated electric markets in other states.

18 You mentioned at the outset of your
19 deposition that one of the things you did to
20 prepare your written testimony and to prepare for
21 the deposition was to review developments in other
22 states.

23 Isn't it true that, in some other states
24 that have deregulated retail generation service,
25 there have been rate caps that have expired and

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

1 that those states now provide retail generation
2 service through a purely market process?

3 A. Yes.

4 Q. Okay. By the way, would you agree with
5 me that since the approved MBSSO has some
6 components that incorporate a rate cap, that that
7 would be another reason why it's not a pure market
8 rate?

9 A. Well, I don't really like the word "cap"
10 because, as I recall the components, they're fixed
11 prices for certain elements. Rather than caps,
12 they're, we'll say -- I don't think they can be
13 reduced down as I recall, either. So I would just
14 say they're fixed estimates, as well as
15 market-based estimates.

16 Q. Okay. And those fixed estimates act as a
17 cap in the sense that the -- that component of the
18 approved MBSSO cannot increase above or below that
19 capped level; isn't that right?

20 A. Well, a cap usually means a one-way
21 limitation. I think some of the estimates are
22 just estimates.

23 Q. Okay. But, shall we say, that those are
24 fixed components of the MBSSO, so that in a given
25 year, the MBSSO can't change either above or below

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

1 that component.

2 A. Some of the components are fixed, yes.

3 Q. Would you agree that the fact that the
4 approved MBSSO contains some fixed components,
5 that that can protect consumers against the cost
6 of retail generation service going above that
7 level, that fixed level, during the year that the
8 plan is in effect?

9 A. Yes. In circumstances where market
10 prices might go up more than the standard service
11 offer price in aggregate, it would protect
12 consumers.

13 Q. Now, other elements of the MBSSO are
14 uncapped. Like fuel, I believe, is one example
15 that you used; correct?

16 A. Yes.

17 Q. And for a component like fuel, the
18 consumer is going to pay whatever the actual costs
19 are, those are just flowed through somewhat --
20 well, not somewhat, really, the same as formerly
21 occurred under traditional regulation for that
22 component of the MBSSO; would you agree?

23 A. Yes. There are basically three trackers.
24 The FPP, the AAC, and the SRT are all cost
25 tracking, and as I recall, also with

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

1 reconciliation. So that any deviations of actual
2 from -- from estimated -- initially estimated or
3 forecasted are reconciled subsequently.

4 Q. Yes.

5 And what is your understanding of what
6 components of the approved MBSSO are fixed?

7 A. Little g, which would also be called, I
8 think -- a version of it, I think, would be called
9 the tariff generation charge, TGC; the
10 infrastructure maintenance fund, the IMF; and the
11 rate stabilization charge, the RSC.

12 Q. Okay.

13 A. I believe those are fixed.

14 Q. Okay. Very well.

15 Now, I started to ask you about the
16 experiences in some other states where rate caps
17 have expired.

18 What states are you aware of that have
19 deregulated retail generation service and have had
20 rate caps that have now expired such that
21 consumers are subject to pure market pricing in
22 those states?

23 A. The articles that I've been reading have
24 referred to future ending of the transition
25 period, not past.

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

1 Q. Okay.

2 A. And a number of states are on the verge,
3 I believe, of ending their transitional periods
4 and there's apprehension that costs might rise
5 very significantly.

6 Q. So you're aware of no states where market
7 caps have already expired such that consumers are
8 paying purely market prices?

9 A. I don't recall that happening -- having
10 happened already, but it may have.

11 Q. Okay. And these other states that you
12 mentioned that are on the verge of having their
13 rate caps expire, I take it that you followed
14 proceedings in those states which have indicated
15 that they're likely to experience high increases
16 for generation service when the rate caps actually
17 do expire?

18 A. Yes. I was reading about Illinois, for
19 example. There's a lot of apprehension that the
20 caps, when ended, the prices will go up very
21 substantially.

22 Q. Did you follow the recent competitive
23 bidding process in Illinois that was certified by
24 the state utility commission at the end of 2006?

25 A. No.

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

1 Q. Do you know what megawatt price was
2 produced through the competitive bidding process
3 for retail consumers in Illinois?

4 A. No.

5 Q. Are you aware of reports in other states
6 that have deregulated retail generation service
7 that consumers have experienced substantial
8 increases in the price of -- in a magnitude of
9 60 percent or greater in some states?

10 A. I'm aware of the fear or threat of prices
11 rising by that order of magnitude. I seem to
12 recall 50-something percent in one case.

13 Q. Is 50 percent the highest report that
14 you've seen of generation services either taking
15 effect or expected to take effect in the near
16 future?

17 A. The numbers that I recall go up into the
18 50s.

19 Q. Okay. That's the highest magnitude of
20 increase you've seen?

21 A. That's all I recall, yeah.

22 Q. Okay. In those states that have
23 experienced or are soon expected to experience
24 such high increases, is it your understanding that
25 the power's procured through a competitive bidding

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

1 process?

2 A. I believe it is in some of them. I'm not
3 sure about all of them.

4 Q. Okay. Now, if Ohio were to adopt a
5 competitive bidding process for obtaining power
6 for retail consumers, would you expect to see
7 increases of a similar order of magnitude that are
8 expected to take effect in these other states;
9 that is, increases in the magnitude of 50 percent
10 or greater?

11 MS. HOTZ: Objection. Beyond the scope.
12 You can go ahead and answer if you can.

13 THE WITNESS: I don't know what the --
14 what the effect will be.

15 BY MR. FINNIGAN:

16 Q. Do you have any expectation of what
17 increases would be expected to incur through --
18 occur through a competitive bidding process if one
19 were adopted in Ohio?

20 MS. HOTZ: Same objection.

21 THE WITNESS: No expectation.

22 BY MR. FINNIGAN:

23 Q. You didn't recommend in your present
24 testimony that Ohio adopt a competitive bidding
25 process for procuring power, did you?

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

1 A. What I recommended is that the Commission
2 should adopt a process which would either move the
3 company back towards a more competitive situation,
4 competitive pricing, or back towards a tighter
5 cost-based standard service offer.

6 Q. That's what I understood you to
7 recommend.

8 As I understood it, your recommendation
9 was that you objected to the fact that such a
10 large component of the company's generation charge
11 was nonbypassable; is that correct?

12 A. Yes, that's correct.

13 Q. And your recommendation was that, and I
14 understood this to be your primary recommendation,
15 that the company's generation charge should be 100
16 percent bypassable; is that fair?

17 A. Correct.

18 Q. And your secondary recommendation was
19 that if the Commission did not adopt your primary
20 recommendation, then you recommended going more
21 towards traditional cost-based pricing as a proxy
22 for a market price.

23 A. My testimony refers to this year and
24 next. Really, I'm not looking at the period
25 beyond. In that time frame, it's probably more

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

1 realistic to talk about tightening up on costs
2 rather than introducing new procedures to get more
3 to a competitive market.

4 Q. Right.

5 But in neither one of those
6 recommendations are you recommending that the
7 Commission adopt a competitive bidding process
8 that would be used to obtain power for retail
9 consumers through the end of 2008.

10 A. All I've said is that if the Commission
11 does not want to go back to a tighter cost-based
12 proxy for prices, that it should introduce more
13 competition, but I've not been specific about a
14 competitive bid process at this point.

15 Q. And the way you would recommend the
16 Commission encourage competition would be to make
17 the company's generation charges 100 percent
18 bypassable; isn't that correct?

19 A. I believe that would help.

20 Q. And you don't make any recommendation in
21 your present testimony that was filed in 2007 that
22 the Commission adopt a competitive bidding process
23 for procuring power through 2008.

24 A. I don't believe I've made any specific
25 recommendations with regard to, you know, the way

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

1 competition would be implemented or competitive
2 pricing would be set.

3 Q. Okay. Now, even though you did not
4 address this in your testimony in 2007, you did
5 make that recommendation in your 2004 testimony;
6 isn't that correct?

7 A. As I recall, yes.

8 Q. Okay. And have you had a chance to
9 review that 2004 testimony in preparation for
10 today's deposition?

11 A. Frankly, no.

12 Q. Well, you mentioned that you recalled
13 making that recommendation. I'm just curious why
14 you explicitly made that recommendation that the
15 Commission adopt a competitive bidding process in
16 your 2004 testimony and you didn't make it in your
17 2007 testimony.

18 MS. HOTZ: Objection.

19 BY MR. FINNIGAN:

20 Q. Why is that?

21 MS. HOTZ: Beyond the scope of his
22 testimony.

23 MR. FINNIGAN: Well, his 2004 testimony
24 is still part of the record.

25 MS. HOTZ: But the 2004 is beyond the

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

1 scope of his 2007 testimony.

2 THE WITNESS: Well, I think time frame
3 enters into the issue because we're dealing with
4 rates now that are currently already in place,
5 subject to a possible true-up as a result of this
6 hearing, as I understand, and whatever the
7 Commission decides to do, which is never a
8 comfortable position for a Commission to be in.

9 But in any event, in the -- in the middle
10 of this two-year rate period, 2007, 2008, it would
11 not, I think, make sense to argue for a
12 competitive bidding process, which would have to
13 be established, which would have to be
14 implemented, prices obtained. It would -- It
15 would be a major proceeding. It would probably
16 not even be over or be over about the time that
17 the end of this period occurred.

18 BY MR. FINNIGAN:

19 Q. That was what I assumed was the reason
20 you weren't recommending that in your current
21 testimony, because this plan that is before the
22 Commission at this time is only a plan to approve
23 a market price through the end of 2008. Isn't
24 that what you understand is the focus of the
25 Commission's mandate from the Supreme Court at the

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

1 present time?

2 A. Yes, and the focus of my testimony.

3 Q. And the focus of your testimony.

4 So, really, here we sit in March of 2007,
5 and even if the Commission were to adopt a
6 competitive bidding process for procuring power
7 through the end of 2008, that wouldn't give very
8 much time, as you mentioned, to implement such a
9 process, would it?

10 A. No.

11 Q. And in addition to not having much time
12 to implement the process, it could produce very
13 volatile prices and very high increases for
14 consumers, couldn't it?

15 MS. HOTZ: Objection. Beyond the scope.

16 THE WITNESS: I really haven't looked
17 into the specifics. There are all sorts of ways
18 in which one can avoid unreasonable prices
19 resulting from a process. One can have staggered
20 contracts. One can -- One can withdraw the offer.
21 I think the State of Maine, for example, and I
22 think other states, too, have not accepted the
23 bids.

24 BY MR. FINNIGAN:

25 Q. Because they've been so high.

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

1 A. Because they've been so high.

2 Q. Right.

3 A. And so they've said, "Well, we'll wait it
4 out for a while, have some stopgap measure for
5 maybe six months or a year, and then we'll go back
6 to the market", and they have, and that's been
7 acceptable to them.

8 Q. What was their stopgap measure?

9 A. I think it was, in the case of Maine, I
10 think they just continued what you might call a
11 transitional period, more or less traditional
12 ratemaking.

13 Q. With any caps on rates?

14 A. I think the rates were set, actually,
15 under the -- under the previous regimen, if you
16 will.

17 Q. So just traditional cost-based ratemaking
18 as if --

19 A. I think so.

20 Q. -- you know, deregulation never existed.
21 That's your understanding of what happened in
22 Maine?

23 A. I think so, yeah.

24 Q. But in any event, do you regard that as a
25 satisfactory stopgap approach or solution to

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

1 protecting customers from high increases, that is,
2 whatever approach was adopted in Maine?

3 MS. HOTZ: Objection. Beyond the scope.

4 THE WITNESS: Yeah. I don't know the
5 answer to that right now.

6 BY MR. FINNIGAN:

7 Q. Now, would you agree that, in this case,
8 the approved MBSSO also is one possible stopgap
9 solution to protect consumers from huge increases?

10 A. I've not recommended it, but yes, it is.

11 Q. Okay. And even though it's not your
12 recommendation, wouldn't you agree that a
13 reasonable commission could conclude that this is
14 a just and reasonable price that protects
15 consumers from huge increases?

16 A. No, I don't think they can. I've -- In
17 my testimony, I've gone into this issue of a
18 reasonable price and it is hard for me to find
19 that this is a reasonable price.

20 Q. Well, haven't you or your firm
21 recommended to state commissions that they
22 maintain rate caps in this transitional period
23 like we're experiencing in Ohio now to protect
24 consumers from huge increases?

25 MS. HOTZ: Objection. Beyond the scope.

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

1 THE WITNESS: I have balked at calling
2 this a rate cap. I've said that there are
3 fixed -- some fixed elements to it. Now, if those
4 fixed elements turn out to be at a lower level
5 than any -- that any bidding process would do,
6 regulatory process might result in, then to that
7 extent, it's a savings. We don't know, however --
8 BY MR. FINNIGAN:

9 Q. To that extent, it would operate as a
10 cap; right?

11 A. As a cap --

12 Q. Yes.

13 A. -- to that extent.

14 Q. Yes.

15 A. But we don't know -- You know, for
16 example, we all know there's financial turbulence
17 these days. And if we were finally to get a
18 recession, which is in ordinary economic terms
19 about due, prices might go down very
20 substantially. You know, it's very hard to
21 predict.

22 Q. There's a risk that market prices for
23 power could go up or they could go down.

24 A. Yes.

25 Q. That risk is always present, isn't it?

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

1 A. It is.

2 Q. And that could happen without any advance
3 notice. We don't really know what tomorrow will
4 bring; right?

5 A. We don't know.

6 Q. And that's the kind of risk that
7 consumers face, as well as suppliers, as well as
8 electric distribution utilities.

9 A. It affects both -- both sides of the
10 market, people with assets and products to sell,
11 buyers with products to buy.

12 Q. And the risk or one problem that
13 suppliers and consumers both equally face is that
14 if they enter into a fixed-price contract, if
15 the -- their cost or the market price goes up or
16 down below that contract, there's going to be one
17 winner and one loser; right? In other words,
18 somebody is going to end up having contracted for
19 a higher or a lower price for power than what
20 would be available from the market?

21 A. Yes. Any fixed-price contract for fixed
22 prices in the future is a bet, if you will, or if
23 you look at it the other way around, taking a bet
24 off the table and getting yourself a certainty.

25 Q. Okay. And that bet entails some risk

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

1 that market prices are going to be different and
2 whoever entered into that arrangement could suffer
3 some losses.

4 A. Yes. They could suffer compared with
5 what they would have done, but there is a
6 difference there that where you enter into a fixed
7 contract that covers an open position that you had
8 before, to use all this jargon now in the --
9 that's current in the financial markets.

10 For example, if you are an automobile
11 manufacturer that needs steel for the year ahead,
12 you think you can sell your cars for a certain
13 amount and you can pay such -- you can afford such
14 and such an amount for steel, and you enter into
15 forward contracts to buy steel, you've covered
16 that risk of prices going up. You've also lost
17 the opportunity of buying it more cheaply if the
18 prices go down.

19 Now, if the price of your product goes
20 up, or goes down, of course, you are left with
21 that. So you're still exposed in that sense,
22 unless you could persuade buyers to forward buy
23 your cars, in which case you'd be covered on every
24 front, and then you'd have a totally covered
25 position.

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

1 Q. Okay. Now, the approved MBSSO is a fixed
2 price that the company commits to for a year at a
3 time; isn't that right?

4 A. Well, the elements are fixed. The
5 elements adjust and track.

6 Q. Right.

7 Now, suppliers who are entering the
8 company's market, or already present in the
9 company's service area, are not required to enter
10 into any fixed contract for any particular period
11 of time; is that right?

12 A. Could you just clarify which -- which
13 type of suppliers you're thinking of?

14 Q. Well, any competing supplier like
15 Constellation can come in and make whatever price
16 arrangements with the consumer that they choose to
17 make.

18 A. They can.

19 Q. They're not required to lock in their
20 price for any particular period of time, are they?

21 A. Well, there are one or two provisions
22 which require companies that switch --
23 nonresidential customers that switch to enter into
24 contracts to the end of 2008, I think. So to that
25 extent, there's a limit on the contracts imposed

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

1 by the standard service offer terms.

2 Q. That's if they want to avoid some of the
3 company's otherwise nonbypassable charges; isn't
4 that correct?

5 A. Yes.

6 Q. Okay. And that ability to avoid some of
7 those charges is only available to a certain
8 percentage of each customer class; isn't that
9 right?

10 A. Yes.

11 Q. Okay. Now, the other differentiating
12 factor for competing suppliers like a
13 Constellation versus an electric distribution
14 utility like Duke Energy Ohio is that a company
15 like Constellation can come into a market at any
16 point in time and decide to compete; in other
17 words, their price does not have to remain in
18 effect for a full calendar year; isn't that right?

19 A. Yes.

20 Q. Now, going back to experiences in other
21 states that you say that you follow.

22 Isn't it true that in these other states
23 where rate caps are expected to expire in the near
24 future, there's even been some discussion and
25 actually legislation introduced to return to some

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

1 form of regulation out of the fear that consumers
2 will experience such huge increases under the
3 current regime of deregulation?

4 A. Yes, I believe so. There was certainly
5 talk about it. I don't know if any states are
6 going to do it.

7 Q. Didn't Delaware actually enact a law
8 introducing some form of reregulation?

9 A. I forget.

10 Q. Okay. And what about Virginia, haven't
11 there been published reports that the legislature
12 has introduced a bill awaiting the governor's
13 signature to introduce some form of reregulation?

14 A. Yes. I've read about that.

15 Q. And what about Texas, haven't there been
16 reports that if prices don't fall to a certain
17 level this year in the Texas market, that
18 legislation will be introduced returning to some
19 form of reregulation?

20 A. I didn't follow that.

21 Q. What about Connecticut, hasn't there been
22 a report recommending that some legislation be
23 introduced to return to some form of reregulation?

24 A. I don't recall.

25 At an earlier time, I could mention that

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

1 I worked for the State of Arkansas and what
2 happened there was what happened in a number of
3 states. About half the states, actually, decided
4 not to go through with deregulation.

5 Q. Yes. You mentioned that in your initial
6 testimony, that you consulted with Arkansas at the
7 time they were contemplating introducing
8 deregulation and they simply stopped in their
9 tracks and didn't proceed with that any further;
10 isn't that right?

11 A. That's correct. They figured out that
12 the price would be higher.

13 Q. They were probably glad that they did
14 that.

15 A. I think they were glad. It's like they
16 didn't vote for the war.

17 Q. Do you know whether any other states like
18 Ohio have requested the electric distribution
19 utilities to introduce or to extend some form of
20 rate plan that would protect consumers from huge
21 price increases?

22 A. I'm not recalling one in particular, but
23 I expect so, that they would have, yeah.

24 Q. In fact, haven't this -- hasn't this
25 expectation of huge price increases from having

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

1 rate caps expire led to a lot of political turmoil
2 in these reports that you've read from other
3 states?

4 Like, you know, one report I've read is
5 that in Maryland the legislation was passed firing
6 all of the state utility commissioners because
7 they approved some huge rate increases to take
8 effect after the rate caps would expire.

9 Have you read that report, too?

10 A. I wasn't aware of that one, but I
11 certainly remember reading quite controversial, if
12 you will, reports of great controversy surrounding
13 this issue.

14 Q. Have you read the report that the
15 Governor of Illinois wrote a letter to the state
16 commissioners stating that they would be acting in
17 gross neglect of their duties and acting
18 incompetently if they approved the results of a
19 competitive bid process that would result in huge
20 increases for retail customers?

21 A. I know that Illinois was or is a state
22 where there's a lot of controversy. I don't
23 recall the details, but all around this issue of
24 the prices going up.

25 Q. There's been a lot of political turmoil

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

1 about the fact that rate caps either have expired
2 or are scheduled to expire soon.

3 A. Yes.

4 Q. Okay. Now, let's talk about the cause of
5 price increases in those states where the rate
6 caps are expected to expire.

7 Would you agree with me -- Well, why
8 don't you discuss that. What is the cause of such
9 huge increases in these states where rate caps are
10 expiring?

11 MS. HOTZ: I object.

12 BY MR. FINNIGAN:

13 Q. What's your understanding?

14 MS. HOTZ: It's beyond the scope of his
15 testimony.

16 THE WITNESS: I think it is rather beyond
17 the scope.

18 BY MR. FINNIGAN:

19 Q. Well, you have to make some
20 recommendation as to, you know, what market price
21 is in effect in Ohio; you've done that. One of
22 the things you've done to prepare is you've
23 reviewed developments in other states. And that's
24 all I'm asking you about. So I'm just asking you
25 about the background, what you reviewed to prepare

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

1 for your testimony and, you know, that's -- that's
2 all I want to ask you about.

3 MS. HOTZ: I think that's more than he
4 needed to do to prepare for this testimony.

5 MR. FINNIGAN: It may be more than he
6 needed to do, but the fact is that he did do it.
7 So I feel like it's fair game for me to ask him
8 and to explore that --

9 MS. HOTZ: I don't think it's fair game.

10 MR. FINNIGAN: -- because he said that
11 was part of his preparation.

12 MS. HOTZ: I think that maybe a certain
13 amount of it may have been part of his
14 preparation, but I think what you're asking him is
15 very theoretical and far beyond what -- beyond
16 what we asked him to do.

17 BY MR. FINNIGAN:

18 Q. Well, let me just ask you, Mr. Talbot,
19 what is your understanding of the cause for such
20 huge increases in retail generation prices in
21 these states where rate caps are soon to expire?

22 A. I don't want to be facetious, but it does
23 depend.

24 Q. That was that same answer --

25 A. Yes, yes, I was thinking that.

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

1 Q. -- that the other witness adopted.

2 A. Yes. It depends.

3 Q. I was thinking of that, too.

4 A. Fuel prices would be one element,
5 although I think they're going down a little bit
6 now, and they may go down more, but that would be
7 one. And the other would be the basic cost of
8 generation, embedded costs of capacity, et cetera,
9 may be lower than the cost of acquiring capacity
10 in the marketplace.

11 Q. Well, isn't one cause that the market
12 structure, that is, the way the prices are set
13 when rate caps expire, is the prices are set based
14 on the market clearing price, which is the highest
15 price of generation available in that market?

16 A. Yes. As I think I pointed out somewhere
17 in my testimony, when the marginal or incremental
18 resource used in generation is natural gas, which
19 we know has gone up a lot compared with the \$2 or
20 whatever it was per unit way back, if that sets
21 the price in the market at least for some periods
22 of the day, it's going to increase prices.

23 Q. Really dramatically, won't it?

24 A. It can.

25 Q. And hasn't gas gone up as much as from \$2

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

1 an Mcf in the early '90s to as much as \$10 an Mcf
2 at the present time?

3 A. Went up to more than that. It's back
4 down. I don't know how far back it's gone down,
5 but it's still a multiple of the \$2 that it was a
6 few years ago.

7 Q. Was that right after Hurricane Katrina
8 that caused the most recent spike that you're
9 aware of?

10 A. That did, and I think it already had a
11 run of increases after many years of relative
12 stability.

13 Q. And would you agree that in Ohio, as in
14 most other markets, gas-fired generators are the
15 most expensive source of generation?

16 A. For many markets. Certainly for many
17 markets, they are, yes.

18 Q. And in Ohio, too, is that your
19 understanding?

20 A. Yes.

21 Q. Now, would you agree with me that another
22 cause for the huge increases in these states where
23 market caps are going to be expiring is the fact
24 that the wholesale markets haven't really fully
25 developed at this present time?

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

1 MS. HOTZ: Beyond the scope.

2 THE WITNESS: Do I answer anyway?

3 MS. HOTZ: Yes, you do.

4 THE WITNESS: Yes.

5 BY MR. FINNIGAN:

6 Q. And what are the problems that exist in
7 the wholesale markets that have prevented them
8 from fully developing?

9 A. The electricity market isn't like the
10 market for, let's say, corn, although that's got
11 its own features.

12 Q. That's more of a commodity; correct?

13 A. It's a commodity.

14 And the problem with electricity,
15 obviously, it's regionally generated and
16 regionally consumed. So it all depends on the
17 ability to get power from where it's generated to
18 where it's needed. And within the relatively
19 limited market areas that result from that, it
20 certainly seems to have been the case that there's
21 been some monopoly power, or oligopoly power,
22 where a few sellers may be able to manipulate
23 prices to their advantage. So I'd say that's the
24 primary issue where you have --

25 MS. HOTZ: Excuse me. Would you like

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

1 some water?

2 THE WITNESS: No, I've got my coffee.

3 Thank you.

4 -- where you have the insufficient
5 development of competition.

6 BY MR. FINNIGAN:

7 Q. Is that because the rules have not fully
8 developed in these wholesale markets to allow for
9 the introduction of competition at the wholesale
10 level?

11 A. Yes. I think it is a regulatory problem
12 that works together with the physical problem of
13 getting the power from Point A to Point B, and the
14 regulators have generally been quite reluctant to
15 break up the old generation entities.

16 Take Texas as an example. There are
17 limits to what the old generators can -- could
18 retain of their generation when the market was
19 deregulated, but probably not enough limits or
20 tight enough limits. So that in that market, I
21 think there has been some -- some ability to
22 affect the price, compounded by the fact that
23 Texas is more or less isolated from the rest of
24 the grid.

25 Q. Well, even in wholesale markets where

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

1 electric distribution utilities fully divested
2 their generating assets, those wholesale markets
3 have experienced major problems, too, haven't
4 they?

5 A. They've experienced problems, yes.

6 Q. And in the present case when we talk
7 about Duke Energy Ohio, the wholesale market that
8 Duke Energy Ohio is in is the Midwest ISO;
9 correct?

10 A. Yes, and neighboring markets.

11 Q. Okay. And would you agree that the
12 Midwest ISO is like other wholesale markets we've
13 been talking about that hasn't fully developed in
14 terms of supporting effective wholesale
15 competition at the present time?

16 MS. HOTZ: Objection. Beyond the scope.

17 THE WITNESS: I don't know the answer to
18 that question.

19 BY MR. FINNIGAN:

20 Q. Okay. If that were the case, would you
21 agree that, you know, we couldn't really have
22 fully effective retail competition until we've got
23 fully effective wholesale competition?

24 A. You don't want to let perfection get in
25 the way, necessarily. More or less effective

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

1 competition can work quite well.

2 Q. Okay. Do we have that? Do we have a
3 state of affairs at the Midwest ISO where the
4 wholesale competition has developed sufficiently
5 well to support effective retail competition?

6 A. I don't know the answer to that question.

7 Q. If not, if the wholesale market were not
8 fully developed, wouldn't it be advisable for the
9 PUCO to adopt some type of interim measures in the
10 short-term that would protect consumers from huge
11 price increases?

12 A. If that were the case.

13 Q. Okay.

14 A. Yes.

15 Q. Now, in the present case, we've got these
16 rate stabilization plans that have been introduced
17 in Ohio. That's what the approved MBSSO is, it's
18 a form of a rate stabilization plan; correct?

19 A. Yes. Reading back over the Commission's
20 orders in 2004, it seemed that the Commission
21 determined that at that point the market was not
22 yet fully developed. So the Commission was
23 reluctant to adopt the kind of rate plan that the
24 company had before, I think, in the CMO standard
25 service offer --

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

1 Q. Okay.

2 A. -- and instructed the company, as I
3 recall, to establish or propose a more stable
4 pricing system as in the so-called RSP.

5 Q. Yeah. And that's what the approved MBSSO
6 is, it's an RSP that provides some degree of
7 stable pricing.

8 A. Yes.

9 Q. And is it your understanding that other
10 Ohio EDUs, or electric distribution utilities,
11 also offer similar rate stabilization plans?

12 MS. HOTZ: Objection. Beyond the scope.

13 THE WITNESS: I haven't looked at the
14 other companies.

15 BY MR. FINNIGAN:

16 Q. So you made no -- Well, strike that.

17 Now, in this case, you criticized Duke
18 Energy Ohio's approved MBSSO because such a high
19 component of the generation charge is not fully
20 bypassable; is that correct?

21 A. That's the primary objection, yes.

22 Q. Yes.

23 And you stated that it was, I believe,
24 13.4 percent of the cost was not fully bypassable.
25 I believe you mention that at Page 21 of your

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

1 testimony.

2 A. I do. Actually, I noticed that the
3 percentage is a bit higher, actually, because I
4 put the AAC under fully bypassable, but, in fact,
5 it is not. If you add in -- If you add in the
6 5.3 percent of this total tariff that -- or, the
7 total revenues, actually, that correspond with the
8 AAC revenues, you get a total of 81.3 percent
9 that's fully bypassable and 18.7 percent that is
10 not fully bypassable. It's a correction that I
11 should probably make on the witness stand.

12 Q. Is that the only change that you would
13 want to make to that chart on Page 21 at the
14 present time?

15 A. I believe it is, yes.

16 Q. And that's moving the AAC from bypassable
17 into nonbypassable.

18 A. To not -- Yeah, not fully.

19 Q. Not fully bypassable.

20 A. Not fully bypassable.

21 Q. Now, would you agree that what you've
22 categorized as not fully bypassable elements of
23 the approved MBSSO are bypassable by some
24 percentage of consumers?

25 A. Yes.

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

1 Q. Okay. And I want to introduce a chart
2 that compares to the one you did at Page 21 of
3 your deposition testimony and talk about that for
4 a moment.

5

- - -

6 Thereupon, Talbot Exhibit No. 1 was
7 marked for purposes of identification.

8

- - -

9 BY MR. FINNIGAN:

10 Q. Okay. There you are, Mr. Talbot.

11 I've handed you a document that's marked
12 as Talbot Exhibit No. 1, and I'll represent to you
13 that that's a chart that we prepared that
14 describes the different elements of Duke Energy
15 Ohio's approved MBSSO and breaks them down into
16 bypassable versus nonbypassable components for the
17 first 25 percent or more in some cases of
18 residential consumers.

19 Now, why don't you take a few moments to
20 look that over and let me know when you've had a
21 chance to study that for a few moments because I
22 want to ask you a few questions about it.

23 (Pause.)

24 A. Yes, I think I -- I think I see what
25 you've done.

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

1 Q. Okay. Now, with regard to the different
2 elements of the approved MBSSO that are under
3 "Rate Component", do you agree that that lists all
4 the elements of the approved MBSSO?

5 A. Yes.

6 Q. And with regard to the 2006 revenue
7 amounts, do you agree that those are accurate?

8 A. Yes.

9 Q. Because those are the same numbers you
10 used to prepare your table on Page 21, aren't
11 they?

12 A. Yes. I should say that they depend on
13 the company's response that I referred to.

14 Q. All right. But it's certainly an
15 apples-to-apples comparison if we're going to take
16 the data you used and the data that we used for
17 this table that's Talbot Exhibit 1; right?

18 A. Yes. The data appears to be all the
19 same.

20 Q. Okay. Now, understand that we're -- what
21 we're attempting to portray here is the percentage
22 of the company's generation charge that is not
23 fully bypassable for the first 25 percent of
24 residential consumers. Do you understand that
25 that's what the company's attempting to portray in

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

1 Talbot Exhibit No. 1?

2 A. I should note one point here. My table
3 referred to residential and nonresidential.
4 Whether the percentages are identical for
5 residential, I'd have to think about it, but they
6 may well be, but I'm not absolutely sure.

7 Q. Okay. Well, let's just keep it simple
8 and stick to residential consumers for the moment.

9 But do you understand that what the
10 company is attempting to represent in Talbot
11 Exhibit No. 1 is the percentage of the company's
12 generation charge that is not fully bypassable by
13 the first 25 percent of residential consumers?

14 A. Yes.

15 Q. Okay. And do you believe that Talbot
16 Exhibit 1 does accurately represent the percentage
17 of the company's generation charge that's not
18 fully bypassable by the first 25 percent of
19 residential consumers?

20 A. Well, I have a slightly different
21 definition. I've said not fully bypassable. I
22 think those figures are correct.

23 The company has separately said -- asked
24 the question which of these charges are partially
25 bypassable, and then it's netted those out and

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

1 come down to which charges are totally
2 nonbypassable. So it's just broken it down a
3 little more -- a little further than I did.

4 Q. Right.

5 And one way to characterize it is
6 partially bypassable, but another way that would
7 accurately characterize Talbot Exhibit 1 is to say
8 that this is a depiction of charges that are fully
9 bypassable by the first 25 percent of residential
10 consumers; isn't that right?

11 A. Yes.

12 Q. And it accurately portrays that
13 information, doesn't it, to the best of your
14 knowledge?

15 A. Yes, with one -- with one cautionary
16 note. And that is that the system reliability
17 tracker figures for 2006 are a negative item and,
18 clearly, that's an anomaly in the long run based
19 on the fact of presuming it was over-recovery in
20 the previous period and now some is being tracked
21 back, flowed back to customers. So assuming that
22 would normally be a positive figure, yes, that's
23 accurate.

24 Q. Okay. Now, with respect to the system
25 reliability tracker, are you aware that for 2007

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

1 the company has presented a claim of approximately
2 \$8 million for that component of the approved
3 MBSSO?

4 MS. HOTZ: Which component was that?

5 MR. FINNIGAN: The system reliability
6 tracker.

7 THE WITNESS: Eight million?

8 BY MR. FINNIGAN:

9 Q. Yes. Approximately eight million.

10 A. Subject to check, I'd accept that.

11 Q. Okay. I better --

12 MR. FINNIGAN: Let's go off the record.

13 (Discussion held off the record.)

14 MR. FINNIGAN: Let's go back on the
15 record.

16 BY MR. FINNIGAN:

17 Q. Let's assume that the amount of the SRT
18 cost, excluding any over-recoveries or
19 under-recoveries from prior periods, that the
20 company is claiming for 2007 is 8.8 million.

21 A. Yes.

22 Q. Now, with that assumption, could you
23 calculate how much of the company's generation
24 charge would be fully bypassable by the first 25
25 percent of residential consumers, that is, if you

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

1 substituted 8.8 million for the negative six
2 million in Talbot Exhibit 1?

3 A. I think you'd get a positive .8 of a
4 percent, something like that.

5 Q. Okay.

6 A. And then if you add in the three percent
7 for the IMF, you'd get 3.8 percent.

8 Q. Okay. So the total would change from
9 2.4 percent to 3.8 percent.

10 A. I believe so.

11 Q. And that 3.8 percent number would
12 represent the percentage of the company's
13 generation charge that's totally bypassable by the
14 first 25 percent of residential consumers.

15 A. Yes.

16 Q. Okay. Now, I take it that you have not
17 compared the company's -- Well, strike that.

18 Now, what kind of market does the first
19 25 percent of the company's residential consumers
20 represent? How many megawatts of load is that, to
21 your understanding?

22 A. I don't have a figure in mind.

23 Q. Okay. You did mention in your testimony
24 that the 2005 peak was something on the magnitude
25 of 4,000-some megawatts.

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

1 MS. HOTZ: Where was that?

2 MR. FINNIGAN: In his testimony.

3 MS. HOTZ: Where in his testimony?

4 BY MR. FINNIGAN:

5 Q. Do you remember where in your testimony
6 you mention that -- you mention the 2005 peak?

7 MR. WATHEN: It's on Page 31.

8 MS. HOTZ: Page 31.

9 MR. WATHEN: Line 19.

10 THE WITNESS: The number I estimated
11 there was 4,862 megawatts.

12 BY MR. FINNIGAN:

13 Q. Okay. Now, given the fact that that's
14 the peak load and given the fact that -- Well,
15 strike that.

16 A. That's for all customer classes, so it's
17 a little difficult to break down by customer
18 class.

19 Q. You've recommended in your testimony that
20 the Commission should approve a generation charge
21 as 100 percent bypassable; correct?

22 A. Yes.

23 Q. Now, would you agree that this generation
24 charge that's available to the first 25 percent of
25 residential consumers, that while not fully

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

1 bypassable, is bypassable by 96.2 percent of those
2 consumers, is a reasonably priced -- reasonably
3 priced service?

4 A. No, I haven't said that. The
5 bypassability was only really one of my -- one of
6 my concerns, a very major one, admittedly.

7 Q. You said earlier it was your primary one;
8 right?

9 A. Well, it's a major concern.

10 The other major concern, and I don't want
11 to put secondary on it -- I don't want to label it
12 secondary, was the basis of these charges is
13 not -- is not sound.

14 Q. Okay. But, really, if such a high
15 proportion of the company's generation price is
16 bypassable by this first 25 percent of residential
17 consumers, regardless of how the company's market
18 price is constructed, if some supplier can beat
19 that price, they can come in and compete against
20 it, can't they?

21 A. They can, but the problem always is one
22 of tight margins in any business. You make -- You
23 cover your overhead and your profits from your
24 margin.

25 For example, if you're a retailer of

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

1 electricity, you will buy electricity in the
2 marketplace or generate it, incurring costs in
3 doing so. And you will sell it, hopefully, for
4 the cost plus a margin, which we talked about
5 earlier.

6 That margin is going to be very -- It's
7 going to be very difficult to get any margin if
8 you have to compete with a 3.8 percent charge,
9 which your customer's going have to pay, or you're
10 going to have to, in effect, pay for your
11 customer, as well as your own costs. It's going
12 to be a big -- much bigger percentage of your
13 margin. It might be 100 percent of your margin.

14 Q. Well, isn't it true, though, that the
15 electric distribution utility has certain costs
16 that it has to incur and recover that suppliers
17 don't face -- other suppliers don't face?

18 A. I think that line of reasoning is not a
19 useful one for purposes of designing a deregulated
20 marketplace, or deregulated generation, or
21 correctly, price generation.

22 I think that charges that are not
23 bypassable should be in the generation component.
24 To the extent the charges -- certain charges need
25 to be recovered by the EDU, electric utility, for

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

1 its legacy role, and historical role, and current
2 role of distribution of electricity, that's the
3 right place for those charges to be.

4 Q. Well, isn't it true that what the
5 Commission has to do is it has to balance
6 competing concerns, and those competing concerns
7 are protecting the consumers against huge price
8 increases and assuring the EDU of some financial
9 stability and also encouraging competition? Those
10 are the competing interests that the Commission
11 has to weigh; isn't that correct?

12 A. Yes.

13 Q. And to the extent that the Commission
14 approves some component of the generation price as
15 a nonbypassable charge, that assures the EDU of
16 some degree of financial stability; isn't that
17 correct?

18 A. The problem about putting it in a
19 nonbypassable generation charge is that you're
20 undermining the competitive market. That's my
21 point.

22 Q. Right. And I agree with you, but I guess
23 the point I'm trying to make is that these are
24 competing or conflicting considerations that the
25 PUCO has to balance; isn't that right?

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

1 A. I wouldn't -- I wouldn't see them as
2 necessarily conflicting. I think if you have
3 appropriate pricing of distribution and a -- and a
4 situation in which competitive retailers have to
5 take on capacity responsibilities similar to that
6 of the utility, you can have a situation where you
7 don't -- you shouldn't need to have a conflict
8 between the fostering of competition and the
9 financial soundness of the utility.

10 A utility should be able to receive a
11 fair price for the generation that it provides, or
12 a market price, if you will, but customers should
13 be able to shop around.

14 Q. Let us assume that utilities are required
15 to offer all the essential electric services and
16 make those available to all consumers in their
17 service area, and that's not a requirement that's
18 placed on suppliers, and that the Commission is
19 restricted from placing that requirement on
20 suppliers and taking it away from EDUs, okay? Do
21 you understand the assumption I'm asking you to
22 make?

23 A. I think so. To the extent that the EDU
24 has a responsibility greater than that of the --

25 Q. Go ahead.

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

1 A. -- competitive retailer, that could be
2 the basis for some reasonable protection of the
3 utility.

4 Q. And the way you would protect the utility
5 in that circumstance is that you would make some
6 component of their generation charge
7 nonbypassable.

8 A. I don't think it's the best way to go.

9 Q. But it's one way to go.

10 A. It is one way to go.

11 Q. And it's one way to go that a commission
12 could elect to take under a reasonable approach to
13 balancing these competing considerations of
14 protecting consumers against huge increases,
15 assuring the utility of financial stability, and
16 encouraging competition.

17 A. I think, you know, you throw the baby out
18 with the bath water when you do that, because, you
19 know, the facts are in. The competitive effort by
20 competitive retailers has faltered and gone into
21 reverse. So that I think, you know, in a sense
22 here, you've got an animal or a person who is
23 diseased and you're trying to diagnose why, why is
24 there no competition. Because these three
25 components of vitality, let's say, utilities'

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

1 vitality, the consumers, and the -- and the
2 competitive provider, the competitive provider is
3 dead.

4 This is a bad situation. One of the --
5 One of the organs of this animal is not alive, so
6 you want to look at it and you want to say why?
7 So if you look for the reason, it has to be, I
8 think, in the -- in the nonbypassable charges.
9 And possibly there are other elements of, you
10 know, restrictive practices or something which I
11 haven't gone into, but just in the pricing arena,
12 that's the element that I would -- I would focus
13 on.

14 Q. So you would conclude, to use your
15 analogy, that the cure is worse than the disease,
16 the disease being not having fully effective
17 retail competition, and the cure being the
18 approved MBSSO. The cure was worse than the
19 disease.

20 A. I don't think the cure was very well
21 designed.

22 Q. The cure killed the patient.

23 A. Well, it didn't -- Well, it killed that
24 portion. You know, that organ is dead at this
25 point. We're on kidney transplant or something

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

1 like that. This is getting into a stretch, but
2 anyway, you want to try and restore the patient to
3 health without some other organ going on the
4 blink, and you don't want the utility to be
5 financially embarrassed. Clearly, I don't think
6 that would make any sense. I don't think that
7 anyone would want that. The Commission certainly
8 wouldn't. The company certainly wouldn't. I
9 don't think it's good for the consumer.

10 So what you do want is to find a way, and
11 I think it is within the feasible options for the
12 Commission to find a way in which the bypassable
13 charges are large enough to encourage competition,
14 as well as keeping the company secure. And I
15 think part of the answer may be the requirement
16 that nonutility retailers should have similar
17 obligations in terms of that they should line up
18 and say, "Well, we have the capacity lined up like
19 the company has to, too".

20 Q. But let's stay under my assumption that
21 the PUCO has a restriction that they can't make
22 that requirement on competing suppliers, okay?

23 Now, under that assumption I'm asking you
24 to make, you've said that it is acceptable for the
25 Public Utilities Commission to approve -- approve

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

1 a market price that includes some component of
2 nonbypassable charges to protect an EDU's
3 financial stability; right?

4 A. Yes, but, and the but is that you
5 wouldn't want those charges to involve an overlap
6 with the charges that the competitive retailer has
7 to provide. That would be a double payment by the
8 customer. I think that is, to some extent, true
9 in the current arrangements --

10 Q. Okay.

11 A. -- because you -- there's no doubt that
12 competitive retailers have to provide some
13 capacity. They have to provide spinning reserves
14 and so forth to qualify as -- I think they're
15 called -- transmission customers and load-serving
16 entities in the Midwest ISO, and I've also no
17 doubt that they, to some extent, line up the
18 capacity that they need as well.

19 Q. Right.

20 A. So to that extent, those two components,
21 let's say the four percent, roughly, of reserve
22 margin that load-serving entities have to provide,
23 spinning reserves, et cetera, et cetera, and some
24 percentage of the remaining, if you will, 15
25 percent that the company's claiming for a -- for a

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

1 reserve margin, some portion of that remaining
2 11 percent is also duplicative with the companies.
3 We don't know how much.

4 Q. How is that? Let me ask you this: You
5 said in your testimony that four percent of the
6 generation charge that the company places in its
7 system reliability tracker is duplicative of what
8 suppliers charge because they have to provide
9 transmission service and they have to provide
10 ancillary services for their own customers; right?

11 A. Yes.

12 Q. And the cost for suppliers to do that is
13 four percent of their generation price; right?

14 A. The Regional Reliability Council and
15 Midwest ISO require a load-serving entity,
16 including a nonutility load-serving entity, to
17 provide --

18 Q. Transmission --

19 A. -- transmission and --

20 Q. -- and ancillary services.

21 A. -- ancillary services, correct.

22 Q. And the cost is four percent of that
23 supplier's generation service.

24 A. It's -- It's the cost of lining up a
25 margin of four percent, in effect, spinning

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

1 reserves and so forth.

2 Q. And transmission service.

3 A. And transmission.

4 Q. And what the company's system reliability
5 tracker recovers is 15 percent of generation cost;
6 correct?

7 A. Of peak demand -- It's the cost of
8 providing 15 percent reserve on top of the
9 company's peak demand, expected peak demand.

10 Q. Right.

11 A. Whatever that cost may be. The company
12 goes out and buys in the marketplace at the
13 margin.

14 Q. Okay. So where is the overlap? I mean,
15 it's the four percent of the supplier's cost
16 versus the 15 percent of the company's peak
17 demand. How much of the company's cost is not
18 overlapping with what the supplier pays or what
19 proportion of the company's generation cost to
20 maintain the reserve margin is not overlapping
21 with the supplier's requirement to incur costs for
22 transmission and ancillary services that they're
23 required to do under the Midwest ISO requirements?

24 A. Well, first you just put transmission
25 costs to one side. I believe that --

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

1 Q. No. No. I'm not doing that.

2 A. Well --

3 Q. Okay. I see what you're saying. You're
4 saying --

5 A. Transmission costs are, I believe,
6 bypassable.

7 Q. Right.

8 A. They're the responsibility of the -- of
9 the competitive retailer, CRES.

10 Q. Okay. But I'm only asking -- I'm asking
11 you to compare that you've lumped in transmission
12 and ancillary services in your calculation of the
13 four percent.

14 A. No. Not transmission. That's just
15 generation.

16 Q. Well, you mentioned transmission in your
17 testimony, didn't you?

18 A. Yes, but I think I said that's a separate
19 issue. I've not argued the transmission was an
20 overlap cost. It's a bypassable cost for the
21 company -- for the CRES, C-R-E-S.

22 Q. Okay. So when you talk about the four
23 percent cost that suppliers incur that's
24 overlapping with the company's SRT costs, you're
25 referring to the ancillary services?

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

1 A. Ancillary services, yes.

2 Q. Okay. Now, if, you know, that component
3 of a supplier's cost is overlapping with the
4 company's cost for maintaining a reserve margin
5 through the system reliability tracker, what part
6 of the company's costs are not overlapping with
7 the supplier's cost to provide those ancillary
8 services?

9 A. We don't know because some suppliers,
10 presumably not all, have -- will line up firm
11 resources to provide the sales to the -- to
12 provide the generation for the -- for their
13 customers, for their retail customers in the
14 company's service territory.

15 So to the extent they are implicitly or
16 explicitly acquiring generating capacity, as well
17 as energy to provide for their customer. For
18 example, they may have a power plant, or a group
19 of power plants, and be selling off of that
20 capacity, so they will be keeping some capacity to
21 provide this load. And to that extent, that chips
22 into the 14 percent. That overlaps the
23 14 percent.

24 Q. Where does the 14 percent come from? Do
25 you mean the 15 percent?

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

1 A. I beg your pardon. I beg your pardon.
2 Fifteen percent.

3 Q. Okay. But isn't it reasonable to
4 conclude that the company has some costs for
5 maintaining the system reliability tracker that
6 are not overlapping with the costs that suppliers
7 pay for ancillary services?

8 A. I don't think it's the cost of 15 percent
9 reserve margin, but it is some cost, yes.

10 Q. Okay. And the company's got to recover
11 that cost through some means, isn't that right;
12 otherwise, it's not going to maintain its
13 financial stability?

14 A. I think that's the wrong way to go. I
15 think the better way to go is to give that
16 responsibility for the Commission to require the
17 company to say, "If your load" -- to the
18 third-party suppliers, "If your load-serving
19 entity's in our territory, you have to pick up --
20 you have to provide not only the requirements that
21 are already there for financial, you know,
22 prudence and things like that, but you need to --
23 you need to tell us -- provide proof that you have
24 capacity, plus a 14 percent margin to cover your
25 load.

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

1 Q. Right. I understand that's your
2 recommendation --

3 A. Fifteen percent. I beg your pardon.

4 Q. -- but I'm still asking you to maintain
5 this assumption that the Commission can't do that.

6 A. If the Commission cannot do that, then
7 there is some portion of that 15 percent that is a
8 legitimate charge that the -- to compensate the
9 company for a responsibility that it has that its
10 competitor retailers do not have.

11 Q. And a legitimate nonbypassable charge.

12 A. Yes.

13 Q. Now, it's up to the Commission to
14 determine what's a fair and reasonable proportion
15 of a nonbypassable charge; correct?

16 A. Under those conditions where there's a
17 different responsibility for the utility than for
18 the competitive retailer, yes, the Commission
19 needs to put a number on that, if you will.

20 Q. And let's assume that the Commission --

21 MS. HOTZ: Excuse me a second.

22 Are you ready for a break?

23 THE WITNESS: Sure. That's a good idea.

24 MR. FINNIGAN: Sure. You want to take a
25 ten-minute break or so?

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

1 THE WITNESS: Yeah. Quarter till 12:00?
2 Whatever. Ten minutes is fine.
3 (Luncheon recess taken.)

4 - - -

5

6

7

8

9

10

11

12

13

14

15

16

17

18

19

20

21

22

23

24

25

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

1 P R O C E E D I N G S

2 - - -

3 Wednesday, March 14, 2007

4 Afternoon Session

5 - - -

6 MR. FINNIGAN: Okay. Let's go back on
7 the record.

8 - - -

9 CROSS-EXAMINATION (cont'd.)

10 BY MR. FINNIGAN:

11 Q. Good afternoon, Mr. Talbot.

12 A. Good afternoon.

13 Q. When we took our lunch break, we were
14 talking about ancillary services and the possible
15 overlap between ancillary services that suppliers
16 provide versus costs that the company has
17 reflected in its market price through the SRT,
18 system reliability tracker, and I wanted to ask
19 you about those ancillary services.

20 Do you know what type of ancillary
21 services that the suppliers are required to
22 provide through the Midwest ISO? Aren't those
23 operating reserves?

24 A. Operating reserves is one of them, yes.

25 Q. Do you know of any others?

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

1 A. I think operating reserves includes
2 spinning reserves.

3 Q. Okay.

4 A. I think that's probably the biggest item.

5 Q. Okay. Are those the only two kinds of
6 reserves that suppliers provide that you're aware
7 of?

8 A. There are about two other charges or
9 ancillary services that are measured as capacity
10 amounts, and I think they add up to four percent
11 in total.

12 I think the operating reserves or
13 spinning reserves is only like two-and-a-half
14 percent, or one-and-a-half percent, something in
15 that range. Then there are a couple of other
16 smaller items.

17 Q. Adding up to a total of four percent of
18 the generation price.

19 A. Yes. I think that's for what used to be
20 the ECAR segment. I now think it's called
21 Reliability First.

22 Q. The Regional Reliability Council?

23 A. Yes.

24 Q. Okay. And as far as Duke Energy Ohio
25 goes, do you know what mechanism it has to recover

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

1 its costs or reflect a market price for operating
2 reserves and spinning reserves?

3 A. I believe that they would include that in
4 the 15 percent capacity margin.

5 Q. Okay. Now, are you familiar with a
6 Rider TCR that the company offers?

7 A. Yes.

8 Q. And what is it your understanding that
9 that price reflects?

10 A. TCR is, I believe, a restructuring
11 charge, transition charge.

12 Q. Well, you know, we have way too many
13 acronyms in this plan.

14 A. Don't tell me.

15 Q. And I can't -- Let's see.

16 A. Transition cost recovery.

17 Q. TRC (sic).

18 MR. WATHEN: Transmission.

19 BY MR. FINNIGAN:

20 Q. I'm talking about TCR, transmission cost
21 recovery. I recall what you're referring to.

22 A. It was transition cost recovery --

23 Q. Right.

24 A. -- that one. Transmission is elsewhere.

25 Q. I'm sorry, I wasn't clear about that, but

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

1 I wanted to refer to the transmission cost
2 recovery component.

3 Are you familiar with the component of
4 the MBSSO -- Strike that.

5 Are you familiar with one of the
6 company's charges referred to as the TCR charge,
7 transmission cost recovery?

8 A. Yes.

9 Q. And what is it your understanding that
10 that is for?

11 A. I believe it's for the actual costs
12 incurred by -- in paying the fees of the -- the
13 ISO, and possibly the Regional Reliability
14 Council.

15 Q. Okay.

16 A. It's a fee, basically.

17 Q. Are you aware of whether the company
18 includes charges for ancillary services in
19 Rider TCR?

20 A. No. I'm not sure about that.

21 Q. Are you aware that Rider TCR is fully
22 avoidable?

23 A. Yes, I'm aware of that.

24 Q. Okay. Now, let me ask you to assume that
25 the company does recover the costs for ancillary

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

1 services for operating reserves and spinning
2 reserves through Rider TCR and that that rider is
3 fully avoidable by shopping customers.

4 Under those assumptions, would you agree
5 that there is no overlap between the ancillary
6 services costs that suppliers incur versus
7 ancillary services costs that the company incurs?

8 A. That would eliminate some of the overlap
9 that I was complaining about, but as I pointed
10 out, the companies -- the independent CRESSs are
11 also responsible for some degree of capacity built
12 into their contracts to a supplier. So it doesn't
13 really eliminate that overlap with the 15 percent,
14 but possibly it chips away at it.

15 Q. Okay. Now, I want to go back to
16 something that we talked about this morning, and
17 that was the state of competition in Ohio.

18 We talked about the analogy to a patient
19 on life support and got into the medical field.
20 We strayed from the utility field a little bit,
21 but what I want to ask you about now is the
22 reasons that competition, retail competition has
23 not fully developed in Ohio.

24 You talked about one reason being the
25 fact that the company has charges for generation

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

1 service that are not fully bypassable; right?

2 A. Yes.

3 Q. Another reason that we talked about was
4 that the wholesale markets have not fully
5 developed in terms of providing for full
6 competition at the wholesale level; correct?

7 A. Yes.

8 Q. And then are you familiar with the
9 shopping incentives that the company formerly made
10 available to customers?

11 MS. HOTZ: I want to renew my objection
12 that this is beyond the scope, but you can answer.

13 THE WITNESS: I'm aware of them, but I
14 don't recall the details. I believe they ended in
15 2005 or so.

16 BY MR. FINNIGAN:

17 Q. Yes.

18 And do you ascribe that as being one
19 other cause that competition has not fully
20 developed at the retail level in Ohio or in
21 DE-Ohio's service area?

22 A. Shopping credits, as far as they go,
23 would, I assume, be similar to rebates or
24 nonpayment of a -- similar to bypassability of the
25 fee, in effect. So I assume that the shopping

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

1 credits would have been part of the reason why the
2 competitive market did seem to be taking hold in
3 the company's service territory and I think
4 elsewhere in Ohio, too, particularly northern
5 Ohio.

6 If you look at a couple years back, it
7 was, you know, like 20 percent shopping or
8 something in that range, a significant amount for
9 a relatively new market. And one might have
10 anticipated that, you know, as with, say, when
11 A&T was -- AT&T was -- had a deregulated market
12 for long distance, that gradually one would be
13 moving in the direction of many sellers, many
14 competitors.

15 The shopping credit ended. The current
16 standard service offer was introduced. Other
17 things probably intervened as well. I've really
18 looked at the tariff or pricing side, but the
19 pricing side seems to me to provide a partial
20 explanation or possibly a complete explanation for
21 the decline of competition.

22 Q. Now, you mentioned that the company at
23 one time had 20 percent shopping and that was at
24 the maximum development of the competitive market
25 in DE-Ohio's service area, wasn't it?

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

1 A. Yes.

2 Q. And are you aware that the company's
3 initial standard service offer pricing and
4 shopping incentive structure provided for a higher
5 level of shopping incentives for the first 20
6 percent of consumers who would switch to a
7 supplier during the time that the shopping
8 incentives were in effect?

9 A. I wasn't aware of that.

10 Q. Okay. And the level of shopping that the
11 company attained was consistent with this higher
12 level of shopping incentives that were available.

13 So would you ascribe any portion of the
14 cause for a decline in competition in DE-Ohio's
15 service area being attributed to the fact that
16 these shopping incentives expired?

17 A. It's possible.

18 Q. Are you aware of any other factors
19 besides lack of full bypassability of the
20 generation charge by DE-Ohio, lack of full
21 competition in the wholesale market, and
22 expiration of the shopping incentives as to
23 possible causes why retail competition hasn't
24 developed more fully in DE-Ohio's service area?

25 A. I'm not aware of any.

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

1 Q. Now, you mentioned that one of your
2 recommendations was that load-serving entities,
3 that is, competing suppliers, should be required
4 to have the same POLR obligation that the electric
5 utility currently has; is that correct?

6 A. Yes. I think it would be better than
7 having these nonbypassable charges impede the --
8 impede competition.

9 Q. Now, do you know what amount of capacity
10 is available in the midwestern region if competing
11 suppliers had that obligation?

12 A. Well, the capacity market is somewhat
13 tighter than it was a couple years ago, I believe.
14 And I believe that the outlook is for further
15 tightening because, as I understand it, the
16 construction of facilities is not keeping up with
17 the pace of demand, at least up to this year, is
18 my understanding, up to now.

19 Again, if Alan Greenspan is right and we
20 get a recession this year or next, then all bets
21 are off, but there's less capacity available, but
22 I don't think we're at the point of the market
23 being 100 percent committed or capacity being
24 100 percent committed. And so I would assume it's
25 possible for sellers to either earmark their own

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

1 generation or generation that they purchase or the
2 product which they purchase to line up resources
3 in the marketplace. I don't see any impediment to
4 that.

5 Q. Okay. Now, are you aware of how much or
6 by what percentage Duke Energy Ohio's generation
7 charge has increased under its approved MBSSO?

8 A. No.

9 Q. And the approved MBSSO has been in effect
10 for how long now? For residential consumers,
11 approximately a year and three months, shall we
12 say?

13 A. Yes, 2006 on.

14 Q. Okay. So you don't know what the
15 percentage increase has been over that period as
16 compared to other states that -- where they're
17 expected to incur increases of a magnitude of
18 50 percent or greater?

19 A. No.

20 Q. So you don't know if the rate
21 stabilization plan has been effective in
22 protecting consumers from high increases because
23 you don't know the magnitude of the increase in
24 Ohio versus the 50-percent-plus magnitude of
25 anticipated increases in other states?

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

1 A. Well, firstly, I think the -- And the
2 50 percent or so increases in one or two states
3 are the largest. Secondly, there are a variety of
4 factors that went into the previous rates, they
5 may have been held way below market, and I assume
6 they were in some states. There was, for example,
7 a freeze which might last several years, and that
8 can be very problematic.

9 I recall in California, for example, it
10 was -- also rates were not frozen, but the retail
11 rate charged by the company -- companies was freed
12 up -- was fixed. So that was an untenable
13 situation where when the market -- when the prices
14 caught up, prices went up dramatically, aided and
15 abetted, one reads, by a degree of market
16 manipulation. The other factor here is that fuel
17 costs are flowed through.

18 So you've got three trackers that are --
19 are at work here in terms of fuel costs, and AAC,
20 and the system reliability tracker.

21 So net-net, you know, I don't know what
22 the prices would be if they'd been negotiated in
23 the marketplace, or if they were to be negotiated
24 in the marketplace -- I don't mean negotiated, I
25 mean competitively bid in the marketplace in six

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

1 months or a year's time.

2 Q. Now, I want to address your testimony
3 that you filed earlier this month.

4 You said that one of the purposes in your
5 testimony was to opine whether the retail
6 generation service offered by DE-Ohio is
7 reasonably priced in terms of market pricing
8 principles.

9 Are you aware of any states where the
10 retail generation service is reasonably priced in
11 terms of market pricing principles?

12 A. Well, I'm aware of two -- two classes of
13 states where I think the reasonableness test is
14 met.

15 The one is the costs of states where
16 prices are obtained from the marketplace and the
17 other is where prices are based on embedded or
18 incurred costs.

19 Q. Okay.

20 A. So those states that have not switched to
21 competitive procurement, or call it deregulation,
22 or partial deregulation, or whatever, are, I
23 assume, for the most part being governed by the
24 same kinds of factors that they always were, cost
25 plus a reasonable rate of return. Some of those

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

1 may have gone to incentive pricing of one kind or
2 another, so -- you know, so pricing effects
3 relative to costs for a while.

4 Q. But to look at your two classes where you
5 say states do it right in terms of adopting
6 reasonable market pricing policies, one of your
7 classes is where states have not deregulated
8 retail generation service, where they apply
9 traditional regulation. And you would view that
10 traditional regulation as producing a cost-based
11 price that's a reasonable approximation of a
12 market price.

13 A. Yes. I think it's -- Over time,
14 cost-based pricing, I think, is a reasonable proxy
15 for market pricing. It, obviously, is more
16 stable.

17 Q. The other category of states that have
18 adopted reasonable market pricing principles are
19 ones where the market price is determined by the
20 marketplace.

21 How does the marketplace determine the
22 price in those states? Is it through a
23 competitive bidding process?

24 A. The ones that I'm aware of, yes. I'm
25 thinking, you know, of the New Jersey example.

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

1 Then other states like Maine and so forth where
2 the utility typically goes out or the state goes
3 out and takes wholesale bids from suppliers,
4 frequently, for portions of total load.

5 Q. Okay. And examples of those states would
6 be, you mentioned Illinois, New Jersey, Maine and
7 Maryland?

8 A. Well, there's New Jersey. I mentioned
9 New Jersey and Maine. I believe Massachusetts
10 does something like that as well.

11 Q. New York?

12 MS. HOTZ: You're mischaracterizing his
13 testimony.

14 MR. FINNIGAN: I'm asking is New York
15 another one.

16 MS. HOTZ: Well, you have to ask.

17 MR. FINNIGAN: Okay. I'm sorry.

18 BY MR. FINNIGAN:

19 Q. Is New York another state that procures
20 the power through a competitive bidding process?

21 A. Frankly, I don't recall. It should
22 affect me, but I -- I live there, but I don't
23 recall.

24 Q. Okay. Mr. Talbot, let's assume that with
25 your two recommendations, one is that the

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

1 Commission makes the market price for DE-Ohio
2 fully bypassable. Let's assume that that would
3 not be acceptable to DE-Ohio and DE-Ohio would
4 refuse to provide the service under those terms.

5 Then let's assume that your second
6 recommendation, that is, that the Commission go
7 back to traditional regulation as a proxy for
8 determining a reasonable market price, is
9 unavailable.

10 Now, if that were the case, under those
11 two assumptions, do you have any other
12 recommendations for what would be a reasonable
13 market price for DE-Ohio to offer?

14 A. To the extent this is a legal question, I
15 don't know the answer. I think something does go
16 to the word "deregulated" or "partially
17 deregulated". It seems that the standard service
18 offer in the case of Duke Energy Ohio is partially
19 deregulated.

20 Now, you know, we can -- we can argue
21 about what that means. And I know the company
22 takes the view that it's a deregulated entity, as
23 far as generation. However, as a practical
24 matter, I observe that the Commission is having
25 regular hearings to determine elements of the

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

1 standard service offer price, such as any of the
2 three trackers. And that the company has come in
3 to the Commission for the period for -- to set
4 rates for the following period, which goes beyond
5 my testimony, 2009, 2010, but it's perhaps
6 relevant in the sense that at this point the
7 company hasn't picked up its marbles and gone
8 home, it's still playing.

9 And as an expert witness, all I can say
10 is some charges seem relatively poorly based, some
11 of the charges in the standard service offer. And
12 I would recommend and have recommended in my
13 testimony that those charges be tightened up or --
14 I haven't been very specific, but I've said
15 tighten up the cost basis, which is the
16 predominant basis of the -- of the standard
17 service offer.

18 I don't know what would happen if the
19 company said, "These terms and conditions are too
20 tight for us. We do want to take our marbles and
21 go home. We don't want to play anymore". I don't
22 know. But I've made the recommendation in terms
23 of ratemaking principles that I think some of the
24 items are poorly based.

25 Q. Okay. I think I understand your

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

1 recommendations, but I'm just trying to explore
2 whether you have any backup recommendations that
3 you haven't written in your testimony that if the
4 company said, you know, "We reject a return to
5 full cost-based regulation", or the Commission is
6 not -- was not authorized to require full
7 traditional cost-based regulation, and then the
8 company rejected having its generation charge
9 fully bypassable. Do you have any backup
10 recommendations that would apply in that
11 circumstance or is that something that you just
12 haven't formulated? I haven't seen anything in
13 your testimony to address that.

14 A. I haven't testified on that.

15 Q. Do you have any opinions on that that you
16 haven't incorporated in your written testimony?

17 MS. HOTZ: It's beyond the scope.

18 THE WITNESS: I think it is beyond the
19 scope. I really don't know. Politics is the
20 financial situation -- Politics is the financial
21 situation of the company, degree to which the
22 company is regulated and can be, so to speak,
23 forced to provide service in its service
24 territory.

25 BY MR. FINNIGAN:

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

1 Q. That's just something you have not
2 addressed at this point?

3 A. No.

4 Q. Okay. Now, you're familiar with the
5 Commission's three objectives for asking utilities
6 to submit rate stabilization plans, aren't you?

7 A. Yes, I am.

8 Q. I believe you mention those in your
9 testimony.

10 A. Yes.

11 Q. Protecting consumers, protecting the
12 utility's financial stability, and enhancing the
13 competitive marketplace.

14 A. Yes.

15 Q. And do you agree that those are all fair
16 considerations for the Public Utilities Commission
17 to address or to consider in approving rate
18 stabilization plans?

19 A. Yes.

20 MS. HOTZ: That's a legal question.

21 MR. FINNIGAN: Well, I'm just asking his
22 understanding or his opinion.

23 MS. HOTZ: Okay.

24 THE WITNESS: Yes.

25 BY MR. FINNIGAN:

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

1 Q. Okay. And do you agree that those policy
2 objectives, to some degree, can conflict with each
3 other?

4 A. Yes, they can.

5 Q. Okay. And it's up to the Commission to
6 try to adopt some path that strikes a reasonable
7 balance among those competing or conflicting
8 policy objectives.

9 A. Yes.

10 Q. Okay. And certainly, you could have
11 situations where reasonable minds could differ
12 with regard to what the best policy objective is
13 to strike that reasonable balance, couldn't you?

14 A. Yes.

15 MS. HOTZ: It's a legal question. I'll
16 object.

17 BY MR. FINNIGAN:

18 Q. Now, you've stated in your testimony
19 that, per your recommendation of tightening up the
20 company's costs, one of the things that you stated
21 was that the company should be permitted to update
22 its little g component of the MBSSO; is that
23 correct?

24 MS. HOTZ: Where is that? What page is
25 that on?

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

1 MR. FINNIGAN: I don't recall, Ann. I'm
2 sorry.

3 BY MR. FINNIGAN:

4 Q. Do you recall making that recommendation?

5 A. I do recall it. I might have made it at
6 the end in the policy recommendations and I might
7 have made it in the summary.

8 What I think I said pretty well verbatim
9 would be that the -- Sorry. What was the
10 exact....

11 MS. HOTZ: Yeah.

12 BY MR. FINNIGAN:

13 Q. Well, you recommended, as I understand
14 it, that the company should be permitted to update
15 its little g component of the --

16 A. Oh, yes.

17 Q. -- MBSSO.

18 A. Well, what I said is I think that the
19 Commission should consider that. It is a
20 cost-based rate, but it's an old one, cost-based
21 component, but an old cost-based component.

22 Q. And do you know if the company did
23 increase its little g component to reflect current
24 market prices, how much of an increase that would
25 be?

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

1 A. I don't know whether it would be an
2 increase if -- as applied to cost -- costing. As
3 to market pricing, I don't know that. And I do
4 not know, in fact, whether it would be an increase
5 in accounting costs, if you look at it that way.

6 I made the recommendation on Page 71.
7 "Little g and the RSC, which is a component of
8 little g" -- and I'm quoting -- "are currently
9 neither market-based nor based on recently-audited
10 costs. The fact is that little g, and by
11 extension the RSC which is a component of
12 little g" -- it's repetitive -- "are legacy items
13 that go back many years. It should be possible,
14 however, to update the cost basis of legacy
15 generation."

16 Q. Now, if the company updated its market
17 price to include a current little g component, do
18 you know how that would compare as to the price
19 that results from the approved MBSSO?

20 A. No.

21 Q. Now, did you read the testimony submitted
22 by the Staff witnesses, Mr. Cahaan and Smith and
23 Tufts?

24 MS. HOTZ: It was just filed. It was at
25 the same time yours was filed.

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

1 BY MR. FINNIGAN:

2 Q. Did you have an opportunity to review
3 that?

4 A. No, I didn't.

5 Q. Okay. So I take it then that you don't
6 know what position the Staff took with regard to
7 the company's AAC filings in those testimonies.
8 You haven't had a chance to review that yet.

9 A. I have not.

10 Q. Okay. You stated at Page 37 of your
11 testimony that the greatest risk facing an
12 electric utility is the risk of fuel and purchased
13 price fluctuations; is that correct?

14 A. Yes.

15 Q. Okay. Doesn't the company incur some
16 degree of risk by being required to have its
17 generating plants available on a standby basis to
18 provide power to serve any consumers that might be
19 returning from competitive suppliers, at least
20 under the current market conditions?

21 THE WITNESS: Could you just read that
22 exact question back to me?

23 BY MR. FINNIGAN:

24 Q. Well, I'll go ahead and just reask it.
25 That's probably easier.

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

1 A. Okay.

2 Q. Do you perceive that the company faces
3 any risk by having to have its generating plants
4 available to serve consumers who may return to the
5 company's MBSSO service from competing suppliers?

6 A. Without going into the magnitude or the
7 possible overlap issue, I agree that there is some
8 risk to the extent that the company has this -- a
9 different responsibility than competitive CRESSs.
10 To that extent, there is a possible risk.

11 Q. Have you tried to quantify that risk?

12 A. No.

13 Q. Is that a risk that the company should be
14 entitled to charge some part of its market price
15 for since it does face that risk?

16 A. I would say that to the extent the
17 company can precisely and narrowly define the
18 extent of its exposure to risk or cost, and to
19 that extent -- and to the extent it's differently
20 incurred compared to the other suppliers, who have
21 risks of their own, to that extent, a case could
22 be made for some -- some charge to recompense the
23 company for that.

24 Q. Okay. And let's say there's a risk of a
25 recession. You stated earlier in your deposition

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

1 that Alan Greenberg (sic) predicts a recession in
2 the near term; correct?

3 A. Yes.

4 Q. Or Greenspan.

5 A. Greenspan, yes. Yes.

6 Q. How quickly they forget.

7 A. How quickly; that's right.

8 Q. I'm sorry.

9 A. He's gone already.

10 Q. Alan Greenspan --

11 A. That's right.

12 Q. -- he predicts that.

13 A. He won't go quietly.

14 Yes, to the extent that he does, okay, if
15 there's a recession, if your -- the company's
16 market diminishes, that's -- that's one of the
17 standard risks that I think any supplier would
18 face that risk.

19 Q. But doesn't the company face that risk to
20 a greater degree than competitive suppliers
21 because the company has the obligation to have
22 generation available on a standby basis to serve
23 consumers returning from competing suppliers, and
24 suppliers don't face that risk, do they?

25 A. Well, we talked about that, the risk of

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

1 returning customers a moment ago. And a
2 recession -- I would say the company doesn't
3 particularly have more risk than any other
4 supplier, because the supplier would have a
5 contract, and I suspect that the company or its
6 affiliates would have a contract with -- with
7 customers.

8 Now, if, for example, say -- the
9 industrial, large commercial customers, leaving
10 them to one side -- for the residential customer
11 and the small commercial, the competitive supplier
12 would not agree or not -- would not get the
13 residential customer to agree to have a minimum
14 take from the supplier. No residential customer
15 is going to say, "I guarantee to take 1,000
16 kilowatt hours a month". They'll take whatever
17 they take. They get a new television or
18 something, demand goes up. There's a recession
19 and they switch off some lights, their demand goes
20 down. So that risk would be borne by the
21 supplier.

22 Q. And the company.

23 A. And the company equally, I would think,
24 roughly.

25 Q. But wouldn't you agree with me that, in a

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

1 recession scenario, the company bears more risk
2 than the supplier because the supplier has
3 unlimited ability to flex down its price and the
4 company does not have unlimited ability to flex
5 down its price?

6 A. Well, a supplier would have limited --
7 would have unlimited ability, but really would in
8 practice maybe have an ability that's financially
9 limited, because he doesn't have the relative
10 stability that the company has with a fairly
11 relatively predictable demand for its services.

12 Q. Well, wait a minute. I mean, let's talk
13 about who some of these competing suppliers are.

14 Some of these competing suppliers are
15 much larger companies than Duke Energy Ohio,
16 aren't they?

17 A. Some are.

18 Q. Like Constellation.

19 A. Some are big.

20 Q. Constellation is a very big, financially
21 stable, competitive supplier, aren't they?

22 A. Some big suppliers go under, but they
23 would have to bear that risk of diminishing sales
24 to their customer base or loss of customers. I
25 would think it's the same as the company base.

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

1 Q. Well, let's talk, though, in terms of
2 what pricing restrictions face a company versus
3 competing suppliers. And certainly, you know,
4 both parties may face their own financial
5 considerations as to what they might want to do,
6 but let's talk about what they can do.

7 Under the MBSSO, the company has limited
8 ability to flex down its price in the event of a
9 recession and suppliers have unlimited ability to
10 flex down their price in the event of a recession.
11 Would you agree with that?

12 A. No. I don't think I can accept that.

13 Let's start with the company, that side
14 of the picture.

15 The company can benefit from lower fuel
16 costs and can track lower fuel costs through the
17 fuel and purchased power component. So that is a
18 flex down provision. As far as the fuel prices
19 drop, they can be flexed down.

20 Q. I agree that it has some ability to flex
21 down its prices because some of the components of
22 the MBSSO are cost-based and they track whether
23 the costs go up or down, so --

24 A. Right.

25 Q. -- I'm not arguing that. But the point I

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

1 would ask you to consider is that isn't there some
2 restriction on the company's ability to flex down
3 its price in the event of a recession; in other
4 words, certain components are fixed and they can't
5 go down? We talked about that earlier in your
6 deposition.

7 A. Some are. Some are fixed, but again, if
8 you take the system reliability tracker or the
9 annually adjusted -- annually adjusted component,
10 those also can track down. So much for the
11 company's side of the picture. There are certain
12 fixed costs -- or, fixed elements in the rate.

13 On the competitive side, I'm reluctant to
14 say that they have less restriction, because I --
15 typically, I think a seller has, you know,
16 financial constraints that can be quite serious.
17 And, secondly, they may have contracts, which
18 limit their ability to respond to a recession,
19 because they're contracted to do something. Some
20 price element in the contract might be fixed.

21 Q. They may and they may not, or they may
22 have flexibly-priced contracts.

23 A. They may.

24 Q. Like, you know, prices in contracts that
25 are tied to some market index price.

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

1 A. Yes.

2 Q. That's a rather common feature of supply
3 contracts, isn't it?

4 A. Yes.

5 Q. Especially longer term ones.

6 A. Uh-huh.

7 Q. Now, you recommend on Page 28 of your
8 testimony that for the FPP component of the MBSSO,
9 that we buy forward products; isn't that correct?

10 A. No. What I said is I had been aware of
11 the fact that the regulation -- the rate
12 regulation of Duke Energy Ohio is quite onerous,
13 it's quite onerous for the Commission and
14 participants because of the frequent FPP
15 adjustments and possibly the other adjustments.
16 And so what I said is the Commission should
17 consider -- I wasn't dogmatic about it -- should
18 consider in the circumstances whether there's
19 something better than a quarterly tracking
20 feature. That's what I address on Pages 27 and
21 28.

22 Q. Okay. But isn't it true that your firm
23 provided consulting services to the Ohio
24 Consumers' Counsel to develop an integrated
25 resource planning approach that was recommended

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

1 for Ohio utilities to follow?

2 MS. HOTZ: Objection. Beyond the scope.
3 You can answer.

4 THE WITNESS: Yes. That report would
5 refer to the period after 2009, 2009 and beyond.

6 BY MR. FINNIGAN:

7 Q. And would you promote that approach now
8 for companies to follow to develop a market price
9 for generation service that follows reasonable
10 market pricing principles?

11 A. I think the smart thing for me to do is
12 just to say I'd stay by my colleague's
13 recommendation. I was not involved in writing the
14 report, but I agree with it. I think it's a
15 reasonable way to go. Even if the process was
16 started now to get that in place, it would
17 probably only be in place by 2009.

18 Q. Okay. But one of the recommendations in
19 that report is that utilities enter into long-term
20 contracts to purchase power that are staggered
21 over varying periods of time; isn't that right?

22 A. Staggered contract periods, yes.

23 Q. And if DE-Ohio followed that
24 recommendation, even if it could flex down its FPP
25 in the event of a recession, if it's locked into a

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

1 fixed long-term contract to purchase power, then
2 it can't flex down the RPP; right? I mean the
3 FPP.

4 A. It depends how the contracts are written.
5 It really goes beyond what I'm testifying here. I
6 mean, we could debate at some length the
7 reasonableness of provisions in that report, which
8 refers to a future period. I'm not making any
9 such recommendation right now for the period 2007,
10 2008.

11 Q. Why not?

12 A. Well, as I've suggested, the time frame I
13 think is a problem.

14 MS. HOTZ: We didn't hire him to do that.

15 THE WITNESS: I'm going to do what I'm
16 told. Just kidding.

17 BY MR. FINNIGAN:

18 Q. I try to do the same thing, too. It's
19 always a sound approach.

20 A. Not always.

21 Q. For consultants and everyone.

22 A. Well, I'm under oath. I'm not under oath
23 when they -- when they ask questions, but I am
24 when I answer them.

25 Q. Now, at Page 41 of your testimony, you

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

1 make the statement that one could argue that the
2 company should compensate consumers for providing
3 an assured market for the company's generation.

4 Can you explain that? What compensation
5 should the company pay consumers for taking the
6 company's generation service?

7 A. Let me draw a distinction in risk
8 analysis between expected prices and variation or
9 risk associated with variable prices.

10 What the rate stabilization plan, and I
11 believe all of the -- to a degree all of the
12 standard service offer proposals, to a greater or
13 lesser degree, does is match up the company with
14 its resources and the standard service offer
15 customers with their demands.

16 Once this matching has occurred and
17 there's some fixed elements in that
18 relationship -- in the prices in that
19 relationship, both sides benefit from greater
20 stability.

21 Now, they may be paying more or less than
22 current market, but that's the way the stability
23 works. They are both protected against -- or,
24 insulated is perhaps a better word, from increases
25 or falls in market price. If the market price

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

1 were to fall, the company would be better off. If
2 the market price goes up, the customers are better
3 off, to the extent of these fixed components. As
4 we know, other components flow through, like fuel.

5 But in terms of risk theory, since both
6 sides of this picture, both the seller, namely the
7 company, and the buyer, namely the standard
8 service offer consumer, to the extent that they
9 face relatively fixed prices, both of them benefit
10 from stability. They have a hedge, if you will,
11 against market variations. That's my point.

12 And the company, I believe, in its
13 assessment of two or three of its charges, has
14 emphasized only the one side of that equation,
15 namely the stability for the customer. Although I
16 notice that Mr. Steffen did say, and I quoted it,
17 and added -- added -- I added emphasis.

18 I do refer to it at Page 41, but then I
19 refer to it again where he adds -- he adds in the
20 benefits to the company, acknowledges the benefit
21 to the company, but doesn't go into it.

22 It might be worth finding that because
23 it's -- I didn't actually comment on it in the
24 testimony. I meant to put it in a Q and A saying
25 that Mr. Steffen acknowledged this, yes, he did,

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

1 but I didn't put that in. I just quoted the
2 statement. I didn't add to it. It might be worth
3 spending a moment to find it.

4 Q. Now, Mr. Talbot, are you familiar with
5 the concept of switching risk?

6 MS. HOTZ: He's not finished yet.

7 MR. FINNIGAN: Oh, I'm sorry. I didn't
8 know.

9 THE WITNESS: I think it might be worth
10 finding.

11 MR. FINNIGAN: Let me withdraw that
12 question. I didn't mean to interrupt you. I'm
13 sorry.

14 THE WITNESS: Yes, on Page 37 I give
15 another quote from Mr. Steffen. This is a more
16 balanced assessment. He says, and I quote, "The
17 IMF allows DE-Ohio to provide stable prices to its
18 consumers and provides some level of revenue
19 certainty to the company". And so I think that is
20 a correct balanced assessment.

21 BY MR. FINNIGAN:

22 Q. Okay. Now, I want to change the subject
23 a little bit and ask you about the concept of
24 switching risk. Are you familiar with that
25 concept?

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

1 A. Yes.

2 Q. What does switching risk mean?

3 A. It's the risk or eventuality that
4 standard service offer customers will simply
5 switch to another supplier or switch back at
6 moments that may be inopportune for the company.

7 Q. Now, would you agree that if wholesale
8 market prices go below the level at which the
9 company can flex down its MBSSO, then the company
10 stands the risk that its consumers would switch to
11 a competitive supplier?

12 A. Yes.

13 Q. Okay. And if that occurred for all of
14 the company's consumers, then it would incur costs
15 that it couldn't recover in the marketplace,
16 wouldn't it?

17 A. Under that assumption, yes, it would.

18 Q. And one condition in which wholesale
19 market prices could fall below the wholesale price
20 that's reflected in the company's MBSSO is in the
21 event of a recession, isn't it? That could
22 happen.

23 A. It could.

24 Q. And, in fact, you -- Well, strike that.

25 Now, let's talk about the converse

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

1 situation. Let's assume that the market price for
2 wholesale power rises above the wholesale market
3 price that's reflected in the company's MBSSO.

4 If that happens, wouldn't you agree that
5 the company would have foregone an opportunity to
6 sell its generating assets into the wholesale
7 market at that higher price?

8 A. Yes, to some degree, to the extent they
9 weren't committed, yes.

10 Q. And that would be what we refer to as
11 lost opportunity cost.

12 A. Yes.

13 Q. And the MBSSO requires the company to
14 lock in a price so it presents at least some
15 degree of lost opportunity cost.

16 A. Yes.

17 Q. Now, is that lost opportunity cost some
18 element that the company should be permitted to
19 reflect in its MBSSO?

20 A. I'm not sure it's a cost that the company
21 disproportionately bears because the same is true
22 for the other side of the picture, namely the
23 competitive retailers; they also bear these -- the
24 other side of that risk.

25 If the market prices go up more than the

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

1 standard service offer, they are left high and dry
2 with some of their costs at the high level. And
3 if market prices go down, they -- well, I guess
4 they wouldn't suffer, they'd take on more
5 customers. They wouldn't suffer from that. I
6 don't think the customer would suffer either. The
7 company would suffer in the sense that if it --
8 Well, okay. The company would have limited
9 ability to flex up less than it would in certain
10 circumstances. I believe that a competitor could
11 flex up at least on new contracts.

12 Q. Okay. And given the fact that --
13 Well, strike that.

14 A competitor could choose not to enter
15 into any contracts and to sell all of its
16 generation in the wholesale market, couldn't it?

17 A. Unfortunately for the competitor, that
18 would probably be the circumstance where it
19 couldn't line up customers for whatever reason, so
20 it would probably be a recession situation.

21 Q. Or it could be a situation where that's
22 just the business strategy of a merchant company,
23 that they just elect to compete in the wholesale
24 market and not to compete in the retail market.

25 A. Well, the retail and wholesale markets

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

1 would tend to be -- go in tandem, I think. Plus,
2 I point out that, in fact, most of the markets for
3 so-called retail customers are actually wholesale
4 markets where the utility is buying the power and
5 distributing it to customers.

6 Q. Okay. Well, I guess, you know, you did
7 make the point that as to new or uncommitted
8 capacity, competitive suppliers would have
9 unlimited ability to flex up their prices;
10 correct?

11 A. Yes.

12 Q. So to that extent, the company would --
13 would have some lost opportunity cost if wholesale
14 prices increased above the price -- the wholesale
15 price reflected in the company's MBSSO.

16 A. Yes.

17 Q. And would it be proper for the company to
18 include in its market price in the MBSSO some
19 amount to reflect that lost opportunity cost?
20 Under economic concepts, isn't that a proper
21 amount to reflect in a market price?

22 A. In practice, I don't think so, because
23 there is the other -- the risk of losing
24 customers. And when the opposite happened, where
25 market prices fall, the company will tend to

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

1 retain some customers above market prices. And to
2 the extent that the pricing is reasonably
3 accurate, the company should be in the position of
4 not suffering fully for that -- for that fall --
5 for that need -- for that potential loss of
6 customers when the -- when the market price falls.

7 Q. Based on the company's current approved
8 MBSSO charge or price, what percentage of the
9 price can flex down to track actual costs
10 incurred?

11 A. Well, maybe we should go back to that
12 table. I think it was on Page 21.

13 The fuel and economy purchased power
14 charge of 18.6 percent would tend to flex down,
15 and to the extent there was -- there were items in
16 the annually adjusted component of 5.3 percent,
17 and presuming the system reliability tracker would
18 fall as well, because you wouldn't need to buy as
19 much capacity.

20 Q. We've got a negative charge for the
21 current period.

22 A. You've got a negative charge, but as we
23 were talking earlier this morning, would normally
24 be a positive charge of some percentage, not a
25 huge charge.

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

1 Q. But isn't that negative charge only to
2 reflect a true-up situation? In any given period,
3 there are going to be positive costs for the SRT,
4 wouldn't there?

5 A. There would be, yes. So you'd have a
6 total of, let's say, 25 percent, thereabouts,
7 would be flexible.

8 Q. Now, let me change the subject.

9 With respect to the testimony that you
10 filed earlier this month where you make your
11 recommendations as to reasonable market pricing
12 principles, are you addressing conditions as they
13 existed in 2004 when this matter was initially
14 before the Commission or are you addressing
15 conditions as they exist today in 2007?

16 A. Both, I think.

17 Q. Okay. Both.

18 So your testimony really is based on all
19 information and all market conditions and evidence
20 available to you up until the present time.

21 A. Yes. I think if you look at my
22 testimony, what it really is, it's an analysis of
23 the current standard service offer. It's slightly
24 different to the extent that the standard service
25 offer under the RSP has evolved, as they say,

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

1 between the company's original proposal, I think,
2 which was in the stipulation in 2004, as I recall,
3 and there were a couple of applications for
4 rehearing, the re-entry order -- the entry on
5 rehearing, et cetera.

6 MR. FINNIGAN: Okay. Let's see. Why
7 don't we take a short break. I believe I'm just
8 about done. I just want to confer with my
9 colleagues and see if they have any additional
10 lines of questioning and then we'll finish up.

11 About, you know, five minutes -- five to
12 10 minutes, would that be okay? Let's say we
13 reconvene at 20 after.

14 MS. HOTZ: That's good.

15 (Recess taken.)

16 BY MR. FINNIGAN:

17 Q. I just want to talk about the features of
18 the MBSSO in terms of being able to modify the
19 price, and also I want to talk about your
20 recommendations with respect to the FPP component,
21 and then also want to talk about little g and what
22 your understanding of the update to little g
23 should reflect.

24 Now, with regard to the MBSSO and flex
25 down, I used that term "flexing down" during

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

1 today's deposition, but I want to make it clear
2 that the way the MBSSO price could go up or down
3 is based on the company's actual cost against some
4 baseline. That is, if the company's actual cost
5 moved up or down in relation to the baseline,
6 that's what determines the degree of the company's
7 ability to change that component of the MBSSO; is
8 that right?

9 A. Yes. That's my understanding, too.

10 Q. So it's based on actual cost. The
11 company doesn't have any discretion to modify
12 that -- those components of the MBSSO other than
13 what the actual costs dictate.

14 A. Correct.

15 Q. Now, competing suppliers don't have that
16 restriction, they could discount their price to
17 capture market share regardless of what their
18 prices or costs are; isn't that right?

19 A. They could. Legally, I don't think
20 there's any limit, but economically they certainly
21 would recover their variable costs; otherwise, it
22 wouldn't be worth -- worth selling anything if you
23 couldn't recover the variable cost of it, but the
24 fixed cost component, they certainly could vary
25 that.

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

1 Q. And with respect to the components of the
2 MBSSO that do change to reflect costs, the company
3 can't lower those components below its baseline;
4 isn't that correct?

5 A. Well, that's a good question. I don't
6 know.

7 Q. Okay.

8 A. If -- If, for example, there was 100
9 million in fuel in the base, and then you had the
10 fuel tracker on top of that, so if the fuel costs
11 were 110, the tracker would pick up the 10
12 million. If it went down to 90, I don't know if
13 it can go negative. It's an interesting question.
14 I don't know the answer.

15 Q. To the extent that the company cannot
16 change these components of the MBSSO that are
17 based on actual costs below a baseline, that would
18 restrict the company's ability to adjust its MBSSO
19 based on market conditions, wouldn't it?

20 A. Yes, but I think -- I have to say I think
21 it's probably a moot point because I don't think
22 the company ever would go below those bases.
23 They're quite low, as I understand, because you've
24 got fuel and economy purchased power and, you
25 know, you're claiming a large amount for that,

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

1 like 194 million. So if the price went down so
2 that the revenue requirement was 194 million
3 lower, then, you know, you'd eliminate the tracker
4 or eliminate the positive tracker. That's a lot
5 of money there.

6 The annually adjusted component, I have
7 an idea that that was set to zero to begin with,
8 so I think all the costs are recovered there. So
9 there you wouldn't have a negative, if I recall
10 correctly.

11 And, likewise, I think the system
12 reliability tracker has a zero base, so I think
13 that wouldn't -- couldn't go negative, it would be
14 down to zero. It's only when you got to capacity
15 charges that are recovered in other fixed
16 components that you could go lower than what's
17 built into those components.

18 Q. And what's your understanding of which
19 components are priced in that manner; that is,
20 that they have a baseline below which the company
21 cannot go below?

22 A. Well, the rate stabilization charge and
23 little g, itself, are fixed, and the
24 infrastructure maintenance fund is fixed. So
25 those components would just stay the same. They

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

1 would not vary.

2 Q. Okay. Now, with respect to the FPP, you
3 recommended that the adjustment should be annual
4 instead of quarterly; isn't that correct?

5 A. Not exactly. What I tried to do there
6 was just open up the question and say to the
7 extent that people feel that this is an onerous
8 tracker from an administrative standpoint, or from
9 the standpoint of fuel cost variability for
10 customers. So introduce price variability quarter
11 to quarter.

12 The Commission could consider smoothing
13 it out a bit basically, either by making it annual
14 with possibly a trigger so that the company
15 wouldn't have major amounts over- or
16 undercollected, or -- or put some smoothing
17 mechanism into the -- into the quarterly measure.
18 So that if the quarterly change was 10 percent,
19 you maybe only pass along half of that or
20 something, and then let it run for another quarter
21 so that you didn't have changes that were too
22 large from quarter to quarter.

23 Q. If the Commission were to adopt your
24 recommendation and implement a smoothing mechanism
25 for the FPP, would you recommend that the company

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

1 be permitted to recover carrying costs on the
2 amount of any increases in its actual costs that
3 are deferred for future recovery?

4 A. I haven't thought about that issue. I
5 don't know what's in there now and I haven't
6 thought about it.

7 Q. You have no recommendation either way?

8 A. I'm not suggesting any other change
9 compared with what's in there now than just
10 saying, if people are concerned about the
11 administrative costs and the volatility of prices,
12 they might consider, the Commission might
13 consider, the company might consider a smoothing
14 mechanism.

15 Q. If the Commission did adopt an annual
16 adjustment to the FPP to relieve its
17 administrative burden, that would impair the
18 company's ability to adjust its charges to respond
19 to market conditions, wouldn't it?

20 A. To a degree, yes.

21 Q. And that would also make the company's
22 MBSSO less reflective of a pure market price.

23 A. That's true.

24 Q. As would a smoothing mechanism.

25 A. To a degree, it would.

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

1 Q. And if there is a smoothing mechanism or
2 an annual adjustment, wouldn't that make --
3 wouldn't that type of pricing mechanism tend to
4 discourage demand response from consumers?

5 A. In the short run, it would. It mightn't
6 be a bad thing in a way for the customers not to,
7 to respond to short-run prices.

8 I think customer responses to prices are
9 a little, you know, less than rational or, you
10 know, whatever, because you really don't want
11 people to -- to respond to a quarterly spike in
12 prices.

13 Q. But shouldn't the Commission's pricing
14 principles be one where the MBSSO price reflects a
15 true market price as much as possible so as to
16 encourage demand response?

17 A. I forget if I say this in the testimony,
18 but I think I do somewhere, that in principle,
19 market prices are the best market prices, you
20 know, they are the -- they are the best evidence
21 of the market price, but I don't think there are
22 too many economists who would be so dogmatic as to
23 say that there's nothing problematic about
24 short-run variations in prices. I think it's the
25 problem with short-run variations and customer

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

1 responses thereto.

2 And I've also mentioned, I think, in
3 passing the market power issue that also
4 undermines the principle of market pricing or the
5 evidence of what a reasonable market price would
6 be isn't necessarily what you see out there in the
7 market because, A, prices vary from time to time
8 and can do so in a rather erratic way and,
9 secondly, there may be market price -- market
10 power or other manipulation of the market in the
11 short run.

12 Q. And then I want to return to the topic we
13 discussed earlier, and that is your recommendation
14 that the company be permitted to update its
15 little g component if the Commission were to
16 tighten up its costs.

17 A. Yes.

18 Q. Okay. In that scenario, or under that
19 recommendation, should the company be permitted to
20 update little g for new additions or for
21 subtractions to its generation capacity?

22 A. I would say that if you're using a
23 traditional framework or quasi traditional
24 framework, traditional framework, that you would
25 take into account all the facts that you would

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

1 when updated from an old generation rate to a new
2 one, new capacity committed to this customer
3 group, standard service offer, retired capacity,
4 depreciation, new construction costs, everything.

5 Q. Now, the two major changes that the
6 company has had since its little g was last
7 updated in the early '90s were that it sold three
8 generating plants to an affiliate, Duke Energy
9 Kentucky, and it also acquired generating plants
10 from an affiliate, Duke Energy North America. Are
11 you familiar with those developments?

12 A. I think it slipped my mind that they'd
13 sold three, but I was aware of the DENA assets.

14 My understanding was -- I may be wrong
15 here -- that they were not committed to standard
16 service offer load, that they were in basically
17 sort of a separate set of accounts compared with
18 the older capacity that was committed to load.
19 That's my understanding. In either case, I don't
20 think they would be reflected in little g at this
21 point.

22 Q. No, they're not now. I was just asking
23 under your recommendation, would you reflect those
24 DENA plants and would you reflect the sale of the
25 three plants to Duke Energy Kentucky if little g

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

1 were updated?

2 A. I would apply the same principles that
3 one would apply in a traditional rate case. You
4 look at the new rate base, the assets in that
5 base, you consider retirements, additions, and you
6 come up with a new cost of capacity dedicated to
7 this group of customers and that's it.

8 MR. FINNIGAN: Okay. That's all the
9 questions I have. Thank you very much for your
10 time, Mr. Talbot.

11 THE WITNESS: Thank you.

12 MR. FINNIGAN: I appreciate it.

13 (Signature not waived.)

14 - - -

15 (Thereupon, the deposition was concluded
16 at 2:37 o'clock p.m. on Wednesday, March
17 14, 2007.)

18 - - -

19

20

21

22

23

24

25

MC GINNIS & ASSOCIATES, INC.
614.431.1344 COLUMBUS, OHIO 800.498.2451

A F F I D A V I T

- - -

STATE OF _____,)

) SS:

COUNTY OF _____,)

Neil H. Talbot, having been duly placed
under oath, deposes and says that:

I have read the transcript of my
deposition taken on Wednesday, March 14, 2007, and
made all necessary changes and/or corrections as
noted on the attached correction sheet, if any.

Neil H. Talbot

Placed under oath before me and
subscribed in my presence this _____ day of
_____, _____.

Notary Public

My Commission Expires: _____.

- - -

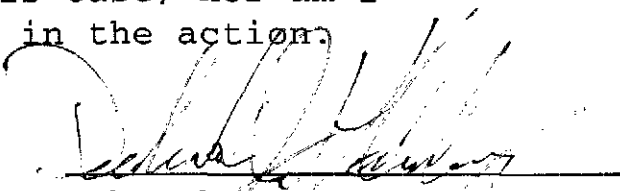
C E R T I F I C A T E

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25

State of Ohio,)
) SS:
County of Delaware,)
 - - -

I, Deborah J. Holmberg, Registered Merit
Reporter and Notary Public in and for the State of
Ohio, hereby certify that the foregoing is a true and
and accurate transcript of the deposition testimony,
taken under oath on the date hereinbefore set forth, of
NEIL H. TALBOT.

I further certify that I am neither
attorney or counsel for, nor related to or
employed by any of the parties to the action in
which the deposition was taken, and further that I
am not a relative or employee of any attorney or
counsel employed in this case, nor am I
financially interested in the action.


Deborah J. Holmberg,
Registered Merit Reporter
and Notary Public in and
for the State of Ohio.

My Commission Expires:
October 07, 2011.

*** CAUTION ***

This certification bears an original signature in
nonreproducible ink. The foregoing certification
of the transcript does not apply to any
reproduction of the same not bearing the signature
of the certifying court reporter. McGinnis &
Associates, Inc. disclaims responsibility for any
alterations which may have been made to the
noncertified copies of this transcript.

- - -

DUKE ENERGY OHIO
Percent of 2006 Generation Revenue That
is Bypassable for Residential Consumers

<u>Rate Component</u>	<u>2006 Revenue</u>	<u>Percent of Total</u>
Tariff Generation Charge	\$ 654,280,074	62.7%
Fuel & Purchased Power	194,302,151	18.6%
Total Fully Bypassable	848,582,225	81.3%
Annually Adjusted Component	55,008,125	5.3%
Rate Stabilization Charge	114,747,660	11.0%
Total Partially Bypassable (25%)	169,755,785	16.3%
System Reliability Tracker	(6,031,653)	-0.6%
Infrastructure Maintenance Fund	31,549,495	3.0%
Total Not Bypassable	25,517,842	2.4%
Grand Total	\$ 1,043,855,852	100.0%

