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BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

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Consolidated Duke Energy	)	Case Nos.
Ohio, Inc. Rate	)	03-93-EL-ATA
Stabilization Plan Remand	)	03-2079-EL-AAM
and Rider Adjustment	)	03-2080-EL-ATA
Cases.	)	03-2081-EL-AAM
		05-724-EL-UNC
		05-725-EL-UNC
		06-1068-EL-UNC
		06-1069-EL-UNC
		06-1085-EL-UNC

Deposition of Neil H. Talbot, a witness herein, called by Duke Energy Ohio, Inc. for cross-examination under the statute, taken before me, Deborah J. Holmberg, Registered Merit Reporter and Notary Public in and for the State of Ohio, pursuant to notice and stipulations of counsel hereinafter set forth, at the offices of Ohio Consumers' Counsel, 10 West Broad Street, Suite 1800, Columbus, Ohio, on Wednesday, March 14, 2007, beginning at 10:10 o'clock a.m. and concluding on the same day.

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ALSO PRESENT:

Don Wathen, Director - Revenue Requirements

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

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

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NEIL H. TALBOT

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

CROSS-EXAMINATION

BY MR. FINNIGAN:

Q. Good morning, Mr. Talbot.

A. Good morning, Mr. Finnigan.

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

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

A. Sure.

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

A. Thank you.

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

A. Yes. I reviewed quite a large proportion of the filings in this docket and the related dockets. I guess the second set of documents that I would have reviewed would have been the responses to data requests that the company provided. So those would be the two main sources.

Q. Anything else besides those two categories of documents?

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

Q. Okay. Anything else?

A. That's all that comes to mind.

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

A. Mostly off their web sites.

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

A. Generally, yes.

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

A. It is, yes.

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

A. Yes.

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

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

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

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

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

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

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

A. I don't think so.

Q. What has been the focus of your

consulting practice since 2004?

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

Q. Good for you.

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

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

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

A. Thank you.

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

A. Yes.

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

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

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

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

A. Yes.

Q. -- that's currently in effect.

A. Yes.

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

A. No.

Q. And why not?

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

Q. Okay. Now, would you agree with me that it's common that market prices in various other industries or other settings have components that recover the producer's or the manufacturer's costs plus a margin for profit built into the price and it's still considered to be a market price?

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

Q. That's true of any market price.

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

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

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

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

A. Well, if I could revisit my previous answer. There were current costs, market costs, in the sense that they're acquired by the company in the marketplace for capacity, for example, or fuel; historical costs in the form of legacy generation costs; and the third element is certain estimates which the company has justified in terms of building up what it regards as a reasonable market price, but I do not.

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

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

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

BY MR. FINNIGAN:

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

MS. HOTZ: If you can.

THE WITNESS: Well, I think the answer I'd give is the same: Namely, that there's some elements which you can't really call costs.

BY MR. FINNIGAN:

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

A. The estimates.

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

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

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

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

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

A. Yes.

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

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

MR. FINNIGAN: Sure. I'll get to that.
THE WITNESS: Let me answer that a little more fully.
There are a number of cost items that I don't think are capped, in fact.
BY MR. FINNIGAN:
Q. Right. But some are.
A. Fuel, for example.
Q. Some are.
A. Some are fixed numbers, yes.
Q. And so some elements of the approved MBSSO feature a cap, other elements do not. Can we agree on that?
A. Yes.
Q. Now, I want to change the focus a bit now and I want to talk about the developments in deregulated electric markets in other states.
You mentioned at the outset of your deposition that one of the things you did to prepare your written testimony and to prepare for the deposition was to review developments in other states.
Isn't it true that, in some other states that have deregulated retail generation service, there have been rate caps that have expired and

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

A. Yes.

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

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

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

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

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

A. Some of the components are fixed, yes.

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

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

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

A. Yes.

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

A. Yes. There are basically three trackers. The FPP, the AAC, and the SRT are all cost tracking, and as I recall, also with reconciliation. So that any deviations of actual from -- from estimated -- initially estimated or forecasted are reconciled subsequently.

Q. Yes.

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

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

Q. Okay.

A. I believe those are fixed.

Q. Okay. Very well.

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

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

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

Q. Okay.
A. And a number of states are on the verge, I believe, of ending their transitional periods and there's apprehension that costs might rise very significantly.
Q. So you're aware of no states where market caps have already expired such that consumers are paying purely market prices?
A. I don't recall that happening -- having happened already, but it may have.
Q. Okay. And these other states that you mentioned that are on the verge of having their rate caps expire, I take it that you followed proceedings in those states which have indicated that they're likely to experience high increases for generation service when the rate caps actually do expire?
A. Yes. I was reading about Illinois, for example. There's a lot of apprehension that the caps, when ended, the prices will go up very substantially.
Q. Did you follow the recent competitive bidding process in Illinois that was certified by the state utility commission at the end of 2006?
A. No.

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

A. No.

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

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

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

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

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

A. That's all I recall, yeah.

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

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

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

MS. HOTZ: Objection. Beyond the scope.

You can go ahead and answer if you can.

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

BY MR. FINNIGAN:

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

MS. HOTZ: Same objection.

THE WITNESS: No expectation.

BY MR. FINNIGAN:

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

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

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

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

A. Yes, that's correct.

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

A. Correct.

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

A. My testimony refers to this year and next. Really, I'm not looking at the period beyond. In that time frame, it's probably more realistic to talk about tightening up on costs rather than introducing new procedures to get more to a competitive market.

Q. Right.

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

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

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

A. I believe that would help.

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

A. I don't believe I've made any specific recommendations with regard to, you know, the way competition would be implemented or competitive pricing would be set.

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

A. As I recall, yes.

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

A. Frankly, no.

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

MS. HOTZ: Objection.

BY MR. FINNIGAN:

Q. Why is that?

MS. HOTZ: Beyond the scope of his testimony.

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

MS. HOTZ: But the 2004 is beyond the

scope of his 2007 testimony.

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

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

BY MR. FINNIGAN:

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

present time?
A. Yes, and the focus of my testimony.
Q. And the focus of your testimony.
So, really, here we sit in March of 2007, and even if the Commission were to adopt a competitive bidding process for procuring power through the end of 2008, that wouldn't give very much time, as you mentioned, to implement such a process, would it?
A. No.
Q. And in addition to not having much time to implement the process, it could produce very volatile prices and very high increases for consumers, couldn't it?
MS. HOTZ: Objection. Beyond the scope.
THE WITNESS: I really haven't looked into the specifics. There are all sorts of ways in which one can avoid unreasonable prices resulting from a process. One can have staggered contracts. One can -- One can withdraw the offer. I think the State of Maine, for example, and I think other states, too, have not accepted the bids.
BY MR. FINNIGAN:
Q. Because they've been so high.

A. Because they've been so high.

Q. Right.

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

Q. What was their stopgap measure?

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

Q. With any caps on rates?

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

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

A. I think so.

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

A. I think so, yeah.

Q. But in any event, do you regard that as a satisfactory stopgap approach or solution to protecting customers from high increases, that is, whatever approach was adopted in Maine?

MS. HOTZ: Objection. Beyond the scope.

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

BY MR. FINNIGAN:

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

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

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

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

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

MS. HOTZ: Objection. Beyond the scope.

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

BY MR. FINNIGAN:

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

A. As a cap --

Q. Yes.

A. -- to that extent.

Q. Yes.

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

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

A. Yes.

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

A. It is.
Q. And that could happen without any advance notice. We don't really know what tomorrow will bring; right?
A. We don't know.
Q. And that's the kind of risk that consumers face, as well as suppliers, as well as electric distribution utilities.
A. It affects both -- both sides of the market, people with assets and products to sell, buyers with products to buy.
Q. And the risk or one problem that suppliers and consumers both equally face is that if they enter into a fixed-price contract, if the -- their cost or the market price goes up or down below that contract, there's going to be one winner and one loser; right? In other words, somebody is going to end up having contracted for a higher or a lower price for power than what would be available from the market?
A. Yes. Any fixed-price contract for fixed prices in the future is a bet, if you will, or if you look at it the other way around, taking a bet off the table and getting yourself a certainty.
Q. Okay. And that bet entails some risk

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

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

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

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

Q. Okay. Now, the approved MBSSO is a fixed price that the company commits to for a year at a time; isn't that right?
A. Well, the elements are fixed. The elements adjust and track.
Q. Right.
Now, suppliers who are entering the company's market, or already present in the company's service area, are not required to enter into any fixed contract for any particular period of time; is that right?
A. Could you just clarify which -- which type of suppliers you're thinking of?
Q. Well, any competing supplier like Constellation can come in and make whatever price arrangements with the consumer that they choose to make.
A. They can.
Q. They're not required to lock in their price for any particular period of time, are they?
A. Well, there are one or two provisions which require companies that switch -- nonresidential customers that switch to enter into contracts to the end of 2008, I think. So to that extent, there's a limit on the contracts imposed

by the standard service offer terms.

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

A. Yes.

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

A. Yes.

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

A. Yes.

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

Isn't it true that in these other states where rate caps are expected to expire in the near future, there's even been some discussion and actually legislation introduced to return to some form of regulation out of the fear that consumers will experience such huge increases under the current regime of deregulation?

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

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

A. I forget.

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

A. Yes. I've read about that.

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

A. I didn't follow that.

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

A. I don't recall.

At an earlier time, I could mention that

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

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

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

Q. They were probably glad that they did that.

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

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

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

Q. In fact, haven't this -- hasn't this expectation of huge price increases from having rate caps expire led to a lot of political turmoil in these reports that you've read from other states?

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

Have you read that report, too?

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

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

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

Q. There's been a lot of political turmoil about the fact that rate caps either have expired or are scheduled to expire soon.

A. Yes.

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

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

MS. HOTZ: I object.

BY MR. FINNIGAN:

Q. What's your understanding?

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

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

BY MR. FINNIGAN:

Q. Well, you have to make some recommendation as to, you know, what market price is in effect in Ohio; you've done that. One of the things you've done to prepare is you've reviewed developments in other states. And that's all I'm asking you about. So I'm just asking you about the background, what you reviewed to prepare for your testimony and, you know, that's -- that's all I want to ask you about.

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

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

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

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

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

BY MR. FINNIGAN:

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

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

Q. That was that same answer --

A. Yes, yes, I was thinking that.

Q. -- that the other witness adopted.
A. Yes. It depends.
Q. I was thinking of that, too.
A. Fuel prices would be one element, although I think they're going down a little bit now, and they may go down more, but that would be one. And the other would be the basic cost of generation, embedded costs of capacity, et cetera, may be lower than the cost of acquiring capacity in the marketplace.
Q. Well, isn't one cause that the market structure, that is, the way the prices are set when rate caps expire, is the prices are set based on the market clearing price, which is the highest price of generation available in that market?
A. Yes. As I think I pointed out somewhere in my testimony, when the marginal or incremental resource used in generation is natural gas, which we know has gone up a lot compared with the $2 or whatever it was per unit way back, if that sets the price in the market at least for some periods of the day, it's going to increase prices.
Q. Really dramatically, won't it?
A. It can.
Q. And hasn't gas gone up as much as from $2

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

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

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

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

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

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

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

A. Yes.

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

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MS. HOTZ: Beyond the scope.
THE WITNESS: Do I answer anyway?
MS. HOTZ: Yes, you do.
THE WITNESS: Yes.
BY MR. FINNIGAN:
Q. And what are the problems that exist in the wholesale markets that have prevented them from fully developing?
A. The electricity market isn't like the market for, let's say, corn, although that's got its own features.
Q. That's more of a commodity; correct?
A. It's a commodity.
And the problem with electricity, obviously, it's regionally generated and regionally consumed. So it all depends on the ability to get power from where it's generated to where it's needed. And within the relatively limited market areas that result from that, it certainly seems to have been the case that there's been some monopoly power, or oligopoly power, where a few sellers may be able to manipulate prices to their advantage. So I'd say that's the primary issue where you have --
MS. HOTZ: Excuse me. Would you like

some water?

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

-- where you have the insufficient development of competition.

BY MR. FINNIGAN:

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

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

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

Q. Well, even in wholesale markets where electric distribution utilities fully divested their generating assets, those wholesale markets have experienced major problems, too, haven't they?

A. They've experienced problems, yes.

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

A. Yes, and neighboring markets.

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

MS. HOTZ: Objection. Beyond the scope.

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

BY MR. FINNIGAN:

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

A. You don't want to let perfection get in the way, necessarily. More or less effective competition can work quite well.

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

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

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

A. If that were the case.

Q. Okay.

A. Yes.

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

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

Q. Okay.

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

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

A. Yes.

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

MS. HOTZ: Objection. Beyond the scope.

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

BY MR. FINNIGAN:

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

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

A. That's the primary objection, yes.

Q. Yes.

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

testimony.
A. I do. Actually, I noticed that the percentage is a bit higher, actually, because I put the AAC under fully bypassable, but, in fact, it is not. If you add in -- If you add in the 5.3 percent of this total tariff that -- or, the total revenues, actually, that correspond with the AAC revenues, you get a total of 81.3 percent that's fully bypassable and 18.7 percent that is not fully bypassable. It's a correction that I should probably make on the witness stand.
Q. Is that the only change that you would want to make to that chart on Page 21 at the present time?
A. I believe it is, yes.
Q. And that's moving the AAC from bypassable into nonbypassable.
A. To not -- Yeah, not fully.
Q. Not fully bypassable.
A. Not fully bypassable.
Q. Now, would you agree that what you've categorized as not fully bypassable elements of the approved MBSSO are bypassable by some percentage of consumers?
A. Yes.

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

\- - -

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

\- - -

BY MR. FINNIGAN:

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

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

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

(Pause.)

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

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

A. Yes.

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

A. Yes.

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

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

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

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

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

Talbot Exhibit No. 1?
A. I should note one point here. My table referred to residential and nonresidential. Whether the percentages are identical for residential, I'd have to think about it, but they may well be, but I'm not absolutely sure.
Q. Okay. Well, let's just keep it simple and stick to residential consumers for the moment.
But do you understand that what the company is attempting to represent in Talbot Exhibit No. 1 is the percentage of the company's generation charge that is not fully bypassable by the first 25 percent of residential consumers?
A. Yes.
Q. Okay. And do you believe that Talbot Exhibit 1 does accurately represent the percentage of the company's generation charge that's not fully bypassable by the first 25 percent of residential consumers?
A. Well, I have a slightly different definition. I've said not fully bypassable. I think those figures are correct.
The company has separately said -- asked the question which of these charges are partially bypassable, and then it's netted those out and

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

Q. Right.

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

A. Yes.

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

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

Q. Okay. Now, with respect to the system reliability tracker, are you aware that for 2007 the company has presented a claim of approximately $8 million for that component of the approved MBSSO?

MS. HOTZ: Which component was that?

MR. FINNIGAN: The system reliability tracker.

THE WITNESS: Eight million?

BY MR. FINNIGAN:

Q. Yes. Approximately eight million.

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

Q. Okay. I better --

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

(Discussion held off the record.)

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

BY MR. FINNIGAN:

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

A. Yes.

Q. Now, with that assumption, could you calculate how much of the company's generation charge would be fully bypassable by the first 25 percent of residential consumers, that is, if you substituted 8.8 million for the negative six million in Talbot Exhibit 1?

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

Q. Okay.

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

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

A. I believe so.

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

A. Yes.

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

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

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

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

MS. HOTZ: Where was that?

MR. FINNIGAN: In his testimony.

MS. HOTZ: Where in his testimony?

BY MR. FINNIGAN:

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

MR. WATHEN: It's on Page 31.

MS. HOTZ: Page 31.

MR. WATHEN: Line 19.

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

BY MR. FINNIGAN:

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

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

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

A. Yes.

Q. Now, would you agree that this generation charge that's available to the first 25 percent of residential consumers, that while not fully bypassable, is bypassable by 96.2 percent of those consumers, is a reasonably priced -- reasonably priced service?

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

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

A. Well, it's a major concern.

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

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

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

For example, if you're a retailer of

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

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

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

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

I think that charges that are not bypassable should be in the generation component. To the extent the charges -- certain charges need to be recovered by the EDU, electric utility, for its legacy role, and historical role, and current role of distribution of electricity, that's the right place for those charges to be.

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

A. Yes.

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

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

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

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

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

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

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

Q. Go ahead.

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

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

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

Q. But it's one way to go.

A. It is one way to go.

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

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

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

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

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

Q. The cure killed the patient.

A. Well, it didn't -- Well, it killed that portion. You know, that organ is dead at this point. We're on kidney transplant or something like that. This is getting into a stretch, but anyway, you want to try and restore the patient to health without some other organ going on the blink, and you don't want the utility to be financially embarrassed. Clearly, I don't think that would make any sense. I don't think that anyone would want that. The Commission certainly wouldn't. The company certainly wouldn't. I don't think it's good for the consumer.

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

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

Now, under that assumption I'm asking you to make, you've said that it is acceptable for the Public Utilities Commission to approve -- approve a market price that includes some component of nonbypassable charges to protect an EDU's financial stability; right?

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

Q. Okay.

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

Q. Right.

A. So to that extent, those two components, let's say the four percent, roughly, of reserve margin that load-serving entities have to provide, spinning reserves, et cetera, et cetera, and some percentage of the remaining, if you will, 15 percent that the company's claiming for a -- for a reserve margin, some portion of that remaining 11 percent is also duplicative with the companies. We don't know how much.

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

A. Yes.

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

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

Q. Transmission --

A. -- transmission and --

Q. -- and ancillary services.

A. -- ancillary services, correct.

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

A. It's -- It's the cost of lining up a margin of four percent, in effect, spinning reserves and so forth.

Q. And transmission service.

A. And transmission.

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

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

Q. Right.

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

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

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

Q. No. No. I'm not doing that.
A. Well --
Q. Okay. I see what you're saying. You're saying --
A. Transmission costs are, I believe, bypassable.
Q. Right.
A. They're the responsibility of the -- of the competitive retailer, CRES.
Q. Okay. But I'm only asking -- I'm asking you to compare that you've lumped in transmission and ancillary services in your calculation of the four percent.
A. No. Not transmission. That's just generation.
Q. Well, you mentioned transmission in your testimony, didn't you?
A. Yes, but I think I said that's a separate issue. I've not argued the transmission was an overlap cost. It's a bypassable cost for the company -- for the CRES, C-R-E-S.
Q. Okay. So when you talk about the four percent cost that suppliers incur that's overlapping with the company's SRT costs, you're referring to the ancillary services?

A. Ancillary services, yes.
Q. Okay. Now, if, you know, that component of a supplier's cost is overlapping with the company's cost for maintaining a reserve margin through the system reliability tracker, what part of the company's costs are not overlapping with the supplier's cost to provide those ancillary services?
A. We don't know because some suppliers, presumably not all, have -- will line up firm resources to provide the sales to the -- to provide the generation for the -- for their customers, for their retail customers in the company's service territory.
So to the extent they are implicitly or explicitly acquiring generating capacity, as well as energy to provide for their customer. For example, they may have a power plant, or a group of power plants, and be selling off of that capacity, so they will be keeping some capacity to provide this load. And to that extent, that chips into the 14 percent. That overlaps the 14 percent.
Q. Where does the 14 percent come from? Do you mean the 15 percent?

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

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

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

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

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

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

A. Fifteen percent. I beg your pardon.

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

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

Q. And a legitimate nonbypassable charge.

A. Yes.

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

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

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

MS. HOTZ: Excuse me a second.

Are you ready for a break?

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

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

THE WITNESS: Yeah. Quarter till 12:00? Whatever. Ten minutes is fine.

(Luncheon recess taken.)

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P R O C E E D I N G S

- - -

Wednesday, March 14, 2007
Afternoon Session

- - -

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

- - -

CROSS-EXAMINATION (cont'd.)

BY MR. FINNIGAN:

Q. Good afternoon, Mr. Talbot.

A. Good afternoon.

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

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

A. Operating reserves is one of them, yes.

Q. Do you know of any others?

A. I think operating reserves includes spinning reserves.
Q. Okay.
A. I think that's probably the biggest item.
Q. Okay. Are those the only two kinds of reserves that suppliers provide that you're aware of?
A. There are about two other charges or ancillary services that are measured as capacity amounts, and I think they add up to four percent in total.
I think the operating reserves or spinning reserves is only like two-and-a-half percent, or one-and-a-half percent, something in that range. Then there are a couple of other smaller items.
Q. Adding up to a total of four percent of the generation price.
A. Yes. I think that's for what used to be the ECAR segment. I now think it's called Reliability First.
Q. The Regional Reliability Council?
A. Yes.
Q. Okay. And as far as Duke Energy Ohio goes, do you know what mechanism it has to recover

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

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

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

A. Yes.

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

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

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

A. Don't tell me.

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

A. Transition cost recovery.

Q. TRC (sic).

MR. WATHEN: Transmission.

BY MR. FINNIGAN:

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

A. It was transition cost recovery --

Q. Right.

A. -- that one. Transmission is elsewhere.

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

I wanted to refer to the transmission cost recovery component.

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

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

A. Yes.

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

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

Q. Okay.

A. It's a fee, basically.

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

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

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

A. Yes, I'm aware of that.

Q. Okay. Now, let me ask you to assume that the company does recover the costs for ancillary services for operating reserves and spinning reserves through Rider TCR and that that rider is fully avoidable by shopping customers.

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

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

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

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

You talked about one reason being the fact that the company has charges for generation service that are not fully bypassable; right?

A. Yes.

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

A. Yes.

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

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

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

BY MR. FINNIGAN:

Q. Yes.

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

A. Shopping credits, as far as they go, would, I assume, be similar to rebates or nonpayment of a -- similar to bypassability of the fee, in effect. So I assume that the shopping credits would have been part of the reason why the competitive market did seem to be taking hold in the company's service territory and I think elsewhere in Ohio, too, particularly northern Ohio.

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

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

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

A. Yes.

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

A. I wasn't aware of that.

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

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

A. It's possible.

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

A. I'm not aware of any.

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

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

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

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

Again, if Alan Greenspan is right and we get a recession this year or next, then all bets are off, but there's less capacity available, but I don't think we're at the point of the market being 100 percent committed or capacity being 100 percent committed. And so I would assume it's possible for sellers to either earmark their own generation or generation that they purchase or the product which they purchase to line up resources in the marketplace. I don't see any impediment to that.

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

A. No.

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

A. Yes, 2006 on.

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

A. No.

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

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

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

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

So net-net, you know, I don't know what the prices would be if they'd been negotiated in the marketplace, or if they were to be negotiated in the marketplace -- I don't mean negotiated, I mean competitively bid in the marketplace in six months or a year's time.

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

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

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

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

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

Q. Okay.

A. So those states that have not switched to competitive procurement, or call it deregulation, or partial deregulation, or whatever, are, I assume, for the most part being governed by the same kinds of factors that they always were, cost plus a reasonable rate of return. Some of those may have gone to incentive pricing of one kind or another, so -- you know, so pricing effects relative to costs for a while.

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

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

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

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

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

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

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

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

Q. New York?

MS. HOTZ: You're mischaracterizing his testimony.

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

MS. HOTZ: Well, you have to ask.

MR. FINNIGAN: Okay. I'm sorry.

BY MR. FINNIGAN:

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

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

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

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

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

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

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

Now, you know, we can -- we can argue about what that means. And I know the company takes the view that it's a deregulated entity, as far as generation. However, as a practical matter, I observe that the Commission is having regular hearings to determine elements of the standard service offer price, such as any of the three trackers. And that the company has come in to the Commission for the period for -- to set rates for the following period, which goes beyond my testimony, 2009, 2010, but it's perhaps relevant in the sense that at this point the company hasn't picked up its marbles and gone home, it's still playing.

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

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

Q. Okay. I think I understand your

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

A. I haven't testified on that.

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

MS. HOTZ: It's beyond the scope.

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

BY MR. FINNIGAN:

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

A. No.

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

A. Yes, I am.

Q. I believe you mention those in your testimony.

A. Yes.

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

A. Yes.

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

A. Yes.

MS. HOTZ: That's a legal question.

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

MS. HOTZ: Okay.

THE WITNESS: Yes.

BY MR. FINNIGAN:

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

A. Yes, they can.

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

A. Yes.

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

A. Yes.

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

BY MR. FINNIGAN:

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

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

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

BY MR. FINNIGAN:

Q. Do you recall making that recommendation?

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

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

MS. HOTZ: Yeah.

BY MR. FINNIGAN:

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

A. Oh, yes.

Q. -- MBSSO.

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

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

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

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

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

A. No.

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

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

BY MR. FINNIGAN:

Q. Did you have an opportunity to review that?

A. No, I didn't.

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

A. I have not.

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

A. Yes.

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

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

BY MR. FINNIGAN:

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

A. Okay.

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

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

Q. Have you tried to quantify that risk?

A. No.

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

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

Q. Okay. And let's say there's a risk of a recession. You stated earlier in your deposition that Alan Greenberg (sic) predicts a recession in the near term; correct?

A. Yes.

Q. Or Greenspan.

A. Greenspan, yes. Yes.

Q. How quickly they forget.

A. How quickly; that's right.

Q. I'm sorry.

A. He's gone already.

Q. Alan Greenspan --

A. That's right.

Q. -- he predicts that.

A. He won't go quietly.

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

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

A. Well, we talked about that, the risk of returning customers a moment ago. And a recession -- I would say the company doesn't particularly have more risk than any other supplier, because the supplier would have a contract, and I suspect that the company or its affiliates would have a contract with -- with customers.

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

Q. And the company.

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

Q. But wouldn't you agree with me that, in a recession scenario, the company bears more risk than the supplier because the supplier has unlimited ability to flex down its price and the company does not have unlimited ability to flex down its price?

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

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

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

A. Some are.

Q. Like Constellation.

A. Some are big.

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

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

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

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

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

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

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

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

A. Right.

Q. -- I'm not arguing that. But the point I would ask you to consider is that isn't there some restriction on the company's ability to flex down its price in the event of a recession; in other words, certain components are fixed and they can't go down? We talked about that earlier in your deposition.

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

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

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

A. They may.

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

A. Yes.

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

A. Yes.

Q. Especially longer term ones.

A. Uh-huh.

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

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

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

for Ohio utilities to follow?
MS. HOTZ: Objection. Beyond the scope. You can answer.
THE WITNESS: Yes. That report would refer to the period after 2009, 2009 and beyond.
BY MR. FINNIGAN:
Q. And would you promote that approach now for companies to follow to develop a market price for generation service that follows reasonable market pricing principles?
A. I think the smart thing for me to do is just to say I'd stay by my colleague's recommendation. I was not involved in writing the report, but I agree with it. I think it's a reasonable way to go. Even if the process was started now to get that in place, it would probably only be in place by 2009.
Q. Okay. But one of the recommendations in that report is that utilities enter into long-term contracts to purchase power that are staggered over varying periods of time; isn't that right?
A. Staggered contract periods, yes.
Q. And if DE-Ohio followed that recommendation, even if it could flex down its FPP in the event of a recession, if it's locked into a

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

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

Q. Why not?

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

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

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

BY MR. FINNIGAN:

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

A. Not always.

Q. For consultants and everyone.

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

Q. Now, at Page 41 of your testimony, you make the statement that one could argue that the company should compensate consumers for providing an assured market for the company's generation.

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

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

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

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

Now, they may be paying more or less than current market, but that's the way the stability works. They are both protected against -- or, insulated is perhaps a better word, from increases or falls in market price. If the market price were to fall, the company would be better off. If the market price goes up, the customers are better off, to the extent of these fixed components. As we know, other components flow through, like fuel.

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

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

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

It might be worth finding that because it's -- I didn't actually comment on it in the testimony. I meant to put it in a Q and A saying that Mr. Steffen acknowledged this, yes, he did, but I didn't put that in. I just quoted the statement. I didn't add to it. It might be worth spending a moment to find it.

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

MS. HOTZ: He's not finished yet.

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

THE WITNESS: I think it might be worth finding.

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

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

BY MR. FINNIGAN:

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

A. Yes.

Q. What does switching risk mean?

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

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

A. Yes.

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

A. Under that assumption, yes, it would.

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

A. It could.

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

Now, let's talk about the converse

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

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

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

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

A. Yes.

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

A. Yes.

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

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

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

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

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

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

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

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

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

A. Yes.

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

A. Yes.

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

A. In practice, I don't think so, because there is the other -- the risk of losing customers. And when the opposite happened, where market prices fall, the company will tend to retain some customers above market prices. And to the extent that the pricing is reasonably accurate, the company should be in the position of not suffering fully for that -- for that fall -- for that need -- for that potential loss of customers when the -- when the market price falls.

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

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

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

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

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

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

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

Q. Now, let me change the subject.

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

A. Both, I think.

Q. Okay. Both.

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

A. Yes. I think if you look at my testimony, what it really is, it's an analysis of the current standard service offer. It's slightly different to the extent that the standard service offer under the RSP has evolved, as they say, between the company's original proposal, I think, which was in the stipulation in 2004, as I recall, and there were a couple of applications for rehearing, the re-entry order -- the entry on rehearing, et cetera.

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

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

MS. HOTZ: That's good.

(Recess taken.)

BY MR. FINNIGAN:

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

Now, with regard to the MBSSO and flex down, I used that term "flexing down" during today's deposition, but I want to make it clear that the way the MBSSO price could go up or down is based on the company's actual cost against some baseline. That is, if the company's actual cost moved up or down in relation to the baseline, that's what determines the degree of the company's ability to change that component of the MBSSO; is that right?

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

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

A. Correct.

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

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

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

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

Q. Okay.

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

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

A. Yes, but I think -- I have to say I think it's probably a moot point because I don't think the company ever would go below those bases. They're quite low, as I understand, because you've got fuel and economy purchased power and, you know, you're claiming a large amount for that, like 194 million. So if the price went down so that the revenue requirement was 194 million lower, then, you know, you'd eliminate the tracker or eliminate the positive tracker. That's a lot of money there.

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

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

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

A. Well, the rate stabilization charge and little g, itself, are fixed, and the infrastructure maintenance fund is fixed. So those components would just stay the same. They would not vary.

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

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

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

Q. If the Commission were to adopt your recommendation and implement a smoothing mechanism for the FPP, would you recommend that the company be permitted to recover carrying costs on the amount of any increases in its actual costs that are deferred for future recovery?

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

Q. You have no recommendation either way?

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

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

A. To a degree, yes.

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

A. That's true.

Q. As would a smoothing mechanism.

A. To a degree, it would.

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

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

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

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

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

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

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

A. Yes.

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

A. I would say that if you're using a traditional framework or quasi traditional framework, traditional framework, that you would take into account all the facts that you would when updated from an old generation rate to a new one, new capacity committed to this customer group, standard service offer, retired capacity, depreciation, new construction costs, everything.

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

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

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

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

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

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

THE WITNESS: Thank you.

MR. FINNIGAN: I appreciate it.

(Signature not waived.)

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

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A F F I D A V I T

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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: ________________________.

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C E R T I F I C A T E

- - -

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.

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

Rate Component	**2006 Revenue**	**Percent of Total**
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%