BEFORE THE PUBLIC UTILITIES COMMISSION OF OHIO

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

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PROCEEDINGS

before Ms. Jeanne Kingery and Mr. Scott Farkas, Hearing Examiners, at the Public Utilities Commission of Ohio, 180 East Broad Street, Room 11-C, Columbus, Ohio, called at 9:00 a.m. on Tuesday, March 20, 2007.

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Tuesday Morning Session,

March 20, 2007.

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EXAMINER FARKAS: On the record. Is there anything before we get started?

MR. PETRICOFF: Yes, your Honor, I would like to enter the appearance of David L. Hoeffel on behalf of OMG.

EXAMINER KINGERY: Is there anything else?

(No response.)

EXAMINER FARKAS: I believe OCC was going to call their witness. Okay.

- - -

NEIL H. TALBOT

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

DIRECT EXAMINATION

By Ms. Hotz:

Q. Mr. Talbot, please state your full name and address for the record?

A. Neil H. Talbot. Twelve -- I beg your pardon. It's the Synapse address. 12 Pearl Street, Cambridge, Massachusetts.

Q. By whom are you employed?

A. Synapse Energy Economics.

Q. For whom are you testifying in the case?

A. The Office of the Ohio Consumers' Counsel.

MR. FINNIGAN: Your Honor, OCC would like to mark Mr. Talbot's prepared testimony as OCC remand Exhibit 1, please.

(EXHIBIT MARKED FOR IDENTIFICATION.)

EXAMINER FARKAS: So marked.

Q. Mr. Talbot, do you have before you what has been marked as OCC Exhibit 1?

A. I do.

Q. Do you have any changes or corrections you would like to make to that document?

A. Yes. There's one change to a table, which is on page 21. The line No. 11 that's part of that table which has a Rate Component, Total Fully Bypassable should be moved up above the previous line, which is Annually Adjusted Component, which then would become line 11, and the percentage that's now on line 11 of 86.6 percent would now become 81.3 percent Total Fully Bypassable, and the dollar number for Total Fully Bypassable is 848,582,225.

Then going down to line 15, the Total Not Fully Bypassable would increase from 13.4 percent to 18.7 percent, and the dollar amount would be 195,273,627.

And then on the next page, first line that's page 22, the first line is 13.4 percent would increase to 18.7 percent. That's the change.

Q. Mr. Talbot, does that change any of your conclusions or recommendations?

A. No.

Q. If you were asked the same questions today that you were asked in this testimony, would you have the same answers?

A. Yes, I would.

MS. HOTZ: Mr. Talbot is available for cross-examination.

EXAMINER FARKAS: Thank you.

MR. FINNIGAN: Thank you, your Honor.

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CROSS-EXAMINATION

By Mr. Finnigan:

Q. Good morning, Mr. Talbot.

A. Good morning, Mr. Finnigan.

Q. Mr. Talbot, could we stay on that table,

and I'd like to direct your attention to AAC. What percentage of consumers can avoid the AAC?

A. The first 25 percent of residential load that shift to competitive retailers could avoid the AAC, and the first 50 of nonresidential load could avoid it.

Q. What about the RSC?

A. Likewise.

Q. The SRT is bypassable for nonresidential consumers who agree to stay off the company's service through the end of 2008 ; isn't that correct?

A. Yes; and I think there are conditions on return.

Q. What is the current MBSSO price?

A. It's about six cents.

Q. What is amount of provider of last resort charge?

A. Adding the components provided by the company, I believe the total would be 2.22 percent -- 2.22 cents.

Q. Do you know the amount of the company's generation charge in relationship to the generation charge for other Ohio EDUs?

A. No.

Q. Do you know the percent of the company's nonbypassable charges in relationship to other Ohio EDUs?

A. No.

Q. Let me change the subject and ask you about the objectives of a rate stabilization plan and the Commission's scope of review. Would you agree with me that the Commission's objectives in reviewing this MBSSO are to determine whether that's a just and reasonable price in light of three policy objectives: protecting consumers against huge increases, providing the EDU with some financial stability, and encouraging competition?

A. Correct.

Q. And would you agree that these policy objectives conflict to some degree such that the Commission must try to set a reasonable balance among these conflicting policy objectives?

A. Yes. I think that is the case.

Q. Would you agree that reasonable minds could differ regarding how to strike that reasonable balance among these conflicting policy objectives?

A. Yes.

Q. Now, let me ask you about the opinions

you rendered in your testimony. One purpose of your testimony was to opine whether the MBSSO provides reasonably priced service in terms of market pricing principles and accounting cost principles.

A. That's, in fact, the primary thrust of my testimony.

Q. And you believe there are two categories of states that provide reasonably priced service in terms of these principles, don't you?

A. Yes.

Q. What are those two categories of states?

A. There are states that have pulled back, if you will, from the move towards competitive markets and have preferred to remain in the regulated arena, and typically under traditional or more or less traditional cost of service based ratemaking. In some cases there are probably incentive rate plans that may depart somewhat from cost based rate making, but, nonetheless, cost based rate making would provide the foundation and an anchor.

The other group would be states where the Commission in one way or another has opened up power supply, generation supply to competitive markets, and those would test the reasonableness in terms of

market price. The latter group of states would be states like New Jersey or Massachusetts or Illinois where power is obtained through a competitive bidding process, or states like Maine where the utility solicits power for the customers.

MS. HOTZ: Mr. Finnigan, are you coming from a particular page in the testimony?

MR. FINNIGAN: No.

A. Yes, I agree.

Q. Now, the first group of states that you mentioned that have pulled back from competition, why did they do that?

A. I'm sure the precise reasons were different from state to state, but clearly beginning around 2000 with the Enron matter and the California crisis when the prices for electricity went very high and spiked for certain periods, there was a loss of confidence in the competitive markets, and a number of states thought it was better to stay anchored to an accounting cost basis as opposed to a market based price for that reason.

Q. And that loss of confidence continues to this day as we've seen more and more states pull back from purely competitive pricing.

A. Yes.

MS. HOTZ: Your Honor, I object. I think that is going beyond that scope.

MR. FINNIGAN: Your Honor, the reason I ask this question, he said the main purpose of his testimony was to render an opinion as to whether our service provides reasonably priced service in terms of competitive marketing principles. He said that there are certain groups of states that do that. I intend to ask him whether he's reviewed those states' standard service offers in preparing his testimony. I believe his answer will be yes, and I think this is very relevant to the opinions that he's rendering in his prefiled testimony.

EXAMINER FARKAS: I'm going to overrule the objection.

Go ahead.

MR. FINNIGAN: Thank you.

Q. Sir, did you review documents about other states' standard service offers to prepare your prefiled testimony?

A. Yes.

Q. And to prepare for your deposition?

A. Yes.

Q. You obtained this information from those state Commission websites?

A. For the most part, yes.

Q. And that's a generally reliable source of information?

A. Yes.

Q. And you keep up with these developments in other states that have deregulated generation service as part of your practice as a consultant?

A. Yes.

Q. Now, let me take a moment and ask you to identify a couple of documents that I'll ask you some questions about, and first, could you turn to tab 1 of the documents that I've placed before you to a document that's marked as DE-Ohio Remand Exhibit 4. Do you see that?

A. Yes.

Q. What is that?

A. This is report issued by Synapse Energy Economics on "Electricity Supply Prices in Deregulated Markets - The Problem and Potential Responses."

Q. That's your firm, isn't it?

A. Yes.

Q. Is this a reliable source of information about developments in the electric industry?

MS. HOTZ: Your Honor, I object. I don't believe that Mr. Talbot is responsible for this. I don't believe that he knows how it was put together. His name is not on this report. I don't think that he can testify to it.

MR. FINNIGAN: Your Honor, the scope of cross-examination is much broader than documents that an expert prepares. The scope of cross-examination includes matters that are recognized as reliable authorities, and that's why I'm asking these questions.

EXAMINER FARKAS: I'm going to allow the questions. I'll overrule the objection.

MR. FINNIGAN: Thank you, your Honor.

Q. Sir, there's a question before you. Can you explain what this document is that's been marked as DE- Ohio Remand Exhibit 4?

A. As I said, it's a report by colleagues of mine on electricity supply prices in deregulated markets.

Q. And is it a reliable source of information about electric restructuring?

MS. HOTZ: Your Honor, this is a 26-page document. How does he know if it's reliable or not?

EXAMINER FARKAS: Why don't you ask him some questions why he would consider this a reliable source of information?

Q. Do you know a Mr. Rick Hornby?

A. Very well, yes.

Q. Do you know an Ezra Hausman?

A. No.

Q. Do you know Ann Sommer?

A. Yes.

Q. And as to Mr. Hornby and Ms. Sommer, how would you characterize the quality of their work?

A. Very professional.

Q. Is the information that they produce generally reliable?

A. Certainly, yes.

Q. And please take a few moments or take as long as you would like and review the document marked as Exhibit 4.

EXAMINER FARKAS: Have you ever seen this document before?

THE WITNESS: I've not seen this document before.

A. I would find it difficult to get on top of a document which is a summary and probably has a lot of work behind it. For example, it refers to a study that Synapse did --

EXAMINER FARKAS: Why don't you look it over for a second --

THE WITNESS: -- regarding Illinois.

EXAMINER FARKAS: -- before you comment on that.

Q. Keep in mind, my question is whether this generally appears to be a reliable source of information.

A. I've scanned through the document. I have a general idea what it says, but clearly it warrants quite a bit more study.

Q. And based on your familiarity with Mr. Hornby's work, Ms. Sommer's work and based on the information in the study, do you have any opinion as to whether it appears to be a generally reliable source of information?

MS. HOTZ: I object your Honor. This is a PowerPoint presentation. It doesn't have any of the research or data that supports it in here. It is just a general PowerPoint presentation.

EXAMINER FARKAS: What's the nature of your questioning with respect to this document?

MR. FINNIGAN: Well, I have some questions in particular. I'd like to direct his attention to page 6.

Q. Do you see the slide numbered 6 there?

A. Yes.

Q. And that slide talks about "Summary, The Problems in Deregulated Supply Markets," and the bullets say, "Increases greater than if market was regulated; High supply prices will continue" --

EXAMINER FARKAS: I haven't allowed you to ask the question. I'm asking what is nature of -- what are you asking?

MR. FINNIGAN: I just have a couple of questions about the particular points in this document. This is one slide. And then I have a couple of other slides I'd like to ask him about. I don't intend to ask him any extensive questions, and I don't intend to review the entire document, but certainly since this is a document prepared by his firm and by his colleagues, who he holds in such high esteem, I'm simply asking him whether it appears to be a reliable source of information.

Now, if his firm does not produce reliable information, than I'll move on. But I assume that it did, generally.

EXAMINER FARKAS: We'll listen to the question and decide whether the question is appropriate and the answer and whether or not we'll strike it.

Q. Sir, does this study appear to be generally reliable?

A. Yes.

Q. Thank you. Now, let me ask you the same question with respect to the document before you that I've marked as Duke Energy Remand Exhibit 5. What is that study?

EXAMINER FARKAS: Is that tab 2?

MR. FINNIGAN: Tab 2, yes.

MS. HOTZ: OCC has the same objections.

EXAMINER FARKAS: I understand. I'll allow the question and then decide.

MR. FINNIGAN: Thank you.

A. This appears to be another study by my colleagues at Synapse Energy Economics that I've not read. It's a presentation titled "Electricity Price Increases: causes, Effects and Solutions."

Q. How do you pronounce in name of the author of that study?

A. Biewald. Bruce Biewald. He's the president of the company.

Q. Are you acquainted with him?

A. Yes, for a long time.

Q. What's the quality of his work?

A. Excellent.

Q. Could you take a few moments and review that document?

MS. HOTZ: Same objections.

EXAMINER FARKAS: I understand.

MS. HOTZ: I'm not sure it's even a study. It's called Restructuring Round Table.

A. It appears to be related to the previous presentation, and, likewise, refers primarily to New England.

Q. And, likewise, with the first study would you agree that it's generally reliable?

A. I assume that it is, yes.

Q. Thank you. Now could you please take a look at tab 3 of the binder, a document that's been marked as Duke Energy Remand Exhibit No. 6. Do you see that?

A. Yes.

Q. What is that?

A. That's a report done for the Office of the Ohio Consumers' Counsel titled "Integrated Portfolio Management in a Restructured Supply Market," by two firms, my firm and another firm, Resource Insight.

Q. Would you please take a few minutes to review that document?

A. I have actually read this document previously, at least the summary portion thereof.

Q. And do you believe it's generally reliable?

A. Yes.

Q. Now, take a look at page 4 -- I'm sorry, tab 4, a document marked as Duke Energy Ohio Remand Exhibit No. 7. Are you there?

A. Yes.

Q. And I'll represent to you that that's a report that's available on the Virgina State Corporation Commission website, and that it's an annual report that's prepared by the Virginia Commission to the Governor of Virginia and the Virginia General Assembly, and it includes a report

that's prepared by a Kenneth Rose and Karl Meeusen. Mr. Rose is with the Institute of Public Utilities for Michigan State University.

Could you please turn back to tab 3 for a moment? Do you see that?

A. Yes.

Q. Now, on tab 3 if you go back to the end, does that have a section called Works Cited?

A. Yes.

Q. And does that have an entry for a Kenneth Rose and Karl Meeusen?

A. Yes.

Q. And is that a work that they prepared in 2005 for the Virginia State Corporation Commission?

A. Yes.

Q. So your firm cited this work and relied on this work in their study that we've already talked about.

A. I don't think that I can conclude that because they may, for example, have cited it critically. I don't know.

Q. Well, they cited it.

A. They cited it.

EXAMINER KINGERY: Can I jump in? It

looks like the citation is to a 2005 report, and this is a 2006 report.

MR. FINNIGAN: Yes, I stand corrected. I'm sorry. Thank you.

Q. Turning back to Duke Energy Exhibit No. 7, could you take a moment to review this document, which is the executive summary of the report?

MS. HOTZ: We object to that. It would take quite a while to get through that.

EXAMINER FARKAS: Tab 7?

MS. HOTZ: Oh, Tab 7, I'm sorry.

THE WITNESS: I thought I was looking at Tab 4, which is Exhibit 7.

MR. FINNIGAN: Correct.

EXAMINER FARKAS: I'm sorry, I stand corrected.

THE WITNESS: It's a pretty long report or summary.

MS. HOTZ: Tab 4?

EXAMINER FARKAS: Yes, tab 4.

THE WITNESS: Would you like me to read through those pages?

EXAMINER FARKAS: Do we have a response

to that objection?

MR. FINNIGAN: I'm sorry, I didn't hear the objection.

EXAMINER FARKAS: You want to repeat the objection?

MS. HOTZ: Yes. This is a very long document. He can't possibly get through this to answer any questions on the spot like that.

MR. FINNIGAN: Well, your Honors, when I started this line of questioning, he said that as part of his preparation for his prefiled testimony he reviewed developments in other states, and he said that the way -- and he said he also keeps up with developments in other states as part of his practice as a consultant in this industry. And he said the way he keeps up with this is he goes on state commission websites, and he said that he finds the information on state commission websites to be generally reliable.

And I'm simply keeping in line with that questioning, that testimony from the witness. So I believe that this is very consistent with what he does for his day-to-day practices. He goes on these websites. He relies on these things. I'm just

asking him whether this document that I've pulled from the Virginia Commission website is reliable, and then I will ask him about some developments in Virginia because he testified to those in his deposition.

MS. HOTZ: Your Honor, if they want to put on rebuttal testimony, they have that opportunity. They should not be using our witness to do this.

EXAMINER FARKAS: When you go on a website and review documents, how do you do that and what's the procedure that you usually follow, and is it normally reliable?

THE WITNESS: I would usually rely on primarily orders from commissions or rulings and sometimes data that would be on the website. I might or might not look at documents like these that are consultant reports. So I would tend to go for official information, if you will, what did the commission do in order to, you know, deal with competitive bidding process or something like that.

EXAMINER KINGERY: If you did look at a document like this, what would it take for you to reach a conclusion in your own mind whether it was

reliable or not?

THE WITNESS: Well, clearly, as Mr. Finnigan said, there is room for difference of opinion. Reasonable people differ, and I would try and figure out where this particular report was coming from. People have axes to grind, so given that understanding of the orientation or flavor of the report, I would place more or less reliance on it, frankly, whether I happen to share that orientation.

EXAMINER KINGERY: Basically would you look to see who had written it?

THE WITNESS: Yes. And I would sort of look at the first couple of pages to see where it was heading and the table of contents, et cetera.

EXAMINER KINGERY: Is that something that you are able to do as you sit here?

THE WITNESS: It's not easy to get at a longish document because there are a number of different aspects, and one would could easily miss something that is very important. I would say that my comments -- anything I said about documents I had not read before would have to be hedged around with some cautions, and the problem is I can't come back

tomorrow and say, "Oops, I didn't see page 7."

MR. FINNIGAN: Your Honor, I'm only going to ask about one or two statements within this report if I would be permitted to do so, and then I would just ask whether he agrees or disagrees with those statements, if I could be permitted to do that.

EXAMINER FARKAS: We will allow you to ask a question and allow him to answer it based on his understanding that he has not read the report.

MR. FINNIGAN: Thank you.

Q. (By Mr. Finnigan) Sir, could you please turn to page No. 3 at the bottom of that document, and spend a moment to look at that chart that's pictured there and let me know when you have had a chance to look at that.

A. I have looked at it already.

Q. What that shows in states where prices for power are determined through a market based process, those prices have risen higher and at a higher rate than states -- other states that have restructured where power is not obtained through a market based process or a pure market based process and higher than the national average and higher than traditional cost based regulated states. Isn't that

correct?

A. Yes.

Q. And do you have any basis to disagree with that information?

A. No.

Q. Thank you. Now, isn't it true that in some of these other states where power is obtained through a competitive process or a pure market process, the price increases that we've seen have been over 60 percent, over 70 percent in at least some of these states?

A. There have been very significant increases, without getting into specific numbers, and the experience has varied from one state to the next. By bad luck or bad management, some of the states that have gone to market based rates have been those where natural gas has been at the margin, it's been referred to in these documents, at the margin of generation, and since natural gas prices rose very substantially, I think peaking at the end of 2005 and early 2006, that tended to have a significant effect on the prices in 2006 and to a degree, 2005.

So it's difficult to generalize, but I think that's a reasonable generalization, that when

you deregulate and go to market based rates and expense of fuel is on the margin of generation at some hours or many hours of the day or week, that that's going to have a disproportionate effect on prices in the near term.

Q. Sir, is natural gas on the margin in the Ohio market?

A. I think it's a minority of hours. I think the majority of the hours coal is probably on the margin and the minority of hours natural gas.

Q. Sir, going back to my earlier question, would you agree the magnitude of the increases in these states have been over 60 percent and over 70 percent in some areas?

A. As I said earlier, I would agree that the magnitude has been significant. I don't recall those specific numbers.

Q. Let me direct your attention to tab 2, the document that we've marked as Duke Energy Exhibit 5. Do you see that?

A. Yes.

Q. And on the first page it indicates that in Maine there were increases of 65 percent.

A. Massachusetts.

Q. I'm sorry, Massachusetts. And then in New Hampshire, 64 percent. Is that correct on both of those?

A. That's what the table says.

Q. And then could you please turn to tab 5, a document that's been marked as Duke Energy Ohio Remand Exhibit No. 8?

And I'll represent to you that's a decision by the Maryland Court of Appeals dealing with developments in the Maryland market, and could you turn to page 9 of that document? It's numbered in the upper right-hand corner. Do you see that?

A. Yes.

Q. And under the heading that says "Facts" in the second line, it says that there was an anticipated 72 percent increase in the cost of electricity by -- for Baltimore Gas & Electric Company; is that correct?

A. I'd just like to look at the date. I don't know what the actual increase was, but somebody anticipated that there would be a 72 percent increase for that company.

Q. Right. Now, how well did the market price mechanisms protect consumers in these states

where there have been increases above 60 percent and above 70 percent?

A. I think that 2006 was a bit of a perfect storm, almost literally, because following Hurricane Katrina in September of 2005, natural gas prices went high, and, for example, in New Jersey the competitive bidding process that they instituted was done I think in February 2006, and that was not a time when gas supplies or electricity supplies were willing to take the risk of prices being very high, so the bids received were very high in 2006.

And some of that I think is reflected here. In periods of very volatile natural gas prices, I think depending on the way in which RFPs or bids are solicited from energy suppliers, electricity suppliers, you could be vulnerable to a substantial increase in rates. In a well-designed system, I submit you would not be as exposed because of staggered contract terms and so forth. But there's some degree of exposure would remain.

Q. My question to you, sir, do you have an opinion as to whether these pure market price mechanisms in these states protected consumers well against huge price increases?

A. I think in some cases they did not protect consumers well.

Q. Sir, could you turn to tab 15?

A. Yes.

Q. And could you take a look at the page --

MR. McNAMEE: Which tab are you on?

MR. FINNIGAN: Tab 15.

Q. Could you please turn to the page numbered 38 of tab 15?

A. Yes.

Q. And please take a look at line 16. I'm going to read that and let me know if I'm reading this accurately. Your testimony at your deposition was:

"ANSWER: 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" --

MS. HOTZ: Objection.

MR. FINNIGAN: Your Honor, I'm not done with my question.

MS. HOTZ: Are you claiming that -- are

you attempting to impeach him?

MR. FINNIGAN: I'm sorry, could I be permitted to finish my question?

EXAMINER FARKAS: Why don't you let him ask the question.

MS. HOTZ: He's just reading from the deposition.

EXAMINER FARKAS: Let him ask the question.

MR. FINNIGAN: Your Honor, I'm impeaching the witness' testimony. The witness testified a moment ago in Ohio that coal is on the margin in the market. He said in his deposition that natural gas was on the margin for pricing in the Ohio market. I'm impeaching the witness by bringing up a prior inconsistent statement. So I'm reading to him what his prior inconsistent statement was, and then I want him to acknowledge whether he made that statement in his deposition. So that's all I'm trying to do.

EXAMINER FARKAS: Go ahead with his question.

MR. FINNIGAN: I would like the courtesy of finishing my question before I get interrupted.

EXAMINER FARKAS: Okay. Go ahead with

your question.

MR. FINNIGAN: Thank you, your Honor, I'll start over again.

EXAMINER FARKAS: Okay.

Q. Now, sir, on page 38, line 16, your answer at that time was: "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 some periods of the day, it's going to increase prices."

And then there was a colloquy about Hurricane Katrina and so forth.

Then skipping down to page 3, line 18, I asked you: "And in Ohio, too, is that your understanding?" And your answer was "yes."

Have I read that correctly, sir?

A. Yes, you have.

Q. Thank you. Now, sir, with regard to these developments in other states, as a result of the 72 percent increase in generation in Maryland, the Governor fired all the commissioners in that state.

A. I believe there was some kind of bruaha --

THE WITNESS: May a make a comment on what I just read out from my previous deposition?

EXAMINER FARKAS: You want to respond to the --

THE WITNESS: I don't think I was given a chance.

EXAMINER FARKAS: That's redirect.

Go ahead. In answer to his subsequent question you said before was a bruaha. Are you agreeing with what he's saying?

THE WITNESS: Yes. I think there have been in a couple of states, Illinois and other ones, there has been political developments around these rate increases.

Q. And you mentioned Illinois. Could you turn to tab 8? Do you see that there, the document that's been marked as Duke Energy Ohio Exhibit 8?

A. Is this exhibit --

EXAMINER FARKAS: Are you talking about 11?

MR. FINNIGAN: I'm sorry, I misspoke on that.

Q. It would be tab 8, the document marked Duke Energy Remand Exhibit 11.

A. Yes.

Q. I'll represent to you that that's a letter from the Governor of Illinois to the Commission. It was filed in the Commission docket. It's available on their website in the case number listed in the first part, 05-0159, and you see in the second full paragraph from the bottom, the last sentence of that paragraph, it says: "I consider an approval of a reverse auction procurement process of market-based rates for wholesale power either a serious neglect of duty or gross incompetence by the ICC." Is that correct?

Q. Is that the political bruaha you were referring to in Illinois?

A. Yes.

Q. Thank you. And then in Connecticut are you aware that the Governor announced a plan to combat the rate shock that resulted from market-based pricing in that state?

A. I don't specifically recall that.

Q. Could you turn to tab 7 of that binder, please, and the document has been marked as Duke

Energy Remand Exhibit 10. Do you see that?

A. Yes.

Q. That's a press release from the Connecticut Governor. It's dated February 5, 2007. And it talks about a new plan -- new energy initiative and could you please take a look at the second page, the very last sentence of that document.

MS. HOTZ: I object to questions on this. This did not come from a website. This is a press release. I don't think he said that he relied on press releases to form his opinion.

MR. FINNIGAN: This did --

EXAMINER FARKAS: I don't believe a question has been asked yet.

MS. HOTZ: Well, he is asking a question from a press release, and he did not rely on press releases.

MR. FINNIGAN: It did come from the website. It's the Governor's website.

MS. HOTZ: He didn't say he relied on the governor's website.

MR. FINNIGAN: And my question was just -- I was going to ask him a sentence or a -- just one question about the last sentence of the

press release where it mentions rate shock, and I just -- he's familiar with all these developments in other states. I was just asking him whether he is familiar with this development too.

EXAMINER FARKAS: Yeah. I am going to allow the question.

MR. FINNIGAN: Thank you.

Q. Now, sir, the last sentence of that press release says that "The rate approval structure currently in place has resulted in rate shock for Connecticut, and it must be changed." Are you familiar with that development in Connecticut?

A. No.

Q. Now, let's move on and talk about some of the causes for these huge rate increases. Now, would you agree with me that one cause for these huge generation increases we've seen in these other states is a problem with the wholesale market and the problem is that the prices are set in the wholesale market at a market clearing price which is usually the price for the highest generation in that market?

A. Well, I would agree that in a commodity-type market there -- it does tend to be greater price volume than in regulated markets.

Q. Is that a yes?

A. A qualified yes.

Q. And would you agree with me that retail competition cannot fully succeed without a viable wholesale market?

A. I agree with that.

Q. Would you agree with me that really retail generation markets were deregulated too soon in Ohio and that, in effect, we got it backwards and we should have deregulated the wholesale market first and then deregulated the retail market?

A. I don't think I would conclude -- I don't have the evidence for concluding at this point that the wholesale market should have been -- is the problem, if you will, or the potential problem in Ohio. What I've said in my testimony -- this is really the thrust of my testimony is that looking at these particular rate components of Duke Energy - Ohio that there is inconsistency regarding their basis. Some are based on legacy generation costs, some current costs, and some estimates of what the market might do, what market price components might be, and I have not recommended moving one way or the other.

I said move one way or the other. I am not recommending which. Either move towards the competitively-based system, more competitive system where market price is set in the marketplace, or if the Commission doesn't trust the market at this point, then move back into the direction of regulated rates. But I believe that the current standard service offer is awkwardly placed between those reasonable structures and is inconsistent.

Q. We are going to get to that, but right now, I am asking you about something different. Now, I am just asking if you either agree or disagree with this statement that in Ohio we deregulated the retail generation market too soon, we got it backwards, we should have deregulated the wholesale market first? Agree or disagree?

A. I don't know. I have not looked at the degree of competition in the marketplace. I have read documents that have said there's plenty of competition, effective competition, in the market. The Commission, I assume, towards the end of 2004 and in 2005 felt otherwise and decided to anchor rates more in terms of accounting costs or historical costs and re -- as a proxy, let's say, for market prices

rather than relying on the current state of the market which I think the Commission did not feel was -- was sufficiently competitive even after the market development period in which the market supposedly would have developed. I guess the Commission didn't believe it did.

I do not have an opinion on that subject. All I have said is either go to a consistent market-based rate or a consistent cost based rate.

Q. Well, would you agree that with regard to the Midwest ISO, the MISO, we're kind of in a wholesale nether world in that there are just a litany of concerns with the state of the market at this time?

MS. HOTZ: Objection, beyond the scope.

EXAMINER FARKAS: I'll allow it.

A. I don't have an opinion on the effectiveness of competition, if you will, within the MISO area.

Q. Okay. Let me ask you if you could please turn to tab 11, the document marked Duke Energy Remand Exhibit 14.

MS. HOTZ: Did you say 11, please?

MR. FINNIGAN: Tab 11, Exhibit 14.

Q. Are you there?

A. Yes.

Q. I will represent to you that's a document that I received in -- and purports to be a presentation by Janine Migden-Ostrander of the Office of the Ohio Consumers' Counsel, June 1, 2006, to the Harvard Electricity Policy Group and let me ask you if you agree or disagree with these statements or whether you have no opinion. Could you turn to the fourth page of that document where it says, "The Wholesale Nether World" at the top.

MS. HOTZ: What's the title of the page?

MR. FINNIGAN: "The Wholesale 'Nether World.'" It's the fourth page.

MS. HOTZ: Okay. The retail or the wholesale?

EXAMINER FARKAS: Wholesale.

MS. HOTZ: Wholesale.

MR. FINNIGAN: Starts "News is full of stories."

Q. Do you see that?

A. Yes.

Q. Do you agree or disagree with the statements on that page?

A. I don't have an opinion on these issues. I haven't read those stories. I beg your pardon. I have read the stories about wholesale auctions in other states resulting in problems which we were talking about earlier, but I have not -- I have not followed the Ohio wholesale auctions she talks about.

Q. Well, you are aware of the problems in Maryland that she talks about there. We talked about those earlier with that 72 percent increase and they fired all the Commissioners.

A. Yes.

Q. Okay. And did you say that you weren't aware that we've tried competitive bidding in Ohio but we have not been able to get any acceptable bids?

A. I was aware that I think there was bidding in the case of FirstEnergy. I do not know what the outcome of that bidding was except that I believe the Commission regarded it as unacceptable.

Q. Now, could you turn to the back of that slide. Take a moment to look at that page and let me know if you agree with the statements on that page.

A. The first statement I would conditionally agree with that short-term market prices --

MS. HOTZ: What's the title of the page?

Excuse me. I'm sorry.

MR. FINNIGAN: It says "The Wholesale 'Nether World'" and the first bullet says "Reflects short-term market prices." It's on the very back of the page we were just discussing.

MS. HOTZ: Oh, okay, okay.

A. Competitive bidding can reflect short-term market prices. It doesn't always do so. I agree with the second bullet in general that there is a problem regarding the lack of construction of new base-load capacity and possibly transmission as well in many regions in the U.S.

Q. And what about the next slide which is the fifth page, it's titled "The Wholesale 'Nether World'" at the top and it talks about "a litany of concerns."

A. I am not aware of those.

Q. Well, would you read the slide and just tell me whether you agree or disagree with the statements on the OCC's presentation.

A. I haven't gone into those issues.

Q. You cannot agree or disagree?

A. Correct.

Q. Same question about the back of that

page.

MS. HOTZ: This is beyond the scope of his testimony.

MR. FINNIGAN: Well, again, this is just, you know, cross-examination into his opinions. He's talking about what we need to do to get reasonably priced service for generation in Ohio. And, now, we are exploring whether the conditions exist such that we could have reasonably-priced generation service using a pure market process or whether it would be prudent for the Commission to consider protecting consumers in some way due to these market conditions.

EXAMINER FARKAS: I am going to overrule the objection. Go ahead.

MR. FINNIGAN: Thank you.

A. I have not studied these issues.

Q. Do you agree or disagree with the statements on OCC's presentation on that page?

A. Neither agree nor disagree, no opinion.

Q. And then my last question is page 6, top of the page, it says "What do we do now? Certainly retail competition cannot succeed without a viable wholesale market." Do you agree with that?

A. Yes.

Q. And the statement below that that those -- "those of us speaking for the OCC who promoted retail competition dramatically underestimated the work that needed to be done to provide such wholesale markets." Do you agree with that?

A. I think it probably depends on the region but depending on the region, yes.

Q. And how about with respect to the MISO region, would you agree with that?

A. I don't have an opinion on that.

Q. So are you saying you don't have an opinion -- strike that.

Would you agree with me that if the MISO wholesale market were not fully developed, then it would be advisable for the Commission to adopt some form of interim measures in the short-term to protect consumers from huge price increases?

A. Yes, I think so.

Q. Now, let's talk about retail competition and -- strike that.

As to the wholesale market, do you know whether the on-peak power prices in this wholesale market are correlated with Henry Hub gas prices in

any way?

MS. HOTZ: Beyond the scope of his testimony.

MR. FINNIGAN: He talked earlier about whether natural gas was on the margin in this market. I am just following up on that point.

EXAMINER FARKAS: I'll allow it. But before he answers the question could we go off the record for a second?

(Discussion off the record.)

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

You can answer the question.

A. I haven't studied the correlation, but I would assume that there is some relationship, yes.

Q. If I told you that there was an 85 percent correlation, do you think that's within the range of reason of what you would expect to see?

A. That was a bit more than I would have expected but.

Q. Not -- is it substantially more than what you would expect?

A. It's significantly more than I would have expected.

MR. FINNIGAN: That's all the questions I have at this point. I do have more but this would be a convenient time for me to take a break.

EXAMINER FARKAS: Okay. Let's take a 10-minute recess.

(Recess taken.)

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

MR. FINNIGAN: Thank you, your Honor.

(EXHIBIT MARKED FOR IDENTIFICATION.)

Q. Mr. Talbot, I have placed a document before you that's been marked as Duke Energy - Ohio Remand Exhibit 18. Have you had a moment to look at that?

A. Yes, I have.

Q. And I will represent to you that that's a document from the Maryland Public Service Commission website that talks about a rate stabilization plan for Baltimore Gas and Electric, and if you look at the description of the rate stabilization plan, I would like to draw your attention to the first bullet under that summary description. "As a result of the legislation passed by the General Assembly, all BGE customers, residential customers, are automatically

enrolled and participate in the rate stabilization plan."

And then skipping two bullets down "Customers will begin to pay back the deferred amount on January 1, 2007."

And then the next bullet says "All customers will receive the monthly deferral credits and the monthly deferral charges whether or not they select a competitive supplier." Have I read those bullets correctly?

A. Yes.

Q. And is that your understanding of a nonbypassable charge for those Maryland consumers?

MS. HOTZ: Objection. Your Honor, he doesn't have any idea what some of these terms are. This is an entirely, you know, different proceeding and they use different terms for different reasons. How can he know what this is?

MR. FINNIGAN: Well, your Honor, this goes back to what he says he does as part of his job as a consultant. He said his job is to keep up with developments in other states that have deregulated and if -- you know, if Ms. Hotz, you know, suggests that he can't read this and understand these terms, I

mean, this witness has testified that he is not very familiar with developments in Maryland, developments in Illinois, developments in Connecticut where they've deregulated the electric markets and had huge increases, yet he is coming in here and telling us that we got it wrong in Ohio, so I believe that I'm entitled to a wide latitude in examining this witness.

EXAMINER FARKAS: Could I hear the question again?

MS. HOTZ: Well, yes, you did hear a question.

EXAMINER KINGERY: No. We want to have it read.

EXAMINER FARKAS: Okay.

MR. FINNIGAN: I will reask it.

EXAMINER FARKAS: Okay.

MR. FINNIGAN: I was just asking Mr. Talbot whether it's your understanding from the portion of that document that I've read that that would describe a nonbypassable charge for those Maryland consumers.

MS. HOTZ: Your Honor, he admitted that Mr. Talbot said he was not familiar with the Maryland

program, and he's asking him to interpret terms here that aren't defined.

EXAMINER KINGERY: Could we talk for just a minute?

EXAMINER FARKAS: Mr. Talbot, from this sheet of paper do you have enough information to answer that question?

THE WITNESS: I don't think I do. There may be all sorts of elements in this. I could give a superficial answer but not really a final answer to what this appears to be.

EXAMINER FARKAS: I'll sustain the objection. I'll sustain the objection.

MR. FINNIGAN: Thank you.

Q. Sir, I would like to switch the topic and talk about retail competition in Duke Energy - Ohio's service area. Would you agree that one cause of the switching rate that we see now in Duke Energy - Ohio's service area is the fact that, you know, aside -- is the fact that shopping incentives have expired?

A. Yes, I believe there were shopping incentives, and they are no longer in place.

Q. And, sir, let me change the subject

again. I want to ask you about competitive-bidding processes.

MS. HOTZ: Objection, beyond the scope of his testimony.

MR. FINNIGAN: Well, your Honor, I believe it is within the scope of his testimony because he's testifying about whether we have reasonably-priced generation service in terms of market-pricing principles and he compares this to other states where he believes they do have reasonably-priced service and they do follow market-pricing principles and those are states he said earlier where they follow competitive-bidding processes, so I feel like, you know, this is part of that same line of cross-examination. And he did -- he did recommend in his 2004 testimony which is still part of the record in this case in favor of a competitive-bidding process in Ohio.

So I am just exploring that testimony that's already part of the record.

MS. HOTZ: He's already been cross-examined on his 2004 testimony.

MR. FINNIGAN: And I am just asking whether he's -- now that we're here in 2007, whether

he would still make that same recommendation or whether he might find reason to step back from that based on these huge increases that we've seen in other states.

EXAMINER FARKAS: I am going to overrule the objection, allow the question.

MR. FINNIGAN: Thank you, your Honor.

Q. Mr. Talbot, you testified in 2004 that you recommended a competitive-bidding process for Duke Energy - Ohio; isn't that correct?

A. What I specifically said was that the company's proposals in their CMO alternatives needed to be updated in terms I think of rules that the Commission had subsequently issued on competitive bidding. The Commission's rules had not yet come out at the time I testified and what I said was when the Commission comes up with rules, the company's proposals in that regard should comply with the rules.

Q. But didn't you recommend a competitive-bidding process in 2004?

A. I don't specifically recall if I -- if I recommended any particular kind of bidding process. What I would say now in answer to that question is

that we have had enough experience of problems in competitive bidding to make it desirable to proceed with caution, if you will, in going out to market, whether a competitive-bidding process such as an auction of the kind they have in New Jersey or an RFP sort of approach that most states have adopted where the company will issue an RFP for -- for standard-offered generation. And I -- I think I would at least entertain the question whether the Commission should reserve the right or the company should reserve the right to reject all bids if none of them were acceptable.

That happened in Maine, for example, and the Commission ordered bidding to resume, if you will, six months or a year later when prices had settled down.

So I would proceed with caution, I would say, rather than a blanket approval for a competitive-bidding process if -- I say this as I have said before, if that is the direction that the Commission believes is the right way to go, the alternative being as I have suggested to tighten up the cost basis of a standard service offer.

Q. Now, Mr. Talbot, I am not sure about the

proceed with caution part. Would you or would you not recommend a competitive-bidding process with Duke Energy - Ohio at the present time?

A. As I've said before, and I think it is the right position to hold, and that is the Commission needs to make a prior determination which way it wants to go. I think if you go back to the legislation, the legislation appears to favor competitive bidding, competitive marketplace, and reliance on that marketplace.

The Commission in its rules since 2004, I think, is moving in the direction of saying until we are sure about the competitive market let's tighten up the cost basis of the standard service offer. And they have done it by relying more on the accounting cost, less on estimates, and less on the marketplace.

Although I say that, some of the cost basis is the cost of acquiring capacity, for example, in the marketplace, and to that extent it's both a cost basis for the company and a market basis since the market has to go out in the SRT, for example, and acquire capacity or the equivalent in the marketplace.

Q. Now, Mr. Talbot, the proceeding -- I'm

sorry. Strike that.

Mr. Talbot, the time period we're dealing with in this proceeding is quite limited, isn't it? We're here in the spring of 2007, and we are only talking about a time period for the current market price that would run through the end of 2008. Do you understand that's the scope of this proceeding?

A. Yes.

Q. That's a pretty limited time period, isn't it?

A. It is a limited time period.

Q. Now, does it make sense or does it not make sense for the Commission to adopt a competitive-bidding process for the company given this limited time period?

MS. HOTZ: Objection. It's beyond the scope of his testimony. He's only testifying on their -- their -- the RSP, MBSSO. He did not testify on competitive bid.

MR. FINNIGAN: Your Honor, same --

EXAMINER FARKAS: I am going to overrule the objection, allow the question.

MR. FINNIGAN: Thank you.

A. It would take a considerable period to

get a -- to structure a competitive-bidding process and implement it and get power from it. So I would -- I would be inclined to say that it's more practical in the short run to tighten up the existing rate stabilization plan in the MBSSO than to -- then to switch at this point to a competitive-bidding process. I'm making no recommendations beyond 2008.

Q. But you agree as to the present case that deals with the time period up to the end of 2008, it just doesn't make any sense to pursue a competitive-bidding process?

A. That's probably correct, yes.

Q. Thank you. Let me direct you to your testimony and I would like to go back to your prefiled testimony. And do you still have that before you?

A. I do.

Q. And could you turn to page 13 of that testimony.

A. Yes.

Q. Now, there you begin an extensive discussion of your understanding of the Supreme Court's opinion. You talk about what the result was at the Supreme Court as it pertains to your

testimony. You talk about on the next page what general issues the Supreme Court has remanded to the Commission, and then you go on and you talk about specific details, et cetera. Do you see that? Are you familiar with that part of your testimony where you go into extensive discussion about your understanding of the Supreme Court's opinion?

A. Yes.

Q. Now, I would like to ask you do you have any understanding as to whether the Supreme Court made any finding about whether the company's market-based standard service offer is a market price?

A. I don't recall if the court made an overall finding in that regard. As I recall, the points that I have emphasized have been the more specific issues such as on page 16 of my testimony, the issue of the rationale and basis for and evidence for and reasonableness of the components of the -- of the MBSSO, for example, the IMF and the SRT.

MR. FINNIGAN: Your Honor, may I approach the witness?

EXAMINER FARKAS: Yes.

Q. Mr. Talbot, I have handed you a copy of

the Supreme Court's decision. I would like to direct you to the page 14 in the upper right-hand corner. Do you see that?

A. Yes.

Q. At the bottom it begins "Proposition of law No. 2." Do you see that?

EXAMINER KINGERY: What paragraph number are you referring to?

MR. FINNIGAN: It's No. 37.

Q. And it says there that "In proposition of law No. 2, OCC challenges the Commission's factual finding that CG&E offered a market-based standard service offer as required by, you know, statute and the rule." And then skipping down to the next page, paragraph 44, it says "We hold that the Commission's finding that CG&E's standard service offer was market based is supported by sufficient probative evidence." Have I read that correctly?

A. Yes.

Q. Okay. Now, you criticized the MBSSO as being a hybrid mixture of different elements, some are current costs, some are historic costs, and some are estimates, and you can't really tell whether they are costs or not. Was that one of your criticisms?

A. That's correct.

Q. Now, would you agree with me in general economic terms in the long run every manufacturer or a competitor in every industry has to recover all of their costs plus some reasonable rate of return?

A. Yes.

Q. Now, with respect to this hybrid pricing that you criticize, I want to ask you a hypothetical question, and let's assume that I go out and get some bids from landscapers to do some landscaping work at my house later on this summer. And they come back with me, and they give me some bids to do the work. And a component of their bids is that they are going to charge me their actual cost for the bushes that they have to go out and buy at the nursery store.

A. Okay.

Q. Now, in that scenario where you have gone out and gotten those bids, would those be market prices that the landscapers are bidding?

A. Yes.

Q. Would they include historic costs like the costs of their trucks and bulldozers?

A. It's difficult to know how a company might or an individual landscaper might price his

service. They could -- they could say as long as I get the money back from my truck which I need to replace every so many years and so forth, depreciation and replacement, they might take that approach, or they might be influenced by market conditions.

For example, if they had gotten a rather expensive truck, they might realize they couldn't recover the costs of that truck. So they would have to go below that historical cost. On the other hand, there might be significant demand for their services, and they might go higher than historical costs plus regional margin even including the cost of the shrubs.

Q. I guess the landscapers that buy the real expensive trucks don't stay in business real long, but would you agree with me in most cases the landscapers' bids would include their historic costs?

A. On average they would, yes.

Q. And when the landscapers are passing through the actual costs for the bushes that they have to buy from the nurseries, is that in the nature of an accounting cost?

A. Yes. It's an accounting cost and a

market cost because they are buying in terms of the current market.

Q. And since they are going to do the work at my house next summer and they don't know how many hours it's going to take them and their crews, they are just providing an estimate that -- a component of their bid is an estimate, isn't it?

A. Yes, I guess it is, yes.

Q. And we don't know what their actual costs are going to be, do we, because they are just giving an estimate; we are selecting the bid based on that?

A. Right.

Q. Let's talk about the company's view of risk. That was something you addressed in your testimony, wasn't it?

A. Yes.

Q. Would you agree with me in Mr. Steffen's testimony the company provides a balanced view of the risks that it faces?

A. No. I respect Mr. Steffen's testimony, but I do think that he has overestimated the degree of risk faced by the company and probably underestimated the degree of risk faced by competitive retailers.

Q. Could you please turn to tab 15, page 101 of your deposition transcript. Let me know when you are there.

A. At what page is that?

Q. 101, please.

A. I've got it.

MS. HOTZ: Mr. Finnigan, are you impeaching him?

MR. FINNIGAN: 101.

MS. HOTZ: Are you impeaching him?

MR. FINNIGAN: I'm trying.

MS. HOTZ: Just wanted to make sure.

Q. Are you at page 101?

A. I am.

Q. Let me direct your attention to line 14. And this is your statement, and I am going to read it, "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 certainly to the company.' And so I think that this is a correct balanced assessment." Have I read that correctly?

A. You have.

Q. Thank you. Now, I want to ask you about the company's obligations as the EDU, and I understand in your testimony you made the recommendation that the Commission should place reserve margin responsibilities on suppliers that are equal to the EDU's obligations; is that correct?

A. Yes.

Q. Now, do you understand under the current market structure that EDU must provide all consumers with a market-based standard service offer of all competitive retail electric services necessary to maintain electric service including a firm supply of generation service under the current market structure?

A. I think that the current market structure requires that obligation on a current year basis or year ahead basis.

Q. And do suppliers face that obligation under the current market structure?

A. Competitive retailers currently are in the Midwest ISO designated as load serving entities, LSEs, and transmission customers and they do have certain responsibilities in that regard including the responsibility of having about 4 percent of spinning

and other reserves available for as you might say ancillary services. But they do not have that overall responsibility of having a reserve margin which would primarily be for outages, cover outages.

Q. They don't have that responsibility to hold an offer to all consumers?

A. I don't -- I don't believe the Midwest ISO requires that of competitive retailers at this point.

Q. Or does the Ohio market structure require that?

A. No, it doesn't.

Q. Now, do you understand under the current market structure if a supplier defaults that the supplier's customers default to the utility until they find another supplier?

A. Yes.

Q. Do suppliers have that obligation?

A. No.

Q. Now, I want to ask you a hypothetical question. Please assume that utilities are required to offer all essential electric service to all consumers in their service area and assume that suppliers do not have this requirement. And further

assume that the Commission cannot remove that responsibility from the utilities and place it on suppliers. Now, under those assumptions, would you agree with me that the utility should have some reasonable protection because it has a greater responsibility than the suppliers have under those assumptions?

A. I think the danger in just answering yes to that question is to what degree. It's -- there is some -- a somewhat greater risk resulting from the here LR responsibility, but I think it really should be quite narrowly interpreted, and I say this for a couple of reasons. One is if you look at, for example, the SRT which is the tracker to cover the costs that Duke Energy - Ohio has going out in the market and acquiring capacity, it's a one-year obligation. It's not really a long-term obligation.

And related to that point if you look at the North American Electric Reliability Council assessment of generating adequacy, according to NERC the reliability first corporation, RFC, which encompasses the old ECAR, E-C-A-R, et cetera, it does not have a capacity shortage below the 15 percent margin, in other words, under current plans before

2012, so we are looking at a five-year period which apparently there is adequate capacity or more than adequate and it seems very unlikely that in those circumstances that any one entity will run short of power.

We are all in the same boat when it comes to electricity. If -- if Duke Energy - Ohio has -- or hasn't set aside 15 percent -- acquired in the market 15 percent of the capacity, it's not going to help anybody if somebody else is short and the whole ship -- the whole boat gets a leak. It takes on water.

So you have to think of it in terms of the region, and region at this point is expected to have enough capacity to 2012. I think there is a problem with our capacity, I think we talked about that, but consent to construct is not adequate at this point probably to allow for sufficient generation and transmission in the long run, but in the short run there's enough.

Q. Now, you gave a lengthy answer there based on -- or describing some nuance about the real question or the rub there is that the amount of protection the company should have. And I am not

asking you about the amount. I am not asking you about that. I am just asking you would you agree with me under the assumptions I gave you that it's reasonable that the utility should have some reasonable protection because it has this greater responsibility than suppliers have. Would you agree that some protection is reasonable?

A. In principle, yes, but I think the Commission should use a pretty sharp pencil when it comes to dollar amounts.

Q. Okay. We will get to that. And would you agree -- and I understand this is not your recommendation but would you agree with me that one acceptable way the Commission could choose to do that and provide reasonable protection to utilities is by making some component of the generation charge nonbypassable as long as there is no overlap with what suppliers have to provide?

A. Subject to the -- to my earlier comment that it behooves the Commission to use a very sharp pencil, I would agree.

Q. Now, with respect to overlapping responsibilities between suppliers and utilities you stated in your prefiled testimony that one area of

overlap is ancillary services, correct?

A. Yes.

Q. And you stated that ancillary services that suppliers provide are operating reserves and spinning reserves which amount to 4 percent of their generation cost.

A. 4 percent of the -- of the peak demand or demand requirement.

Q. Yes. And are you familiar with the company's system reliability tracker?

A. Yes.

Q. Do you know what that's intended to recover for?

A. Yes.

Q. What is your understanding?

A. The acquisition in the marketplace of specific contracts for capacity, if you will, and possibly some capacity -- physical capacity to meet peak demand plus a 15 percent reserve margin for standard service offer customers and other customers, namely, shopping customers.

Q. Would that include operating reserves and spinning reserves?

A. I believe it includes it, yes.

Q. Yes.

A. The 15 percent, in effect, would include the 4 percent.

Q. And that is 100 percent bypassable, isn't it?

A. The SRT --

Q. Well, for non-residential -- for non-residential consumers that meet the conditions and know to stay off the company's service through 2008. I believe we have already talked about that.

A. SRT by my notes is not bypassable by any residential customers. As you say, it's bypassable by nonresidential customers subject to certain conditions.

Q. Now, let me change the subject. I want to ask you about the risk and the opportunity cost the company faces. Would you agree with me that if wholesale market prices rise above the prices reflected in the MBSSO, then the company has a lost opportunity cost because under the MBSSO the company forgoes its opportunity to sell its generating assets into the market at such high a price?

A. In stabilizing prices under the SSO by including certain fixed price elements the company

gets an assurance of sales relative to market and could suffer as you've suggested if market prices were to rise above that but would benefit, of course, if market prices fell below that.

Q. So was that a yes if as in my question I asked if the market prices rose above the MBSSO? Is your answer yes to that?

A. Yes, they have reduced the risk in the interest of certainty. The company has greater certainty in its sales to standard service offer customers because very few are shopping. And the customers have also reduced risk because of the dedication of these resources to them.

Q. Does the company incur an opportunity cost if the wholesale market prices rise above the prices that are embedded in the MBSSO?

A. If market prices rise higher, the company is suffering an opportunity cost relative to what it might have earned. Vice versa, if prices were to fall, if, for example, there would be a recession this year and fuel prices went back down, the company might benefit by having relatively fixed prices but somewhat higher in the market.

Q. How would it benefit if all of its

consumers switch to a supplier that is allowing lower prices?

A. We are not seeing it. Prices have come down. We haven't seen any switching to speak of. I think the level is 3 percent of load currently, at least the figure for the end of September of 2006. I haven't looked at the end of December which came up more recently. The -- I would say that appears to be a rather remote eventuality at this point.

Q. What? A recession?

A. No. Shopping seems to be rather remote, recession. Alan Greenspan is not such a remote possibility, but the shopping issue is not just a question of price. You have to have the infrastructure of pricing, and it seems that compared to 2004, competitive retailers have sort of backed off the marketplace. In New York where I live I never get any solicitations any more. I used to get some. There is also generally a reluctance by consumers to move unless they face a substantial savings. You may get people switching, but in the case of prices falling which we are talking about in the marketplace, it's probably a bit of a non-event, so I would be skeptical about how many customers will

actually move even if market prices drop below the standard service offer price. And even if there were fewer nonbypassable charges, I have argued not only are the charges in the standard service offer in many cases not well based, but they shouldn't be nonbypassable except for basic generation.

Q. I am just asking you about if wholesale market prices would fall below the prices that are reflected in the MBSSO like if there is a recession, then the company would face a risk that it's consumers could switch to another supplier who is offering lower prices; that's a risk the company faces?

MS. HOTZ: He's already answered this question.

MR. FINNIGAN: I am not sure he did. It was a very long answer.

EXAMINER FARKAS: I will allow him to answer.

A. There is some degree of risk. But, again, one shouldn't forget that the company through its fuel and purchase power tracker would reflect in its rate declines in the current market for fuel and for its economy-purchased power which would

presumably increase market prices declining, so the company would be able to flex down those cost elements.

Q. Just some of them?

A. Some of them.

Q. Not all of them?

A. Not all of them.

Q. And if --

A. I say that Duke Energy - Ohio in its official tariffs has relatively limited flex down. The customers most likely to move, however, are industrials and large commercial, and I do not know to what degree Duke Energy through its affiliates might be able to flex down prices to meet competition. It may be able to do that.

Q. Do you know?

A. No, because that testimony has been rendered confidential, and I decided I would rather not see it for that reason. I didn't want to have to be confidential. I prefer to be on the public record.

Q. Your table on page 21 would seem to indicate that the substantial majority of the company's prices are fixed and cannot be adjusted

downward or upward.

A. The tariff -- the tariff generation charge referred to on page 8 -- on line 8, page 21, would not be flexible as little "g." That's about 62.7 percent of revenues. The 18.6 percent reflected by fuel economy purchased power would be flexible, possibly elements of the AAC. And the system reliability tracker would be flexible -- happens to be a negative item in 2006 but would normally be to the tune of about 1 percent of risk. So partially yes, and partially no.

Q. Well, my question was that is that the majority -- the majority of the company's charges are fixed and cannot be adjusted upward or downward, and I don't know if that's a question that you can answer partially yes, partially no. I think it calls for a yes or a no.

A. The majority of them are fixed under the SSO, yes.

Q. Thank you. And if a recession occurs, would you expect that wholesale market prices for power would be likely to fall in the event of a recession?

A. I would expect that.

Q. You personally feel like conditions are such that a recession could occur.

A. I do personally. I am in the minority, but I am glad to say the Federal Reserve ex-chairman agrees with me.

Q. Alan Greenspan is also predicting a recession for sometime in 2007 or 2008.

A. Yes, that's right.

Q. Now --

A. One-third probability.

Q. That's a pretty big risk, isn't it?

A. It's a risk.

Q. Now, I want to switch topics a little bit and talk about the company's MBSSO. It's a form of a rate stabilization plan, correct?

A. Yes.

Q. And would you agree with me that these fixed price components, they can't be adjusted up or down, and if market prices would go above the level of fixed prices, that, in effect, they act like a rate cap and they provide some degree of protection for consumers if market prices would rise above the level of the mixed prices reflected in the MBSSO?

A. Yes.

Q. And wouldn't it be good policy for the Commission to adopt a rate cap to protect consumers from huge increases? Wouldn't that be good policy?

A. Other things equal, yes.

Q. And your firm has recommended that consumer groups and commissions and stakeholders try to extend rate caps to protect consumers against these huge increases; correct?

A. I'm not recalling that specifically, but I wouldn't be surprised.

Q. Could we turn to tab 1 of the documents before you? Are you there?

A. Yes.

Q. Let me ask you about -- this is your firm's study that you said was a reliable authority. On the slide number 6 in the bottom right-hand corner it talks about these increases being greater than if the market was regulated. Then turn to page 8, slide 8. It says: "Potential Responses, extend or impose rate caps." And on the next slide 9: Extend or impose rate caps. Use any available leverage. Done in Delaware, Pennsylvania, Rhode Island, and Proposed in Illinois and Maryland. Have I read that correctly?

A. I would just add one point, the disclaimer on page 7: "Not all potential responses will be feasible or advisable in every jurisdiction." But subject to that, clearly from a consumers' standpoint, protection against price spikes is a good thing.

Q. And I know this is not your recommendation, but is the MBSSO one possible stop-gap solution to protect consumers from huge increases?

A. I don't know, and I think on the record, there really is a precise estimate of what the market prices would be absent the MBSSO, but the MBSSO to the extent that has fixed price elements in it would protect against high prices, leaving aside the issue of whether the prices are currently high or about where the MBSSO is.

Q. Now, I want to talk about the issue of bypassability. You criticized the company's MBSSO on the grounds it's not fully bypassable; is that correct?

A. Yes.

Q. And we started off your testimony with the chart on page 21. Could you go back to that

point, please?

A. Yes.

Q. Now, first, you know, you discussed in extensive detail the Supreme Court's opinion. What's your understanding of whether the Supreme Court found that any of the company's bypassable charges are proper as -- what's your understanding whether the Supreme Court made any finding as to whether it's proper for the company to have these nonbypassable discharges as long as it supports a proper amount for the SRT and IMF in this proceeding?

MS. HOTZ: Objection, calls for the legal conclusion.

MR. FINNIGAN: Your Honor, I'm just asking his understanding. He spent about five pages in his testimony talking about his understanding of the opinion.

EXAMINER FARKAS: I'll allow it as long as we recognize that he's not an attorney.

Go ahead.

A. The Court was uncertain about the source or basis of some of the charges, which are not being present in the proposals before the Commission during the hearing, as I recall.

Q. And I -- I'm sorry. You seemed like you might not have been finished.

A. Yes, I wasn't quite finished.

So in calling for those charges to be looked at again, I think they're really getting to the issue of the reasonableness of the charges, and the bypassability or otherwise is one of the issues of reasonableness, I would say. So I would -- I personally thought that what the Court was saying was the Commission should look at these again and see if they think they're reasonable.

Q. And that was the premise of my question. The purpose of the hearing and this reason we're here this week is for the company to attempt to support a proper amount for the IMF and the SRT charge.

A. And since those charges sound very like charges that are other charges in the SSR, I would say by implication, I think, with respect, it behooves the Commission to say: Well, here is, you know, the rationale for this charge and here's this rationale for that charge, and if we can't find a rationale independent of the other rationales of the other particular charge, it shouldn't be there.

Q. I'm just asking you about the general

concept. Do you have an understanding whether as a general concept the Supreme Court made any finding as to whether nonbypassable charges are proper if supported at the proper level?

A. I don't recall them specifically saying one way or the other.

Q. Can you please turn to page 19 of the opinion. Let me know when you're at that point.

EXAMINER FARKAS: What paragraph number?

MR. FINNIGAN: 63.

Q. Are you there?

A. Yes.

Q. Let me read that: OCC maintains that this Commission violated some statutes by approving nonbypassable charges for those customers switching to competitive retail electric service providers without a rate case and without statutory authorization.

And then the last sentence of that paragraph: OCC essentially claims these charges should be avoidable by shopping customers.

And then down to paragraph 88, second last full paragraph, first sentence: "We conclude that the Commission's decision in this regard was not

unlawful." Have I read that correctly?

EXAMINER KINGERY: What was that last paragraph reference, 88?

MR. FINNIGAN: 68. I'm sorry, 68.

MS. HOTZ: Your Honor, I object to Mr. Finnigan just reading off the documents and asking the witness if that's what it reads. I think that he can cite to this in a brief. There's no reason for him to be just reading things into the record and ask if that's what it says.

MR. FINNIGAN: I didn't ask him what it means.

EXAMINER FARKAS: Mr. Finnigan, are you formulating a question based on what you just asked him?

MR. FINNIGAN: No. I have nothing further on that topic, and I don't know if there's a pending question, but I'm ready to move on to another topic, and this my last area I want to cover with the witnesses, and that's the amount of bypassability. I'm ready to move on. I won't have any further questions about that. I'll withdraw my question.

EXAMINER FARKAS: Okay. Thank you.

Q. Now, the last thing I'd like to discuss

with you, Mr. Talbot, is the amount to which the company's generation charge is nonbypassable.

A. Very well.

Q. And could you go back to page 21 of your prefiled testimony where you discuss that?

A. Yes.

Q. And please take a look at tab 13. Do you see the document that's at tab 13?

A. Yes.

Q. And it's been marked as Duke Energy Ohio Remand Exhibit 16.

A. Yes.

Q. And do you recognize that as something we discussed in your deposition?

A. I do.

Q. Do you believe that calculation to be accurate?

A. I do.

Q. Subject to the fact it uses the same revenue numbers that the company supplied in response to a data request as you used on page 21 of your prefiled testimony.

A. Yes. There's only one point that I'd like to make, and that is, if I look at the system

reliability tracker, which is not bypassable by residential customers, that is negative item of $6 million or .6 percent because of an accounting, if you will, of overcollection in a previous period. So that this is a negative or repayment to customers, credit to customers in the current period, which is 2006.

I believe that that number would be something in the range of up to one percent positive for 2007 and '08, so in other words, there are expenses in that item, which changes the figures by in effect normalizing them. So I would point out this is not normalized.

Q. That would just be a minor change, wouldn't it?

A. Well, not so minor. So if you go from negative .6 to positive one percent or .8 percent something in that range, you do end up with more like 4 percent total nonbypassable, which is not an insignificant item when you consider it in relation to potential margins of competitors. It might, in effect, eliminate their margin, their profit margin so that I would say that it's actually a significant item.

Q. Have you studied suppliers' margins and the margins that they plan to obtain when they enter a retail market?

A. Yes. This came up in 2004 in the previous proceeding, and it was pretty clear that those margins are not easy to identify, and it all depends on a variety of factors. But if you look at -- I think what we looked at then was retail margins for retail businesses generally, and they were not a large number. It was a relatively single digit margin, as I recall. So if you're talking about a single digit return, knocking three or four percent off that is a big -- is a big reduction in margin.

Q. Now, with respect to the document that you have before you, it says residential consumers but wouldn't that apply to residential and nonresidential consumers for the most part?

A. Yes.

Q. And the only difference would be that the system reliability tracker is avoidable by nonresidential consumers under certain circumstances if they sign a contract and agree to remain off the company's system through 2008.

A. Yes.

Q. With those changes, do you believe this document is accurate?

A. Yes, I do.

Q. Then please turn to tab 14, the document marked Duke Energy Ohio 17. Do you see that?

A. Yes.

Q. And that's the same calculation, and I'll represent to you that the only change is that we've inserted for the system reliability tracker an amount of 8.6 million, which I'll represent to you is the amount that the company claims for the current time period exclusive of any true-up balance?

A. Yes, I understand.

Q. Subject to check on that amount, does this calculation appear to be accurate?

A. Yes. I think there would be a bit of positive true-up here in the sense there's not been some undercollection, so it might round up to something more like one percent, in that range, for a total of 6 percent totally nonbypassable, about 3.8 percent, 4 percent.

Q. Now, the same question with respect to the last exhibit. This one says residential

consumers, but actually it's avoidable by the first 25 percent of residential and nonresidential consumers; correct?

A. As I understand, this would be -- would not be bypassable by residential customers. It would be a slightly different picture for industrial or nonresidential generally who would have the ability under certain conditions to avoid the SRT.

Q. I'm just asking you whether this accurately portrays how much of the company's generation charge is bypassable for the first 25 percent of residential consumers and at least the first 25 percent of nonresidential consumers?

A. Yes, I agree with that.

Q. So we could change where it says "residential consumers" at the top to reflect that point.

A. Yes.

Q. And some of the charges, the AAC and the RSC can be avoided by up to 50 percent.

A. Of nonresidential.

Q. Of nonresidential consumers; Isn't that correct?

A. Yes.

Q. And the SRT, as we talked about earlier, can be avoided by nonresidential consumers and switch to a supplier and agree to stay off the company's service through '08; correct?

A. Yes.

Q. So what we have here is if you look at that -- what it says is 3.8 percent not bypassable, so I guess that leaves us with 96.2 bypassable. 96.2 percent for the first 25 percent of load.

A. Yes. Like I said, it like a small number but actually in relation to margins is not small.

Q. So 96 .2 percent is not a big number.

A. You need to look at the way a competitor would see it. A potential competitor, for example, might be a financial firm like JP Morgan Chase, which would be buying power in the marketplace and selling it, reselling it to customers. Their margin might only -- the total margin might only been a small percentage.

Q. I appreciate your concern about those suppliers' margins, and I understand that, but we talked about earlier that the company does have some risks that have been so compensated that are unique and that suppliers don't face; isn't that correct?

A. Well, the company -- I've suggested the company tends to overestimate or have a somewhat unbalanced assessment of risks, because if you look at competitive retail, they bear risks, too, and some of those risks are greater than the company's risks, specifically they don't have an established customer base. They need to do marketing. They need to do -- to establish administrative structure, billing, et cetera, et cetera, and enter into contracts with the company and with their suppliers, if they, themselves, have suppliers. So when you look at their risks, it's not difficult to understand why they have not entered the competitive marketplace.

Q. But --

A. Or they have withdrawn from the marketplace, really.

Q. I'm sure every business faces risks, but in the -- in this electric utility industry as the provider of last resort, we talked about how the electric utility faces some risks that's unique to the electric utility. They have to stand ready to serve all consumers that are returning or who's supplier might default. They have to hold out a standard service offer to all consumers in their

service area. We talked about how those risks are unique from other suppliers. Do you recall that testimony?

A. Yes. That's one side of the picture, yes.

MR. FINNIGAN: That's all the questions I have. Thank you, Mr. Talbot.

THE WITNESS: Thank you.

EXAMINER KINGERY: Any questions.

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CROSS-EXAMINATION

By Mr. Kurtz:

Q. Mr. Talbot, turn to the summary of your testimony at pages 5 and 6. Start at page 6 at the top. Are you there?

A. Yes.

Q. Your point No. 9, let me paraphrase a little bit. You discussed it at length with Mr. Finnigan, is that the RSP or the MBSSO price that the Commission has approved is neither fully cost based nor fully market based, therefore, it's flawed. Is that right?

A. Yes.

Q. You would agree if the Commission went to

a fully market based MBSSO, rates would go up on consumers, wouldn't you, based upon the evidence you've seen from Maryland, Illinois, so on and so forth from the documents Mr. Finnigan showed you?

A. I don't think I could draw that conclusion. It depends when and how the solicitation and the market access were arranged. It depends on conditions at the time. It wouldn't happen today or tomorrow. It would happen in the a year's time, say, or two years.

Q. For the period remaining 2007 through 2008, the period that we're focused on -- let me back up. What is the MBSSO on average that Duke - Ohio customers are paying?

A. It's about six cents.

Q. Do you know, do you see Mr. Rose's testimony that estimated the price of the market priced forecast was much higher than that?

A. I believe -- well, what I do recall is that he estimated what market prices would be using his methodology from 2004. As I've said quite extensively in my previous testimony, and I think repeated it briefly here, there is such a wide range in those estimates that they aren't really very

helpful for understanding whether the MBSSO rate is higher, lower or in the middle of those rates:

As to futures prices, they change.

Q. Can you turn to tab 2 of what Mr. Finnigan showed you, which is the Synapse Energy, Mr. Biewald's analysis?

A. Yes.

Q. Do you see those market prices that were experienced in Rhode Island, Massachusetts, Maine and New Hampshire ranging from 8.4 cents to 12.7 cents per kilowatt-hour?

A. Yep.

Q. Those are all higher than six cents, aren't they?

A. Yes. But here's the difficulty of comparing across not only time frames but across states or regions. These are all New England states, and in New England I believe natural gas is on the margin 100 percent of the time virtually, very high percentage. So during that period, which is 2005-2006-2007, natural gas prices, parts of that period were very high. So one thing we do know about fuel prices, we know it from the gas costs, gasoline costs, that they're volatile. So it all depends on

when you go out to market and the time period of your -- of your request and such.

Q. Do you know what percentage of the time MISO or Duke has located gas on the margin?

A. I believe gas is on the margin for a minority of hours, a minority, maybe 40 percent. But that's a bit of a guess, but I believe that's the case. Coal is the majority of hours, I believe.

Q. Just to be clear, it's the OCC's recommendation that the Commission should put everyone at market?

A. No. I don't think I've said that, and the OCC hasn't said that, as far as I'm aware. But what I've said is the Commission should consider establishing a more consistent set of MBSSO pricing arrangements or components that either move back in the direction -- which I think the Commission has been moving in up to now, get an actual accounting cost basis for its cost components, which is not a bad proxy for market prices in the long run. Or go more towards the market based pricing depending on whether the Commission believes at this time, or whatever time it looks at this issue, that the market is well enough developed, stable enough to be relied

upon.

Q. Let's look at that second analysis, move more towards cost based. Is it your position -- well, you state that the RSC and IMF have no cost basis and should be terminated. Is that your position? Line 11, page 6.

A. That's my recommendation, yes.

Q. And then you go on to say that basically that this generation component, little "g," whatever you want to call it, is based upon historical costs that are outdated, 1992 costs; is that right?

A. Yes.

Q. And the Commission should consider updating that cost component if it's going to terminate the RSC and the IMF; is that correct?

A. Yes.

Q. If the Commission were to conduct a rate case, so to speak, on Duke's generation, wouldn't the Commission need to determine depreciation rates for those power plants, for example?

A. Yes.

Q. Would the Commission need to set a return on equity and a capital structure and fixed domain and operating costs and all those? That would be

traditional in a rate case.

A. Yes. I believe if the Commission returned in the direction of cost based ratemaking, it would taking on something like a traditional rate case.

Q. Now, you have not actually calculated what the MBSSO would look like under a fully consistent cost based proxy, have you?

A. I have not.

Q. So you're not recommending market, and you haven't done an analysis to see what the full cost price would be; isn't that right?

A. I would let the chips fall where they may.

Q. You don't have an actual set of rates for the Duke rate schedules that would fall out from your proposal. It's nowhere in your testimony, is it?

A. Well, I've recommended certain estimate-based items do not have a basis.

Q. Under a pure cost based analysis, you don't know what the MBSSO prices would be.

A. No. But as an interim, if you removed some of the estimated, particularly the overlapping estimated components, for example, if the RSC is

retained and switched to a bypassable component, that goes back into little "g," which then becomes what it was before, basically, before the latest iterations of the SSO. The IMF, I don't frankly see a basis for it.

Q. If you're not recommending market and you haven't done the analysis on fully consistent costs, how do you know your proposal, whatever it is, is more reasonable that than what the Commission has already approved?

A. If you use a reasonable method, you have to let the chips fall where they may. I'm not saying -- I am just not arguing for lower rates. What I am arguing for is that these items are not well based. Now, I do also think whether immediately or at some point if the Commission is going to go back towards cost based rates, it is only reasonable to update little "g" because little "g" is an old number now. It's a very old number.

Q. So for the remainder of '06 and '07, would the Commission conduct a full-blown generation rate case and let the chips fall where they may.

A. Yes.

Q. And sitting here right now, you don't

know if that would be an increase or decrease in price for consumers.

A. I don't know for sure.

MR. KURTZ: Thank you, your Honor.

EXAMINER KINGERY: Any questions?

MR. McNAMEE: I have one detail.

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CROSS-EXAMINATION

By Mr. McNamee:

Q. Mr. Talbot, answering the question of Mr. Kurtz, you said average MBSSO price was six cents. Where do you find that?

A. I think it was provided in responses to data requests. There are a few sources for that information. There's a confidential response. It actually shouldn't be confidential because it's the same information provided in a nonconfidential response, which gives the total revenues divided by the number of kilowatt-hours, which anyone can do. However, I think there is no breach of confidentiality to say the total is about six cents. That was in response to OCC Interrogatory 06-RI-159.

MR. McNAMEE: Thank you. That's all.

EXAMINER KINGERY: I think that's

everyone.

Any redirect?

MS. HOTZ: We would like to go out for a moment.

EXAMINER FARKAS: Let's take a five-minute recess.

(Recess taken.)

EXAMINER FARKAS: Back on the record.

Proceed with your redirect.

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REDIRECT EXAMINATION

By Ms. Hotz:

Q. Do you think your statement in your deposition about natural gas being on margin was inconsistent with your statements about natural gas and coal being at the margins today?

A. No. Just to clarify, in tab 15 in the materials that Mr. Finnigan gave me, which was my deposition transcript, on page 39, I made some statements about gas on the margin, and I did earlier today. And I'm glad to see I agree with myself. In both statements I don't think there's any inconsistency. In some states gas is 100 percent on the margin. I believe here it is not 100 percent on

the margin. In Ohio it is under 50 percent, the minority of hours, and the majority of hours coal would be on the margin. It might run some for flexible capacity, if you will, but mostly coal.

Q. Do you have any comments to add to Mr. Finnigan's claim that there was a 5 percent correlation between the Henry Hub price and the into Cinergy price?

A. I felt the number was a bit high, and I still do. And I really feel I shouldn't testify to a statistic which is really only the result of what one would come up with if someone did a statistical study, when one would have two times the Henry Hub price for natural gas. You'd have the electricity price variable. Now, it's not clear which electricity price variable was used. Is it on peak, off peak, all hours, et cetera? And what period did this cover and so forth? It's really, you know, really one shouldn't testify to a number like that without having seen the database. What does 85 percent correlation mean, R squared, for example? It isn't clear.

Q. In the deposition transcript under tab 15 on page 101, Mr. Finnigan read your response into the

record. Do you have any comments about this?

A. Yes. Looking back at my testimony to the reference there, I had actually misunderstood something that Mr. Steffen said. I thought he was referring to the standard service offer as a whole, not just the IMF, and in that context it says he provides some level of revenue certainty to the company. That's my opinion, that the standard service offer does provide revenue certainty to the company. But he didn't say that, and I misunderstood him to say that. He referred specifically to the IMF.

MR. FINNIGAN6: That's all.

EXAMINER KINGERY: Do you have recross?

MR. FINNIGAN: No more questions, your Honor. I'd like to move some of the exhibits.

EXAMINER FARKAS: Okay. Any questions in response to the redirect?

(No response.)

EXAMINER FARKAS: Okay. Go ahead.

MR. FINNIGAN: Your Honors, I'd like to move into evidence DE-Ohio Remand Exhibits 4, 5 and 6, the Synapse studies he testified were reliable authorities.

I'd like to withdraw Exhibit No. 7.

And then I'd like to ask the Commission to take administrative notice of DE-Ohio Remand Exhibits 8 and 9. 8 is a Maryland case and is a bill that was introduced to the Texas legislature because I believe the Commission can take administrative notice of laws and statutes and regulations in other states.

DE-Ohio 10 I withdraw.

DE-Ohio Remand Exhibit 11, I move to admit into evidence because that's the Illinois situation he testified he was familiar with.

DE-Ohio Remand Exhibits 12 and 13 I ask the Commission to take administrative notice of because 12 is a Delaware law and 13 is a bill introduced into the Maine legislature.

DE-Ohio Remand Exhibit 14 is an OCC study, which I move into evidence. I assume the OCC would be willing to stipulate to that.

DE-Ohio Remand Exhibit 15 I withdraw.

DE-Ohio Exhibits 16 and 17 with the charts that Mr. Talbot testified were accurate, I move they be admitted into evidence.

EXAMINER KINGERY: What about 18?

MR. FINNIGAN: 18 is the press release dealing with the Maryland situation where it explains the components of the rate stabilization plan, the fact there are nonbypassable charges in Maryland. The witness didn't seem to be familiar with that particular document, but I ask the Commission to take administrative notice that's the kind of thing that he relies on in his practice, a document from the Maryland Commission website where the Commission explains.

MS. HOTZ: Objection. Object to DE-Ohio Exhibit 4 because Mr. Talbot had nothing to do with this. This is not even really a study. This is presentation at a NASUCA mid-year meeting, and, you know, it's simply not necessarily relevant.

EXAMINER FARKAS: Let's do them one at the time.

Anybody else object to DE-Ohio 4?

(No response.)

EXAMINER FARKAS: We will admit that.

(EXHIBIT ADMITTED INTO EVIDENCE.)

MS. HOTZ: DE-Ohio Exhibit 5, we object on the basis, again, Mr. Talbot had nothing to do with it. It's a restructuring roundtable. It's

would not even be relevant.

EXAMINER FARKAS: Anyone else have any objections?

(No response.)

EXAMINER FARKAS: We will admit that.

(EXHIBIT ADMITTED INTO EVIDENCE.)

MR. FINNIGAN: Your Honor, to make it clear, we are asking about the remand exhibit numbers.

EXAMINER FARKAS: Yes.

MS. HOTZ: I understand Exhibit 7 is withdrawn.

EXAMINER FARKAS: Remand Exhibit 6, do you object to that?

MS. HOTZ: No, we don't object to that.

EXAMINER FARKAS: Anyone else object to that?

(No response.)

EXAMINER FARKAS: That will be admitted.

(EXHIBIT ADMITTED INTO EVIDENCE.)

EXAMINER FARKAS: Seven is withdrawn.

Eight they asked for administrative notice.

MS. HOTZ: We don't object to 8.

We object to 9 because it is not law.

EXAMINER FARKAS: Wait a minute.

Mr. Finnigan, why are you moving -- not moving remand Exhibit 8 is an exhibit rather than us taking administrative notice of it?

MR. FINNIGAN: Well, I think since it's a reported decision from the Maryland Court of Appeals, the Commission could take notice, or we could simply cite it as the case from a jurisdiction that bears on this issue.

EXAMINER FARKAS: We will take administrative notice of that exhibit.

EXAMINER FARKAS: Nine.

MS. HOTZ: We object to 9 because it is not a bill -- it's a bill. It is not a law, and it was never discussed in the cross.

EXAMINER KINGERY: Are you asking for notice of No. 9?

MR. FINNIGAN: Yes.

EXAMINER FARKAS: We will take administrative notice of DE-Ohio Remand Exhibit 9.

MS. HOTZ: My understanding is No. 10 is withdrawn.

EXAMINER FARKAS: Withdrawn.

MS. HOTZ: OCC objects to Exhibit 11 because it's not relevant in Ohio and because it's simply a letter from the Governor to the Commissioners and not something that Mr. Talbot would typically consider in formulating his testimony.

EXAMINER FARKAS: We are going to admit Remand Exhibit 11, DE-Ohio.

(EXHIBIT ADMITTED INTO EVIDENCE.)

MS. HOTZ: We object to Exhibit 12 because it is a bill that is not law. I don't believe it was ever discussed in cross.

EXAMINER FARKAS: We will take administrative November of DE-Ohio Remand 12.

MS. HOTZ: We object to DEO Exhibit 13, because again, it is not law. It's been introduced.

EXAMINER FARKAS: We will take administrative notice of that one also.

MS. HOTZ: We don't object to Exhibit 14.

EXAMINER FARKAS: No one else has an objection?

(No response.)

EXAMINER FARKAS: That will be admitted.

(EXHIBIT ADMITTED INTO EVIDENCE.)

MR. FINNIGAN: We understand that Exhibit

15 is withdrawn.

EXAMINER FARKAS: Yes.

MS. HOTZ: We do not object to Exhibit 16. We don't object to Exhibit 17.

EXAMINER FARKAS: Anyone else? Wait a minute.

MS. HOTZ: We do object to Exhibit 18. In fact, our objection was sustained when the question was asked.

EXAMINER FARKAS: 16 and 17 DEO remand exhibits will be admitted.

(EXHIBITS ADMITTED INTO EVIDENCE.)

EXAMINER FARKAS: Does anyone else have an objection to this exhibit?

(No response.)

EXAMINER FARKAS: We are not going to allow the admission DEO Remand Exhibit 18.

MR. FINNIGAN: Your Honor, I think I jumped the gun. I didn't give a chance for Ms. Hotz to move into evidence Mr. Talbot's prefiled testimony, and we have no objection.

MS. HOTZ: Thank you.

EXAMINER FARKAS: That will be admitted.

(EXHIBIT ADMITTED INTO EVIDENCE.)

EXAMINER FARKAS: Yes.

You're excused, Mr. Talbot.

(Witness excused.)

EXAMINER FARKAS: Why don't we go off the record?

(Discussion off record.)

EXAMINER FARKAS: We will take a recess until 1:30.

(Luncheon recess taken.)

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Tuesday Afternoon Session,
March 20, 2007.

- - -

EXAMINER FARKAS: Let's go back on the record. I believe you can call your next witness.

MR. McNAMEE: Thank you, your Honor. At this time the staff would call Richard C. Cahaan.

EXAMINER FARKAS: You may proceed.

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RICHARD C. CAHAAN

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

DIRECT EXAMINATION

By Mr. McNamee:

Q. Mr. Cahaan, would you state and spell your name for the record, please.

A. Richard C. Cahaan, C-A-H-A-A-N.

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

A. I am employed by the Public Utilities Commission as chief economist in the Capital Recovery and something, Division of the Utility Department. We keep reorganizing.

MR. BOEHM: It is going to get more

difficult as we go along.

Q. What is your business address?

A. 180 East Broad Street, Columbus, Ohio 43215.

MR. McNAMEE: I'm sorry. Your Honors, at this time I would ask to have marked for identification as Staff Remand Exhibit 1 a document previously filed in this case denominated Prefiled Testimony of Richard C. Cahaan.

EXAMINER FARKAS: So marked.

(EXHIBIT MARKED FOR IDENTIFICATION.)

Q. Mr. Cahaan, you have before you what has just been marked for identification as Staff Remand Exhibit No. 1.

A. Yes, I do.

Q. Could you tell me what that document is.

A. It is my prepared testimony in this proceeding.

Q. Okay. Was it prepared by you or under your direction?

A. Yes.

Q. Do you have any changes, corrections to be made to that document today?

A. Yes, I do.

Q. What would that be?

A. On page 5, line 7, where it states, "The rate setting provisions of Ohio Revised Code 4909 do not apply," I wish to add the words, "do not seem, from a nonlawyer's view, to apply."

Q. Okay. With that correction, enhancement, I don't know, would -- if I ask you the questions that are contained within this document that's been marked for identification as Staff Remand Exhibit No. 1 today, would your answers be as they are presented therein?

A. Yes, they are.

Q. Okay. Are the answers contained therein true to the best of your knowledge and belief?

A. Yes.

Q. Do you adopt this -- what's been marked for identification as Staff Remand Exhibit No. 1 as your direct testimony in this case?

A. Yes.

MR. McNAMEE: The witness is available for cross.

EXAMINER FARKAS: Do you want to go first?

MR. COLBERT: Your Honor, Duke Energy -

Ohio has no questions for this witness.

MR. DORTCH: The same is truth for Duke Energy Retail Sales and for Cinergy Corp.

MR. NEILSEN: No questions, your Honor.

MR. PETRICOFF: I have a few, your Honor. Thank you.

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CROSS-EXAMINATION

By Mr. Petricoff:

Q. Good afternoon, Mr. Cahaan.

A. Good afternoon.

Q. I want to explore a couple of concepts that you have on page 9 of your testimony. And to set the stage for page 9, is it your belief that the Commission has three goals that it sought to achieve in its RSP opinion and order?

A. Yes.

Q. And that one of the three goals was to increase market development or to assist in market development?

A. Yes. I used the words, I believe, "encourage market development."

Q. And would you agree with me that to the degree that the price that CRES, competitive retail

energy suppliers, that the total CRES product would be reduced, that that would increase the market and thus have market development? Let me start again.

A. Yeah.

Q. Is there a relationship between market development and the price that customers pay for competitive retail electric service?

A. I have a problem with the question. The price that customers pay for competitive service or the price they pay for the standard service offer?

Q. Competitive service.

A. I'm afraid I don't understand the question then.

MR. PETRICOFF: Your Honor, I would like to have marked as OMG Exhibit No. 2.

EXAMINER FARKAS: Okay.

(EXHIBIT MARKED FOR IDENTIFICATION.)

MR. PETRICOFF: May I approach the witness?

EXAMINER FARKAS: Yes.

Q. Mr. Cahaan, you are an economist by training?

A. Yes, I am.

MR. SMALL: Howard?

MR. PETRICOFF: Oh, I'm sorry.

Q. Mr. Cahaan, you are an economist by training.

A. Yes.

Q. And have you ever seen a matrix like this before?

A. A diagram like this? Yes, I have seen many.

Q. Fair to say that it's a fairly standard way in which economists evaluate volume and price and the relationship between the two?

A. Yes, it is. I just wish that the real life lines were so well behaved.

Q. Oh, don't we all.

Let's start with the line that is labeled -- first of all, do you understand the matrix of volume and price, the volume on the X axis, the price on the Y?

A. And by volume you are talking about the -- it's a quantity of megawatt-hours sold.

Q. That's correct.

A. Yes. You are using sort of the British way of putting this diagram together. The American way is to put the price usually on the vertical and

the quantity on the horizontal, but yes.

Q. But you can function in the international mode?

A. Right, as long as I don't get things behind and foremost.

Q. Okay. And you would agree with me that it is a common axiom in economics that as the price will increase, the supply will increase?

A. Yes, in almost all cases.

Q. All right. And since we are talking about electricity, do all electric generation units run at the same price?

A. No.

Q. So one would assume that if we increase the price, more of these units would be able to run economically.

A. Yes. That's a -- that's the basis on which the load dispatch is usually handled, yes.

Q. And is there a similar relationship between the demand from customers and the price?

A. That is a big problem. And that is the problem -- I am not saying that is a problem in this industry. I am not saying this necessarily means this diagram is invalid because for CRES providers it

might be a reasonable representation for electricity as a whole.

The big problem in the functioning of the electric market is the elasticity of demand, and one of the major reasons is because consumers are not -- many consumers are not responsive to price because they don't see the price, and those that see the price, a lot of them, their elasticity itself is very low, so what amounts to a vertical demand curve -- or actually in this case it might be a horizontal demand curve because we have got things backwards is a problem in the industry, so this representation does require a little bit of caution.

Q. But if we have a market -- a functioning market in which there was price transparency, then you would expect that the relationship -- there would be a relationship between price and demand?

A. More than just transparency, the ability to adjust the usage, the load based upon price, which means not only to customers -- not only is their market price knowledge but this is transmitted to the customers. It has to be more than transparent in principle. It has to be actually transparent to each individual customer making the decision.

Q. Okay. So if we increase that definition to transparent and available.

A. I will accept that roughly, yes.

Q. And would you expect that if that was the case, we would be able to tell in classic fashion at a given price what the volume would -- of sales would be, assuming we had a market in which there was both transparency and the information was readily available?

THE WITNESS: Could I have that question read?

(Question read.)

A. If there was this information, and if we knew the nature of the demand curve, which is the relationship between the price and the quantity demanded, if that were known or reasonably well known because it won't be known with precision, then you would have reasonable expectations that if you were to know the price, you would know the quantity demanded given a number of other assumptions in terms of the time period we are referencing and a -- the typical other things being equal, conditions that are assumed here.

So basically with all that caveat, yes.

If you knew the demand curve, that if you knew the price, you would know the quantity.

Q. But even if you didn't know the exact shape of the curve, assuming that we had a market in which there was price transparency and the information was readily available, wouldn't you be able to predict what the outcome would be if prices fell, that is, if prices came down, that volume would go up?

A. The issue of elasticity is the issue of how much. If you know that there is some elasticity of demand but you don't know how much there is, then you would certainly be able to say, yes, if prices went down, the quantity demanded would go up, but you would not necessarily know how much it would go up.

Q. And, in fact, wasn't that an assumption that you made, that there was this relationship between price and volume when you did your analysis on page 9 of your -- of your testimony to try to determine what the outcome was of the opinion and order versus the stipulation versus the opinion and order on rehearing?

A. Well, this relationship between price and quantity is so well drilled into anyone who has

studied economics that it becomes a background part of the thinking. So I don't think I specifically referred to this concept when I was making my statements that are contained on chapter -- in page 9, but it would have been impossible for this not to be behind my thinking when I was writing page 9. Is that sufficient for you?

Q. That's sufficient.

A. Good.

Q. And with that in mind, would you agree with me that if the Commission in this proceeding were to permit the IMF charge to be fully bypassable, that we would expect that there would be more shopping, that there would be more market development?

A. Yes.

Q. Thus far, we have talked about the demand curve. And I want you to take -- to take another assumption. Let's assume for some reason that there had been a code of conduct violation such that some of the demand in the Duke Energy - Ohio market had been withdrawn. How would we draw the demand curve? How would you adjust the demand curve that I have depicted here on OMG-2?

A. In order to answer this I think I might have to go back to this OMG-2 to see exactly what we have here. This is a demand curve for the product of CRES suppliers, is it not?

Q. That's correct.

A. So it is a demand for electricity from only the CRES providers. It's not a demand for electricity by all native load in the Duke - Ohio service territory.

Q. Let me insert one word. It would be the eligible or available demand for CRES service.

A. And the supply is the supply curve of the CRES providers to the Duke - Ohio customers?

Q. What they could bring into the Duke - Ohio service territory, that's correct.

A. As much as I love demand curves and supply curves that make little Xs on pieces of paper, I question as to whether the downward -- the way this demand curve is drawn is reasonable and accurate, even conceptual representation. One of the problems facing the -- this concept is the demand to CRES providers is in a sense a residual demand after the sales to -- by Duke - Ohio are taken account of.

Alternatively it works the other way

around as well. Demand facing Duke - Ohio is a residual after the sales to the CRES providers are taken account of.

And this, of course, is what you are driving at in your question is what happens to this demand curve if something happens in the relationship between Duke - Ohio and the customers to change this relationship here.

Q. That's right.

A. But the question -- the problem I have here is this nice smooth -- smoothness here, and one of the reasons for the problem is what amounts to that if certain price levels, depending on the customer, there probably will be no -- let me back up a second.

Depending upon what Duke - Ohio's price is, the price to compare, there may be no demand facing CRES providers, and that increasing the price to compare marginally might not make any difference until you've reached some kind of trigger point where it got into the supply area of the CRES providers.

I notice in your diagram here the supply curve goes down to an axis that looks like it's at 10 megawatt -- $10 a megawatt-hour, and that's implying

that there would be some supply to customers if they wanted to have it at $10 a megawatt-hour.

I think that anyone who knows this industry would question as to how much would be available at that price. So these -- although it looks nice to draw an X as I have done on the blackboard many times, in reality they don't necessarily look like small Xs, and I have to be very careful in what we have here.

MR. PETRICOFF: Your Honor, I would like to have an exhibit marked as OMG-3 and once again approach the witness.

(EXHIBIT MARKED FOR IDENTIFICATION.)

EXAMINER FARKAS: Okay.

MR. PETRICOFF: You are apparently the recipient of the hand-drawn one.

EXAMINER FARKAS: Thank you.

Q. Now, Mr. Cahaan, with the caveat that nice smooth curves probably don't -- don't reflect the real world and, in fact, these curves can be very jagged at any particular pricing point, wouldn't you agree with me as a matter of just conventional economic under -- conventional economic wisdom, that if customers -- or if the demand had been reduced,

demand for CRES product, that the curve would move in this case down and to the left on the British international crossing X and Y curves?

A. Yes.

Q. But that's what you would expect.

A. Well, in terms of the diagram, a reduction in demand is shown by a downward leftward movement of the curve.

Q. All right.

A. And somewhere in this discussion you are claiming, we haven't achieved it yet, that there is a reduction in demand.

Q. That's correct. And that's an issue that is -- might well be before this tribunal. In fact, there has been some testimony that has been introduced on that stage, but I am just exploring with you these relationships just as you've explored relationships on page 8 and 9. And one would expect if the demand had been artificially reduced, that basically the volume would be reduced at the same pricing point for CRES products?

A. By definition I think that is what would be said. If the demand is reduced, that means that the volume that people want at any given price is

reduced by definition and, therefore, by the same definition the volumes would be reduced. So the answer is yes, that's a description of reduction and demand.

Q. And if the Commission wanted to restore the volume without changing the demand curve, couldn't that be done by altering the price?

A. I don't know. That depends upon the responsiveness of the volume to the price, the elasticity question that I mentioned earlier.

Q. And if you assume for a moment that the elasticity is any number greater than zero, then wouldn't your answer have to be yes, that is a way to restore the volume?

A. Well, if elasticity is extremely small, for instance, then the -- it could be done, but it would require an extremely large change in the price. In other words, if the -- it's a very small -- if the elasticity is small, I believe you are talking about having -- cutting the price by 90 percent. So as a matter of principle, by definition if the elasticity is any number other than zero and then you could increase the volume by reducing the price, that's a true statement. But the elasticity question of how

much is extremely important as to whether this is at all a reasonable, practical method of doing things.

MR. PETRICOFF: I have no further questions. Thank you.

EXAMINER FARKAS: Do you have any questions?

MR. KURTZ: I would like to ask just one or two follow-up.

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CROSS-EXAMINATION

By Mr. Kurtz:

Q. Mr. Cahaan, you used the phrase "trigger point" in your discussion with Mr. Petricoff. What do you mean by that?

A. What I am describing is a situation where if electricity provided by a CRES provider and electricity provided by the company are extremely close substitutes, almost perfect substitutes, except for those people who really care what name's on the electron and, therefore, if, for example, just as a hypothetical picture, suppose that the price of the standard service offer were 3 cents and the minimum price that a competitive supplier were willing to sell would be 6 cents, then a reduction in the price

of the competitive supplier to 5 cents probably wouldn't make any difference whatsoever until it got down to that 3-cent level, in which case there would be 3.1, 3.01, 2.9, the various questions of how much marketing and how -- how difficult it is to penetrate, all of these would be relevant, but it may not be relevant if the disparity is too great. And that's what I meant by trigger point in this case.

Q. If the market price for electricity is much, much higher than the standard service offer price and the marketers' share on the Duke system is zero, it would still be -- their share would still be zero, even if some demand was taken out of the system, given a large enough price disparity; isn't that also true?

A. Yes. That -- I am having trouble with if the word demand were taken out. I don't know the case that's being discussed, but I do know that's what was mentioned a few minutes ago, but if the quantity demanded is zero and then some more is taken out, it's sort of still zero. That's why I am having trouble answering the question.

Q. I was really following up on this hypothetical code of conduct violation where demand

is taken out of the system, and one might assume the marketing community is hurt. But it would not be hurt at all if the price disparity was such that their market share was still very small or nonexistent. If their price is much, much higher than what Duke is offering, taking the -- taking load out of the system would still have no effect on the marketing community.

A. Stopping half the people from shopping at a meat market is not going to make much difference if those people are all vegetarians in the first place, so if there is no demand for the product at that price, no quantity demanded at that price, and then you prevent some people who are not buying it at that price from buying it at that price which they weren't willing to do in the first place, then, yes, there is no effect.

MR. KURTZ: Thank you.

EXAMINER FARKAS: Do you have any questions? OCC?

MR. SMALL: Yes, I do.

EXAMINER FARKAS: Okay.

MR. SMALL: Thank you.

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CROSS-EXAMINATION

By Mr. Small:

Q. Good afternoon, Mr. Cahaan.

A. Good afternoon.

Q. At the end of your testimony, page 14, line 3, I see the word "efficient," and actually you use the word "efficient" or "inefficient" in other places in your testimony. Now, when -- we've gone through that your educational background is in economics. From an economist's standpoint, efficiency or economic efficiency means having prices match costs; is that correct?

A. No. I am not sure I have ever heard that definition whatsoever as a definition of efficiency, that prices would match costs.

Q. Well, what I am referring to here is the economic concept of having prices giving correct signals to consumers.

A. It is design -- it is certainly desirable for prices to give correct signals to consumers. I agree with that. The concept of efficiency is not the same as that.

Q. All right. What is your concept -- and I really am asking as a concept here, you use the word

"efficiency." I don't believe I see it defined here anywhere. How are you using that term?

A. If I can take you back to probably the first or second day in the principles of economics course where there is the idea of tradeoffs that are being presented and there is something called a production possibility curve which is simply a rounded line between two axes that show the possible outcomes that one can have. You can have more of one thing and/or more of the other thing but not more of both.

There's tradeoffs, and that's crucial -- an absolutely crucial idea presented in the very first day of any economics course, and the production possibility curve says if you want to have more of X, you better give -- you have to give up some Y, or if you want to have some of Y, you have to give up some of X, and that is true for any point on that curve.

Now, after that idea of tradeoffs is established, the next idea that is presented is a point inside of that curve closer to the axis less X or -- and/or less Y. And you can have more of X or more of Y or more of both if you are inside the curve and you get to the curve.

Now, the idea of efficiency is that if you are not at the maximum in terms of the choices of X and Y, if you are inside, it is inefficient. So if you are dealing with choices between different goals and you are in an efficient situation, that means in order to have more of one goal, you have to give up some of the other goal.

Alternatively, you could have an efficiency in which you have some, in effect, ways where you have some, for instance, risk. In this case that is ex -- is just not necessary and you can have more of something by getting rid of the risk, so that is an inefficient situation. And that's what I meant by the use of efficiency in this testimony.

Q. And the normal terminology, I believe you used it in your answer for what you described as being inside the production possibility frontier, is economic waste, is it not? Is that the terminology? You can have more of both things or you can have more of one thing without sacrificing another, there is economic waste. Isn't that the terminology?

A. I will accept that, yes.

Q. Now, as far as economic efficiency, doesn't that concept add to what you are talking

about about selecting the point that's on the production possibility frontier, in other words, an optimal choice along that curve?

THE WITNESS: Could I have that reread?

(Question read.)

A. No, not really. The issue of selecting a point, choosing an optimal point between efficient points along the front -- the production possibility frontier is not a question of efficiency at all. Frankly, you would have to bring in additional considerations if they could be brought in to allow for that selection. I am only describing the question of an efficient choice sense.

So the efficiency has nothing to do with the choice between various outcomes which are the best possible outcomes in terms of not being able to have more of one without having to give up some of the other.

Q. All right. Let's go back -- let's go back to our concept about prices reflecting -- or correct prices. What is the -- what is the economic rationale for having prices giving correct signals to consumers?

A. It allows them to make better decisions.

Q. And it provides for a more efficient economic system; is that correct?

A. Better pricing information can be assumed to provide for more efficient economic solutions when -- in general when one makes a lot of other assumptions and specifies millions of things actually. So in principle I would say, yes, proper pricing is -- proper pricing is a good thing to an economist. That statement makes every economist feel warm in his heart and is a wonderful platitude. I am not sure how far it goes beyond that.

Q. What is proper pricing?

A. I don't know in this case what proper pricing would be in a market which is extremely imperfect.

Q. I'm sorry. We are still on the higher playing level here. As an economist, what is proper pricing?

A. Proper pricing to an economist is something -- a price which reflects the true scarcity value of the commodity being consumed or whatever we are talking about.

Q. True scarcity value, is this another word for cost?

A. No.

Q. What is it?

A. The problem with the word "cost" means what kind of a cost are we talking about? The true cost is the true scarcity value. There's accounting costs, historical costs, opportunity costs. Which kind of cost are we talking about today?

Q. Economic cost.

A. Okay. The economic cost, the true economic cost of a commodity is the true economic cost of all of the things that it takes to make that commodity.

Q. When you refer -- I will get back to your testimony. When you referred to "efficient outcome," you are not -- in your testimony you are not referring to that result, that is, the correct pricing result according to economic costs in the response you just gave?

A. No. The -- you are correct. What I am referring to has very little to do with the idea of efficient pricing in economic theory. This is more a question of social choice and policy making between competing goals and not prices of commodities.

Q. Okay. Could you turn to page 9 of your

testimony. And at the bottom you refer to three control variables. I think you use the word "control." You use it elsewhere in your testimony. I'm on -- also on page 7, lines 14 through 17. Price, avoidability, and cost tracking mechanism, is that an accurate quick view of your control variables? I am on page 9 at the bottom.

A. Yes, I see that. And this is what I meant by control variables, yes.

Q. Okay. And is it generally your thesis in this testimony that these are the basic areas the Commission can effect to reach its goals? Is that what you mean by control variable?

A. Yes. It can change the level of standard service offer which is the prices. It can change the degree of avoidability, and it can change the method of changing that price which -- in terms of cost pricing, the tracking.

Q. All right. I would like to turn to the bottom of page 8, and at the bottom of page 8 begins some scenarios that you worked there, but in particular on the bottom of page 8 there's a scenario where the company submits a rate plan to the Commission that has the attribute high price, a price

that's largely non-avoidable, and no tracking mechanism. Is that what that scenario is at the bottom of page 8?

A. Yes.

Q. And in your experience -- or would you expect a customer response -- and I am talking here in your regulatory environment sense. Would you expect a customer response to such a proposal that customers would protest that type of situation typically at the Commission; is that a fair thing to say?

A. For the purpose of letting you get to where you are going, I will say yes.

Q. Now, have you read Mr. Steffen's testimony?

A. Yes, I have read it.

Q. And you are aware that it -- from your reading of the testimony there is a reference to a --

MR. SMALL: I pause, your Honor. It's because I am about to go into an area that is a gray area as far as the document that I am about to mark or ask to have marked. The reason why I think it's a gray area is because while the document that I have before me is stamped confidential, proprietary, trade

secrets, there have also been representations, including by the company, that this is a public document, and it has been available actually for years.

EXAMINER FARKAS: Do you want to have the company look at it?

MR. SMALL: Sure, just to be on the safe side. I get nos from both of them.

EXAMINER FARKAS: No, that is not confidential.

MR. SMALL: No, that it is not confidential.

EXAMINER FARKAS: Okay. Then we will proceed.

Q. You are aware that Mr. Steffen in his testimony refers to an agreement between Cincinnati Gas & Electric Company and the City of Cincinnati.

A. I am aware that he referred to it. I did not read that section of his testimony carefully.

MR. SMALL: If I may, your Honor, I would like to mark an Exhibit OCC Remand 6.

EXAMINER FARKAS: So marked.

(EXHIBIT MARKED FOR IDENTIFICATION.)

Q. Mr. Cahaan, if you would please direct

your attention to OCC Exhibit 6. And I will direct your attention to paragraph 2 and that is the paragraph just as a general representation. It's a document entitled "Settlement Agreement" and dated June 14, 2004. I will direct your attention initially to paragraph 2. Do you see the $1 million payment I just referred to?

A. I see paragraph 2, yes.

Q. Okay. And I will direct your attention to paragraph 4 where it relates that payment to the settlement and the City of Cincinnati's withdrawal from 03-93. Do you see that?

A. I see paragraph 4. I am just scanning it right now. I have never seen this before.

Q. Take your time. I am only going to refer to those two paragraphs.

A. Okay. I have read the paragraphs.

Q. Okay. And you see the $1 million payment in paragraph 2?

A. I see that the paragraph 2 states that the company will provide the city with a million dollars in consideration of something else in this document, yes.

Q. And you see in paragraph 4 that it's

conditioned upon the City's approval of amendments and so forth and so on, including withdrawal from PUCO Case No. 03-93-EL-ATA; is that correct?

A. Yes. It says, among other things, that the -- it is conditioned upon the City's withdrawal from that case within three business days of approval by the City Council, yes. So that, yes, it is conditioned upon withdrawing from the case according to what this settlement agreement says.

Q. Okay. I wanted -- keep our eyes on paragraphs 2 and 4 and go back to your testimony at the same time.

A. Okay.

Q. Page 8 you sort of define control variables. These are things that generate outputs among goals; I am using your terminology. Is that what a control variable is?

A. Yes.

Q. Okay. Now, isn't the Commission's review oversight of stipulations such as the shown on OCC Exhibit 6, isn't that also something that could be -- should be added to your list as a control variable? In other words, oversight of stipulations could also be a control variable that the Commission could

utilize in order to come out with the outputs that it desires?

MR. COLBERT: Objection, your Honor.

EXAMINER FARKAS: There is an objection.

A. This is such a stretch this is mind-boggling.

EXAMINER FARKAS: Stop. We have got objections.

MR. COLBERT: This -- there's no foundation that this settlement is jurisdictional to the Commission. It is a contract between CG&E and the City of Cincinnati whereby, of course, as it says, CG&E provided the City $1 million and this is part of a number of other agreements that it's an amendment to.

It's not a rate case. It doesn't affect anything else before the Commission. There's no indication that it should have been filed before the Commission or should otherwise -- otherwise be considered by the Commission in any way, and, in fact, there is no testimony on the record, including Ms. Hixon's that we haven't crossed yet, that alleges any wrongdoing in the entering of this contract or any other contract. In fact, Ms. Hixon simply asks

for an investigation.

So there's nothing to tie this to the Commission, and any consideration by the Commision which is the basis of Mr. Small's question --

MR. McNAMEE: Your Honor, I might note there is this either. The witness has never seen this document before, has not read this document before, and he cannot apparently vouch for what it even is. So I don't know what we're doing here. I object.

MR. SMALL: Well, I am a little bit at a loss for an argument that says the stipulation entered into between two parties to a case regarding that case cannot be brought up before the Commission and that's not jurisdictional to the Commission. In fact, I believe it should have been both submitted to the Commission and served upon the parties according to the Commission's rules regarding stipulations in this case.

MR. McNAMEE: Your Honors, that may be fine but this witness can't do it. He doesn't know what this is.

EXAMINER FARKAS: Okay. Could we have the question reread.

(Question read.)

EXAMINER KINGERY: We will allow your question as long as you modify that to reflect you are asking about Commission oversight or stipulations in general rather than trying to get this witness to respond as to whether the Commission has reviewed this document.

MR. SMALL: All right. I didn't intend him to be reaching any legal conclusion. Maybe that was your concern.

EXAMINER KINGERY: Yeah. I didn't think you were so.

Q. (By Mr. Small) In fact, Mr. Cahaan, your entire testimony, as I understand it, is policy related and not a legal matter, so I am asking -- if this helps to clarify it for the Bench, I am asking you on a policy basis whether this oversight by the Commision could be -- or should be another control variable added to your list of three.

EXAMINER KINGERY: This oversight being the Commission's overview of stipulations in general?

MR. SMALL: Oversight of stipulations -- yes, stipulations. Stipulations between parties, how's that?

EXAMINER FARKAS: Okay.

A. What we have here is a very, very major problem in levels of conceptualization. I am talking about certain general principles, and you are asking something that's much, much more detailed. In terms of even though it's a principle, one can go through a whole mess of actions. Should the Commission engage in public relations campaigns to promote acceptability? Should the Commission do millions of things? On a practical level this would be something that perhaps the Commission should do, perhaps the Commission should not do. A lot depends upon legal issues as to whether the Commission has jurisdiction.

But in terms of my testimony, the question is asking me something that is drastically different in nature and level than my testimony is directed at. It's like asking someone who is planning a military campaign as to whether the boots should be of a certain thickness or not when really they are just moving a whole army around. At a very different level, and I cannot answer what the Commission should be doing with respect to its policy with regard to stipulations. It is not a control variable at the level my control variables are being

conceptualized.

Q. And the reason for that, as I understand it, is that your control variables are in the realm of economics, and it's my understanding you are not -- you are not testifying about control variables that might be in the realm of procedure as in Commission procedure, the legal process, and so forth. You've segregated to just the economics portion of it.

A. As an economist, I am definitely not testifying as to legal procedure.

Q. Not quite the question.

A. I am testifying as an economist, and I am not testifying as to the particular legal procedures that should be followed.

Q. Well, basically my question is are these the only three control variables, or are they the only three you have identified within a more narrow range of your -- of your responsibility for this case?

A. Well, frankly, these -- these are all that I have been talking about. And if we are talking about legal procedures or things like the ability to look at stipulations, you are not talking

about a control variable. You are talking about a structural framework.

Q. Well, a control variable I thought from your perspective was something that the -- what was the -- what was the vehicular example that you gave?

A. Let me clarify it to you this way, a variable is -- control variable is a variable. It can vary. It can be more. It can be less. There can be more money, less money, a greater degree of avoidability, a lesser degree of avoidability.

Now, I am not sure if there is a greater degree of scrutiny of stipulations or lesser degree of scrutiny of stipulations. That doesn't make sense to me. It is not a variable. It is a structural consideration. It is the framework in which other things operate.

Q. Aren't we here today, at least in part, because the Supreme Court has said that we are -- they weren't sure whether there had been the degree as in shades of -- shades of supervision and degree of oversight over stipulations?

MR. DORTCH: Object.

MR. McNAMEE: Object.

A. I am not there for that reason.

MR. McNAMEE: Too late.

A. I think I misspoke. I am not here for that reason.

Q. You testified earlier in this case regarding settlement discussion between CG&E and other parties in the case; is that correct?

THE WITNESS: Could I have that read, please.

(Question read.)

A. You mean another -- in another hearing; is that correct?

Q. Well, I specifically mean Staff Exhibit 2 which is your supplemental testimony in this case. Would you like -- I have a copy of it -- provided to you on the stand, if you would like.

A. Yes, please.

MR. SMALL: Your Honor?

EXAMINER KINGERY: Yes.

MR. SMALL: I am not sure about distributing it. It is an exhibit in this case already.

A. Yes. You handed me what we call Staff Exhibit 2, supplemental testimony that was docketed on May 24, 2004.

Q. That's correct. And that's the testimony I was referring to. Bottom of page 2, top of page 3, you testify about settlement discussions; am I correct?

A. I don't know. I am having to read this anew.

EXAMINER KINGERY: I believe it's actually pages 1 to 2. The first page is unnumbered.

MR. SMALL: I'm sorry.

EXAMINER KINGERY: There is a cover page that was apparently page 0.

MR. SMALL: All right.

EXAMINER KINGERY: Just so we can find it later.

Do you want him to read that?

MR. SMALL: I am talking about the bottom of page 1 --

EXAMINER FARKAS: I am going to allow Mr. Cahaan to read his -- go back and reread.

MR. McNAMEE: Your Honor, I would like to interpose an objection.

EXAMINER FARKAS: Okay.

MR. McNAMEE: He has already been cross-examined about this three years ago, or almost

three years ago.

MR. SMALL: And, your Honors, the problem with that cross-examination, I was not permitted discovery of this particular document with which to ask this -- these questions. This is an exhibit. This is his testimony and it is the -- it is the fault found by the Supreme Court that I didn't have the discovery to ask these very precise questions.

I don't intend on going far with this. I just have a couple of clarifying questions, but it would have been impossible for me to have asked the question at the time when Mr. Cahaan was cross-examined on this matter.

MR. McNAMEE: I withdraw my objection.

EXAMINER KINGERY: Okay.

Proceed when you're ready. Are you ready?

A. Is there a particular question and answer you want to direct me toward?

Q. I think we were giving you a chance to read it just in general, but I was at the bottom of page 1.

A. What question is that?

Q. "Does this settlement represent a product

of serious barg" --

A. Is that question 5?

Q. That's question 5.

A. Thank you.

Q. Questions 4 and 5 I am referring to.

A. Okay. 4 -- okay. I have read the questions and answers referred to.

MR. COLBERT: Your Honor, I am going to object. On Mr. -- even on Mr. Small's basis this witness couldn't have had and wouldn't have had this agreement at the time he testified. This agreement was signed -- or contract was signed on June 14 after the hearing. This would have been with -- this wouldn't have been responsive to any discovery. It wouldn't have been. OCC would not have found it based on the discovery questions that they made at the time, and they wouldn't have had an opportunity to question Mr. Cahaan on it so there would have -- Mr. Small -- the point is Mr. Small was not deprived of any opportunity the first time around.

EXAMINER FARKAS: I am going to overrule the objection and allow the question.

Q. With respect to your testimony concerning settlement discussions, were you aware of settlement

discussions between Cincinnati Gas & Electric Company and the City of Cincinnati?

A. I am sorry; I didn't hear that.

(Question read.)

EXAMINER FARKAS: You have to speak up.

A. I was aware, and all that I was aware of was that the company had engaged, was engaged in discussions with a lot of other parties. I did not know with whom particularly, when, or any of the details.

Q. So that's no with respect to the City of Cincinnati?

A. Yes, that's a no.

MR. SMALL: I have no further questions.

EXAMINER FARKAS: Okay. Barth?

MR. ROYER: Yes. I am going to move over here.

- - -

CROSS-EXAMINATION

By Mr. Royer:

Q. Mr. Cahaan, just to follow-up on Mr. Small, is it your testimony that, for example, at the bottom of page 9 where you say, "simply the goals of the RSP and the allocations of money and risk are

controlled by the level of the SSO, the degree of avoidability, and the nature of cost tracking mechanisms in place," are you suggesting by that it is not important to know actually what customers are paying in terms of -- paying to the utility at the bottom line in terms of price?

A. That's embedded in this.

Q. So if -- if there was a million dollars that doesn't appear in the standard service offer that you are referring to here but it actually reduces the price the customer pays, shouldn't that be considered in balancing these very factors that you have identified?

MR. COLBERT: Objection, your Honor. There is no evidence at all that the City of Cincinnati or any other customer didn't pay a full price to DE-Ohio at that time or any other time.

MR. ROYER: Well, my question is what's the -- what is the customer out-of-pocket if we are talking about what the -- if the SSO is -- is controlling or is important in determining allocations of money and risk, we ought to know what the total -- what the total pool of money is. If it is reduced by a million dollars, it seems to me that

changes the mix, and I want to see if the witness agrees with that.

EXAMINER FARKAS: I will allow the question.

A. I am totally confused. I don't really understand the business with the City of Cincinnati. The rate stabilization plan sets certain levels of prices in effect, the little "g"; the IMF, all these things, sets of avoidability, and all of the comprises. Now, to the customer. Now, I don't know where some million dollars that is being passed around somehow on -- and being shown to me how that fits into this.

Q. Well, that's my question. Should it not?

A. I don't know.

Q. If the standard service offer is not -- is not actually what the customer is out of pocket, how can you -- and we have subsequently learned that the customer has been paid a million dollars on the side, wouldn't that be important in -- in balancing these factors that you have identified here in determining -- in determining the allocations of money and risk?

A. Are you suggesting that the price that

the customer -- I mean, the customer that's paying the standard service offer that's being set in this proceeding by the rate stabilization plan, that they are not paying the standard service offer?

Q. I am saying that they are paying the standard service offer, but, in fact, they are being subsidized by the company by a million dollar side agreement. Isn't that -- wouldn't that be important in --

A. Is that the same customer that's being the standard service offer?

MR. DORTCH: I am going to object.

A. I don't know the situation. I don't know how this fits in.

EXAMINER FARKAS: I am going to allow him to answer.

MR. COLBERT: I am going to object to the characterization as a side agreement. This is a contract between the utility and the City of Cincinnati. There's, you know, no indication that it should have been in any way before the Commission -- before the Commission to opine on.

In regard, you know, to Mr. Royer's questions specifically, it's no different than a

variety of things that his client agreed to in the case. For example, in the stipulation which Mr. Royer's client signed, there was a, I believe, $7 million amount for the marketers to subsidize residential customers. There's simply, you know, nothing that is here that -- that is out of the ordinary, and, you know, the implication is otherwise.

MR. ROYER: I have never once, I don't believe, suggested there was anything wrong with this agreement, that the agreement required Commission approval, that there was anything wrong in the original stipulation about the $7 million shopping credit for marketers, which I might add was removed which was why my client was no longer a party -- a part of the subsequent proceedings in that case or no longer signatory in any supporting memoranda for the rehearing applications.

I am not trying to address legal niceties or anything like that. I am just trying to find out if the standard service offer that he has indicated is an important variable is not truly reflective of what the customer -- customer is actually out-of-pocket, if that would influence the balancing

that he suggests should go on.

EXAMINER FARKAS: Okay. Just for purposes of the record, why don't we refer to these as agreements and not side deals.

MR. ROYER: I'm sorry?

EXAMINER FARKAS: Let's refer to these as agreements rather than side deals.

MR. ROYER: All right.

EXAMINER FARKAS: Okay. Thank you.

THE WITNESS: Okay. Do you want me to answer the question?

EXAMINER FARKAS: Yes. Go ahead and answer the question.

A. One of the reasons I have difficulty with the question is because I'm looking, for instance, at a number -- a piece of paper which has the number of 1,043,582,852, and this is dollars, of the amount of revenues in 2006. And this is what the company receives; it's what the customers pay.

And we're talking in this discussion about a million dollars which is not inconsequential to me personally in terms I would like to have it, but in terms of the picture I have been looking at and describing in my testimony falls out in terms of

the level of obstruction and conceptualization that I am dealing with.

So the whole consideration of if a million dollar contract should or should not be considered by the Commision in terms of an appropriate balance in the scale of things as I am discussing them in terms of balancing this, if you were to picture this as a weight on a wheel that's being balanced in an automobile shop, this is a gnat.

Q. And you testified previously about the input that the various parties had into the settlement agreement, the original stipulation in this case, correct?

A. It's in the record, yes. And what it said was that all parties to the case are notified and were invited to participate in the settlement discussion. The staff encourages the company to meet individually with each of the parties in the case to work out their individual problems. There were no restrictions about who would participate in these discussions. That's what I said at the time and that was my knowledge at the time and still is.

Q. At what point would -- at what point would the number become relevant?

A. I would have to give that some consideration whether -- you know, when, are we talking about 10 million, 20 million, I really don't know how to answer that question. I'm simply saying in terms of what I was describing in my testimony in terms of the conceptual framework and in terms of the nature of the overall problem facing the Commission, this is not a big, major matter in terms of overall balancing between various goals.

It may be very important as an issue that some people have in this case for their own, you know, at a lower level of conceptualization. It might be very critical for all I know. I am not saying it's not important. I don't know, but in terms of the level of construction I am working at, it doesn't come on the radar screen.

Q. Would a figure in excess of 20 million be important?

A. Well, it's more important than one. It's less important than 100. I really can't say. In fact, let me simply refer you back to the OCC witness where he did percentages and you can see $1 million comes out in percentages in various categories of costs. It's not very, very much. I have no idea.

Is it 1 percent important? Half a percent important? A lot was made about, for instance, 3.8 percent being some very important number in terms of the charges to customers. You know, I think to a large extent maybe it's the Commission's role to decide what they consider to be important.

Q. Well, you -- would you agree with Mr. Talbot's assessment that marketers typically operate on very small margins?

A. Mr. Talbot is describing -- I mean, let me stop. I am sure that they operate on small margins because they are selling a commodity that is no different than the commodity produced by the company. The idea that was floated around back before we had deregulation was somehow this would be a significant improvement in the industry and for these margins to be so small is very disappointing and scarey to me. It reminds me -- it makes me think that the only reason to deregulate telephones was to get a rotary black box 10 cents cheaper. The fact that these margins are small is itself a problem.

Q. In any event, the margins based on the lack of competition -- current lack of competition in the Duke service area would suggest whatever they are

not sufficient to competition?

A. To me, the purpose of competition is to benefit the customer. And if the customer isn't benefitted by larger margins, then I am not so sure what the competition does for the customer in the first place.

Q. Well, isn't one of your goals to encourage competition?

A. Only as an etiological goal. The goal was to help the customer.

Q. So, in any event, your assessment as to whether the margins are too small to be significant doesn't -- you don't draw from that that at the current -- current levels of competition, that there is not sufficient margin for CRES providers to compete?

A. It's almost tautological that if they are not there, there is insufficient margin. I firmly believe that people respond and businesses respond to economic incentives, so if there is a profit opportunity, the -- there would be businesses coming in to fulfill that profit opportunity.

Now, of course, one way of having a profitable opportunity for CRES providers is that

15-cent electricity, and that has been suggested, so the profitable opportunity is not itself necessarily either a direct or even intermediate goal.

Q. I guess we started this conversation -- this conversation when you suggested the 3.8 percent might not make any difference. Do you remember in terms of the magnitude of these numbers what was important to you? And I am only trying to determine if you think it might be important to competitive suppliers.

A. It might or it might not be important to competitive suppliers. There are people who made millions of dollars by one-tenth of 1 percent they were skimming off bank transactions and lots and lots of transactions taking just a mil of each, so the percentage doesn't necessarily matter. What matters is the costs that are involved in reaching those percentages.

Q. Well, if we discount that possibility that that's what's going on, is your answer still the same?

A. I am not sure --

THE WITNESS: -- could I have my answer read back?

Q. I withdraw it.

A. Okay.

MR. ROYER: That's all I have.

EXAMINER FARKAS: Okay. Did you have any questions? Do you have any questions?

I believe that's everyone. Any redirect?

MR. McNAMEE: Could we take a few minutes? I would like to chat with Mr. Cahaan.

EXAMINER FARKAS: Take a 5-minute recess.

(Recess taken.)

EXAMINER FARKAS: Why don't we go back on the record.

EXAMINER KINGERY: We are on the record.

EXAMINER FARKAS: We are on the record now.

Did you have any redirect?

MR. McNAMEE: No, your Honor. We have no redirect. At this time I would move for the admission of Staff Remand Exhibit No. 1.

EXAMINER FARKAS: Any objection?

(No response.)

EXAMINER FARKAS: Then it will be admitted.

(EXHIBIT ADMITTED INTO EVIDENCE.)

MR. PETRICOFF: Your Honor, I would like to move to admit OMG Exhibits 2 and 3, but I want to make one change to Exhibit 3. I would like to cross out in the title the "Code of Conduct Violation," just cross that out. Other than that I think we are -- we would move to admit it.

EXAMINER FARKAS: Okay. Is there any objection?

MR. McNAMEE: None.

EXAMINER FARKAS: Okay. Those will be admitted.

(EXHIBITS ADMITTED INTO EVIDENCE.)

MR. SMALL: OCC moves OCC Exhibit Remand 6.

MR. McNAMEE: I will object, no foundation. The witness doesn't know what that document is, no basis for admitting it. Probably could be a basis through another witness but not through Mr. Cahaan.

MR. COLBERT: The company would similarly object both on lack of foundation and on our continuing relevancy grounds, though we know contracts are coming in throughout this.

MR. ROYER: Your Honor, I would join

Mr. Small -- in support of Mr. Small. This is the same document that was talked about in Mr. Steffen's testimony, refers to the $1 million payment. I think it would be very beneficial to the Commission to have the entire document in the record.

MR. COLBERT: Your Honor, then they could have asked Mr. Steffen and they didn't and they could have laid a proper foundation through Mr. Steffen. Ms. Hixon is coming on the stand tomorrow. She references the various agreements. You know, if they are going to come in, that would be the proper place for them to do so.

EXAMINER KINGERY: Would you like to stand up? Were you about to stand up?

MR. PETRICOFF: Yes, I was going to join with Mr. Small and Mr. Royer.

EXAMINER KINGERY: Okay.

EXAMINER FARKAS: We are going to admit that.

(EXHIBIT ADMITTED INTO EVIDENCE.)

EXAMINER FARKAS: I believe that concludes today.

MR. PETRICOFF: One other thing before we close the record today.

EXAMINER FARKAS: Okay.

MR. PETRICOFF: I wanted to give an update of the status of calling Mr. Whitlock as a witness as on cross-examination. I've worked out an accord with the company, and in lieu of calling Mr. Whitlock, we would like to enter into the record the deposition of Mr. Whitlock which we will, I guess, e-mail to all parties.

There is a confidential section to it so what we will do is I guess we will e-mail to all the counsel of record in full text and then regular service list with just the public portion.

MR. SMALL: If I may clarify, because I believe this is my deposition that I took.

MR. PETRICOFF: That's correct.

MR. SMALL: There are extensive attachments to it which would be part of the deposition. I am making a point here because my office has gone through quite a bit of work in order to deal with the attachments to the deposition transcripts.

MR. PETRICOFF: We -- I was not anticipating attaching the attachments.

MR. SMALL: Okay.

EXAMINER FARKAS: Just the deposition?

MR. PETRICOFF: I'm sorry, what?

EXAMINER FARKAS: Just the deposition?

MR. PETRICOFF: Just the deposition, not the attachments, correct.

MR. SMALL: Just thought that would be useful to go through that because I know I attached quite a few documents to the transcript.

EXAMINER FARKAS: Okay. Thank you.

Is there any objection to that?

MR. COLBERT: No objections. Mr. Petricoff accurately stated the accord.

EXAMINER FARKAS: Okay.

MR. NEILSEN: Your Honor, with the exception that to the extent there are in that deposition and I was -- I was present at that deposition, but I can't remember if there were any discussion of accounts, actual account numbers, so with --

MR. SMALL: I don't think there is any.

MR. COLBERT: Not in the public.

MR. PETRICOFF: If we don't put in those attachments.

MR. SMALL: Question and answer I don't

think there is anyway. I could have --

MR. NEILSEN: I don't think that, but I want to make at least --

MR. SMALL: I don't believe I ever asked the question, nor do I ever recall receiving an answer with account numbers.

EXAMINER KINGERY: I would presume if we are not getting the attachments, the text is going to be understandable without the attachments.

MR. PETRICOFF: For the purposes that we seek to use it, yes. There are some very straightforward questions and answers and that's what we want to get into the record.

EXAMINER KINGERY: That's fine.

EXAMINER FARKAS: Okay. We will recess until 9:00 a.m. tomorrow.

(Thereupon, the hearing was adjourned at 3:06 p.m.)

CERTIFICATE

I do hereby certify that the foregoing is a true and correct transcript of the proceedings taken by me in this matter on Tuesday, March 20, 2007, and carefully compared with my original stenographic notes.

Rosemary Foster Anderson, Professional Reporter, and Notary Public in and for the State of Ohio.

Karen Sue Gibson, Registered Merit Reporter, and Notary Public in and for the State of Ohio.

(RFA-7012)

(KG-4643)

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Case Number 03-93-EL-ATA, 03-2079-EL-AAM, 03-2081-EL-AAM, 03-2080-EL-ATA, 05-725-EL-UNC, 06-1068-EL-UNC, 06-1069-EL-UNC, 05-724-EL-UNC, 06-1085-EL-UNC

The following exhibit(s) were prefiled and can be located with the pleadings:

Exhibits	Date Filed
DE-OHIO REMAND EXHIBITS	
4 - NASUCA Mid-Year Meeting, June 13, 2006	
5 - Restructuring Roundtable, May 19, 2006	
6 - Integrated Portfolio Management in a Restructured Supply Market	
7 - Report to the Commission of Electric Utilities Restructuring of the Virginia General Assembly	
8 - Schisler, et al. vs. State of Maryland case summary	
10 - Release from Governor Rell	
11 - 8-31-05 letter from Governor Blagojevich	
13 - An Act to Establish the Northern Maine Power Agency	
14 - Harvard Electricity Policy Group Forty-Third Plenary Session	
INDEX (Continued)	
- - -	
DE-OHIO REMAND EXHIBITS	
16 - DEO Percent of 2006 Generation Bypassable Revenue	
17 - DEO Percent of 2006 Generation Bypassable Revenue, without true-up	
18 - BGE Rate Stabilization Fact Sheet for Residential Customers	

Case Number 03-93-EL-ATA, 03-2079-EL-AAM, 03-2081-EL-AAM, 03-2080-EL-ATA, 05-725-EL-UNC, 06-1068-EL-UNC, 06-1069-EL-UNC, 05-724-EL-UNC, 06-1085-EL-UNC

The following exhibit(s) were prefiled and can be located within the pleadings:

Exhibits	Date Filed
STAFF REMAND EXHIBITS	
1 - Prefiled Direct Testimony of Richard C. Cahaan	
OCC REMAND EXHIBITS	
5 - Prefiled Direct Testimony of Neil H. Talbot	
6 - Settlement Agreement CG&E and City of Cincinnati	
OMG REMAND EXHIBITS	
2 - CRES Market Equilibrium Charts	
3 - CRES Market Chart	

Synapse
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Electricity Supply Prices in Deregulated Markets - The Problem and Potential Responses

NASUCA Mid-Year Meeting

June 13, 2006

Rick Hornby, Ezra Hausman, Anna Sommer

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DE-OHIO EX. 4

High Prices in Deregulated Supply Markets

- Electricity supply prices up as much as 65% from 2005 to 2006 (New England)
- Gas-fired units are the dominant **marginal** source, well out of proportion to energy contribution—set hourly clearing price
- Natural gas prices have increased dramatically
- This is not the whole story!

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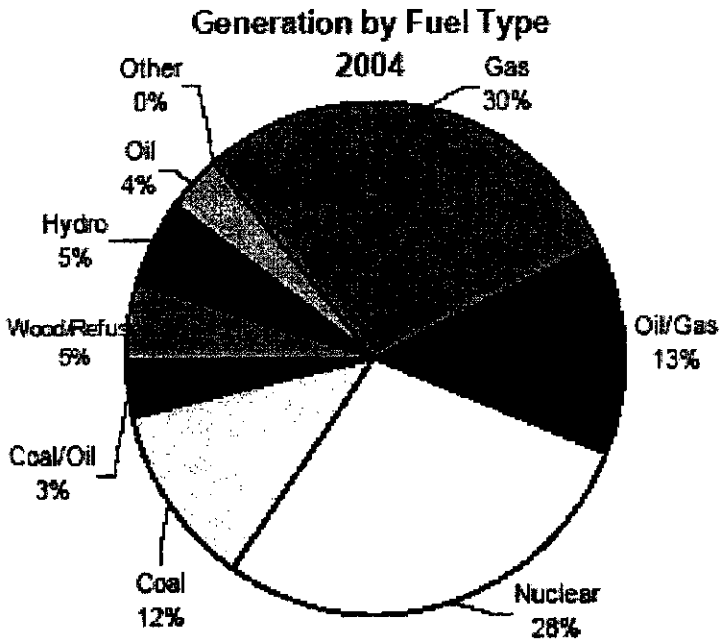
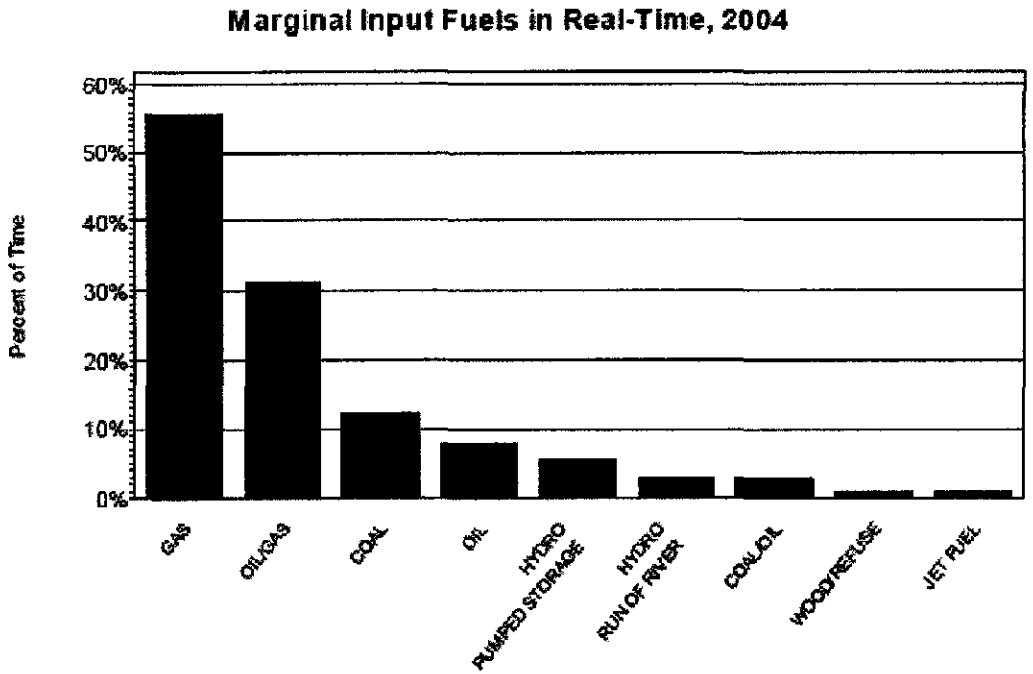
New England Fuel Mix for Electricity Generation

Generation by fuel…



…and fuel on the Margin



Source: ISO-NE "2004 Annual Markets Report," page 23.

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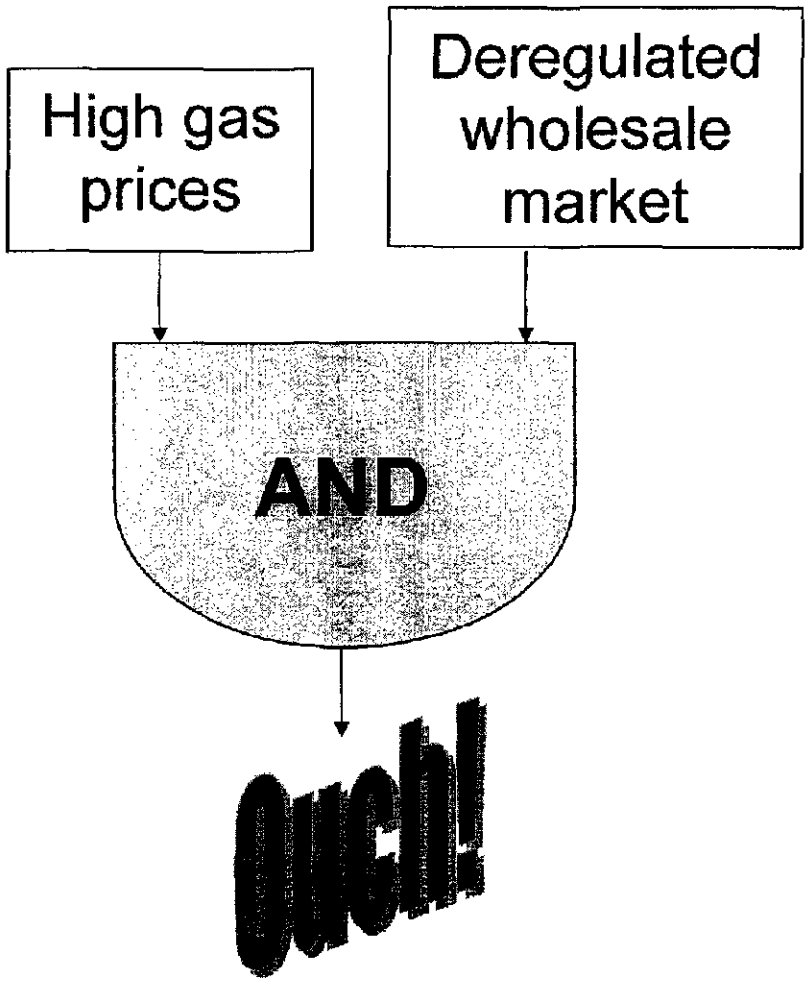
Cause and Effect: Boolean "AND" Function

Logical "AND" Function

Input A	Input B	A "And" B
0	0	0
1	0	0
0	1	0
1	1	1



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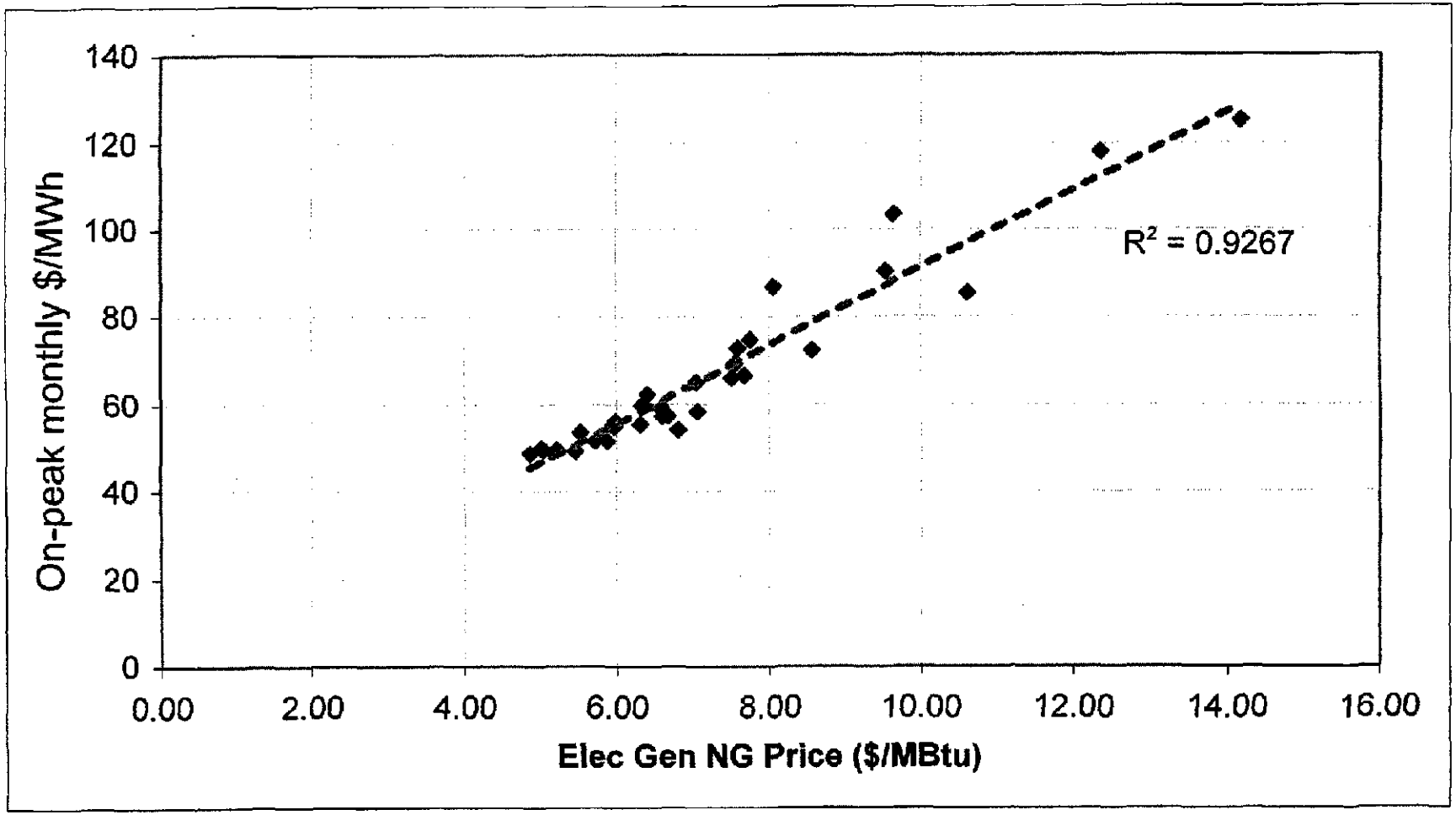
Natural Gas Prices Drive Wholesale Electricity Prices in New England: 2003-2006



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Summary:
The Problem in Deregulated Supply Markets

- Increases **greater** than if market was regulated
- High supply prices **will continue** unless policymakers and regulators take action
- Major impact on consumers and economy ($8 billion/year in New England)
- Near-term impact on ratepayers magnified by expiration of rate freezes

Summary
Inventory of Potential Responses

Inventory of Potential Responses:

- Disclaimer - not all will be feasible or advisable in every jurisdiction
- Think creatively to develop a comprehensive list
- Chances of success will increase with support from commercial, institutional and commercial customers
- Some may require legislation
- Some require a regional or national approach – coalitions will be essential
- Impacts will vary by response and by timeframe

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Potential Responses

Disclaimer - not all feasible or advisable in every jurisdiction

1. Extend or impose rate caps
2. Challenge any further increases
3. Improve procurement process for "standard offer service"
4. Decrease reliance on electricity supply at market prices
5. Reduce impact of natural gas prices on electricity supply prices
6. Transfer revenues from owners of existing generation to electricity consumers

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Potential Responses

Disclaimer - not all feasible or advisable in every jurisdiction

1. Extend or impose rate caps
   a. Use any available leverage (e.g. proposed mergers, rate case) to force regulated utility &/or unregulated parent company/affiliate to absorb the electricity supply costs in excess of the rate cap,
   b. Defer recovery of electricity supply costs in excess of the rate cap.

Done – DE, PA, RI

Proposed - IL, MD

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Potential Responses

Disclaimer - not all feasible or advisable in every jurisdiction

2. Challenge any further increases
   a. Question the design of new, additional charges proposed to promote investments in new generation capacity (e.g., reliability price mechanism proposed for PJM)
   b. Question the method of allocating funds from carbon allowances (e.g., Regional Greenhouse Gas Initiative)

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Potential Responses

Disclaimer - not all feasible or advisable in every jurisdiction

3. Improve procurement process for "standard offer service"
   a. Require entity responsible for SOS to acquire supplies via a portfolio of contracts. (Do not go into the market at any point in time to acquire 100% of supplies for a several month period).

Proposed – DC, ME

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Potential Responses

Disclaimer - not all feasible or advisable in every jurisdiction

4. Decrease, or terminate, reliance on electricity supply at market prices
   a. Increase energy efficiency initiatives
   b. Acquire a portion/all of supply at prices tied to actual production costs via build or buy long-term (through utility or public power authority).

      Done – AZ, CO, NY, CA

      Proposed – CT,ME,MT, OH
   c. Return to regulation of electricity supply

      April 2005 brief in US Court of Appeals by coalition including PULP, Public Citizen, NCLC, CO OCC, RI AG, NM AG, UT CCS.

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Potential Responses

Disclaimer - not all feasible or advisable in every jurisdiction

5. Reduce impact of natural gas prices on electricity supply prices
   a. Develop a different algorithm to calculate market prices
   b. Reduce electricity use by increasing energy efficiency initiatives
   c. Encourage development of new generation from other sources such as wind and coal.

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Potential Responses

Disclaimer - not all feasible or advisable in every jurisdiction

6. Transfer revenues from owners of existing generation to electricity consumers
   a. Collect "over-recovery" of stranded costs (CT – CL&P rate case)
   b. Impose a windfall profits tax (CT – proposed)
   c. Impose a state tax on electricity generation from carbon-intensive and radioactive fuels
      - Define the problem more broadly than rates: "Consumer and economic harm from unreasonable electricity prices."
      - Tax of 2.5 to 3.0 ¢/kWh would recover 50% of the increase

Illustrative Analysis for New England

Source: ***Electricity Price Increases: Causes, Effects, and Solutions,*** presented by Bruce Biewald at the Restructuring Roundtable, Boston, MA, May 19, 2006.

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Recent Electricity Supply Price Increases for Small Customers in New England

	Supply Price in ¢/kWh (prior period)	Supply Price in ¢/kWh (new period)	Increase
Narragansett (RI)*	6.7 (8/04 to 9/06)	10.0 (1/07 to 5/07)	49%
CMP (ME)	6.9 (3/05 to 2/06)	8.4 (3/06 to 2/07)	21%
Bangor Hydro (ME)	7.1 (3/05 to 2/06)	8.7 (3/06 to 2/07)	22%
NSTAR/BECo (MA)**	7.7 (7/05 to 12/05)	12.7 (1/06 to 6/06)	65%
Granite State (NH)***	5.2 (7/05 to 4/06)	8.6 (5/06 to 10/06)	64%

Note: These supply prices are only the generation component of retail rates. The other major component of total retail rates are transmission, distribution and other charges.

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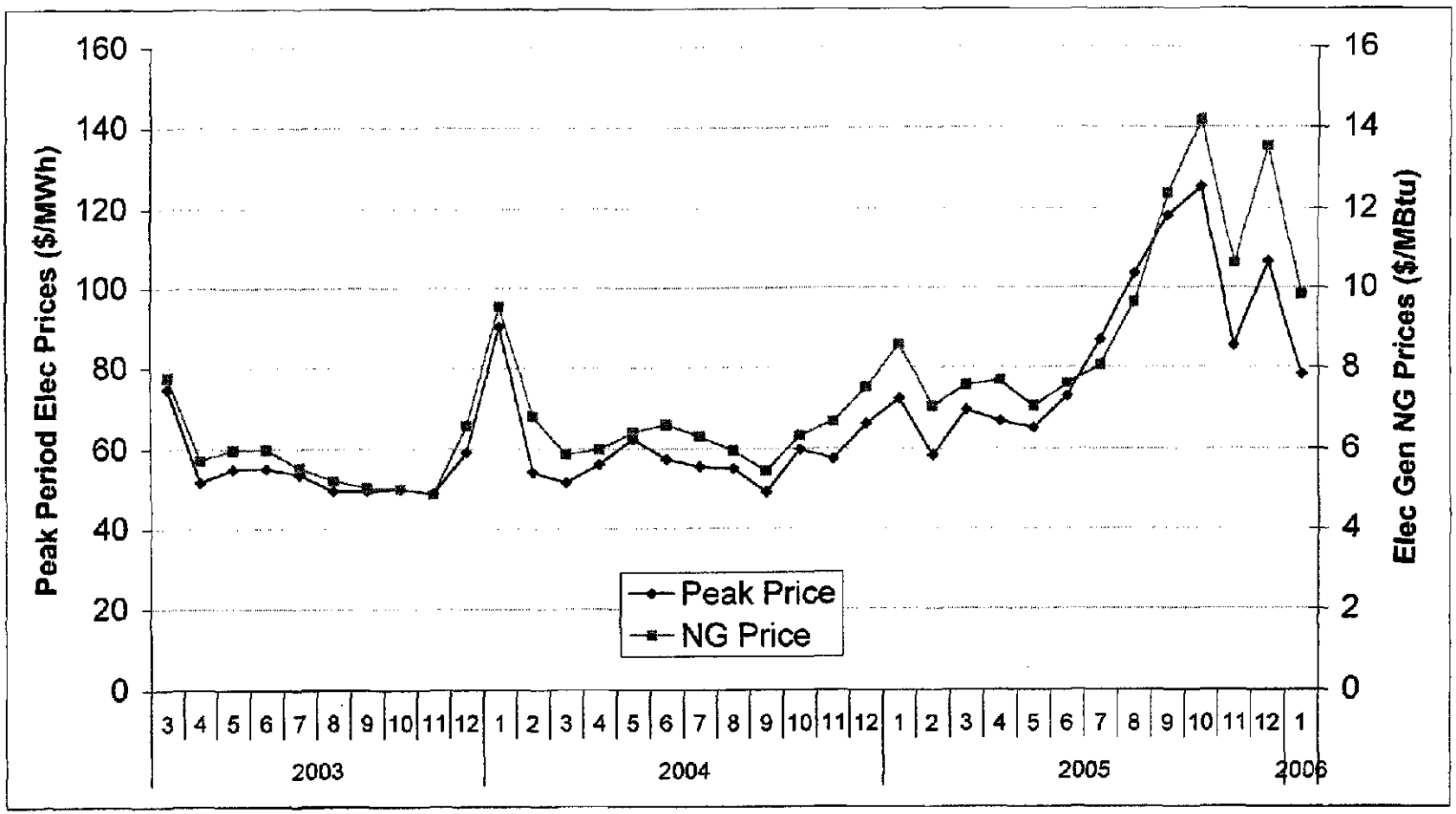
Natural Gas Prices Drive Wholesale Electricity Prices in New England: Time Series



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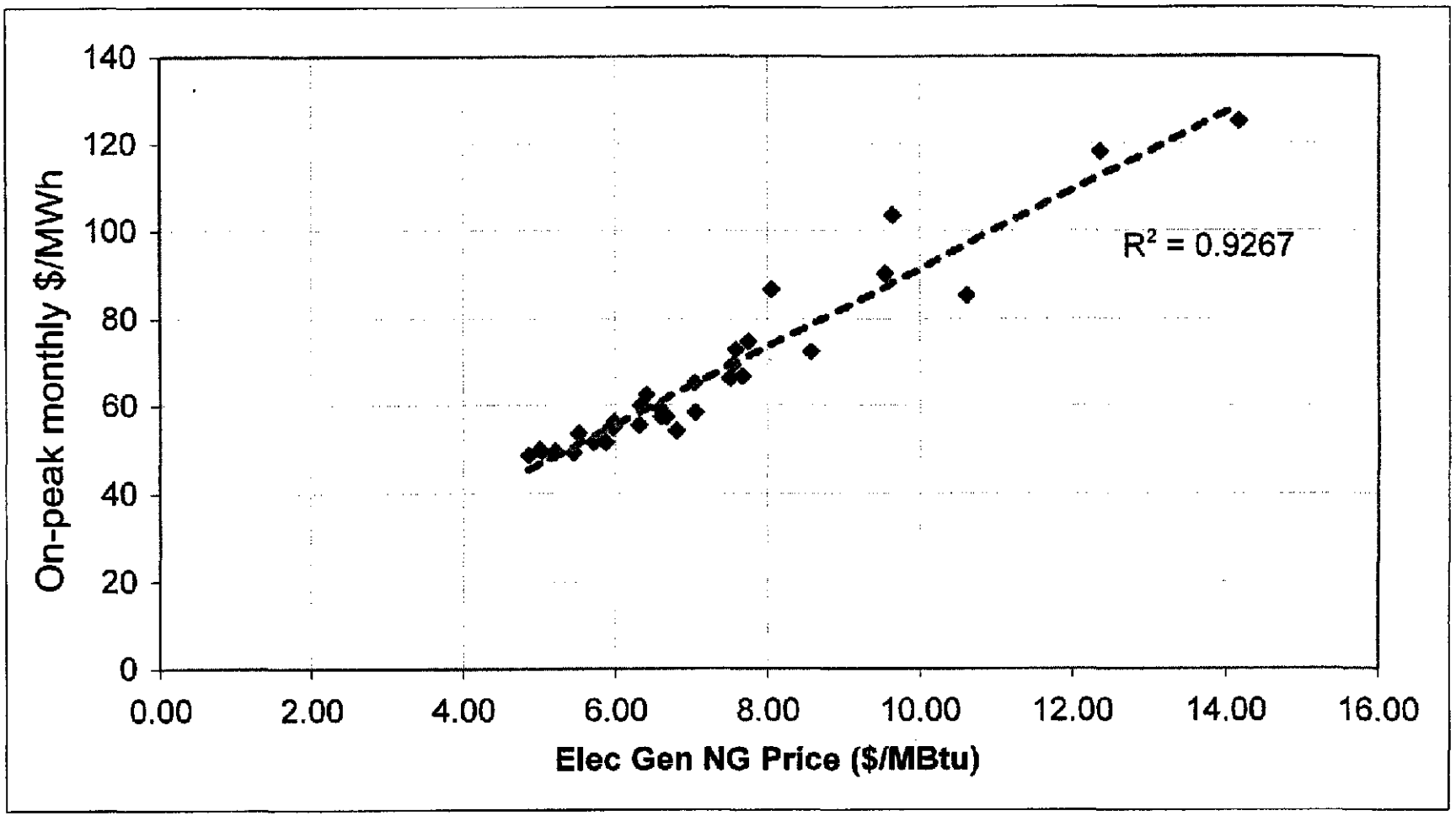
Natural Gas Prices Drive Wholesale Electricity Prices in New England: 2003-2006



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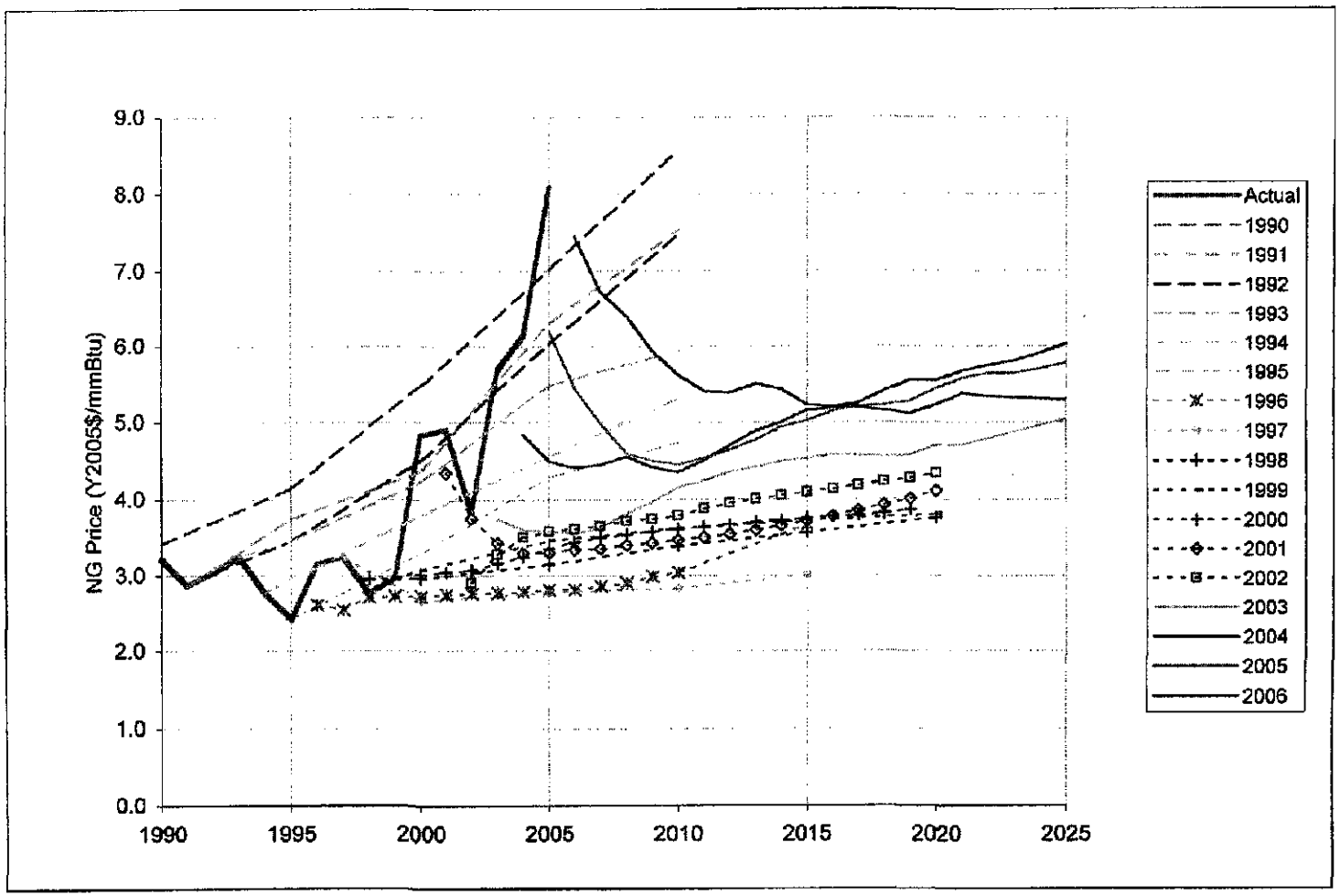
Forecasts of Natural Gas Prices Have Not Been Accurate



Source: Compiled by Synapse from EIA's Annual Energy Outlook reports.

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Natural Gas Prices

Gas prices on the rise:

- 1995 = $2/MMBtu
- 2002 = $4/MMBtu

- 2009 expected $10/MMBtu
- Lots of volatility and uncertainty

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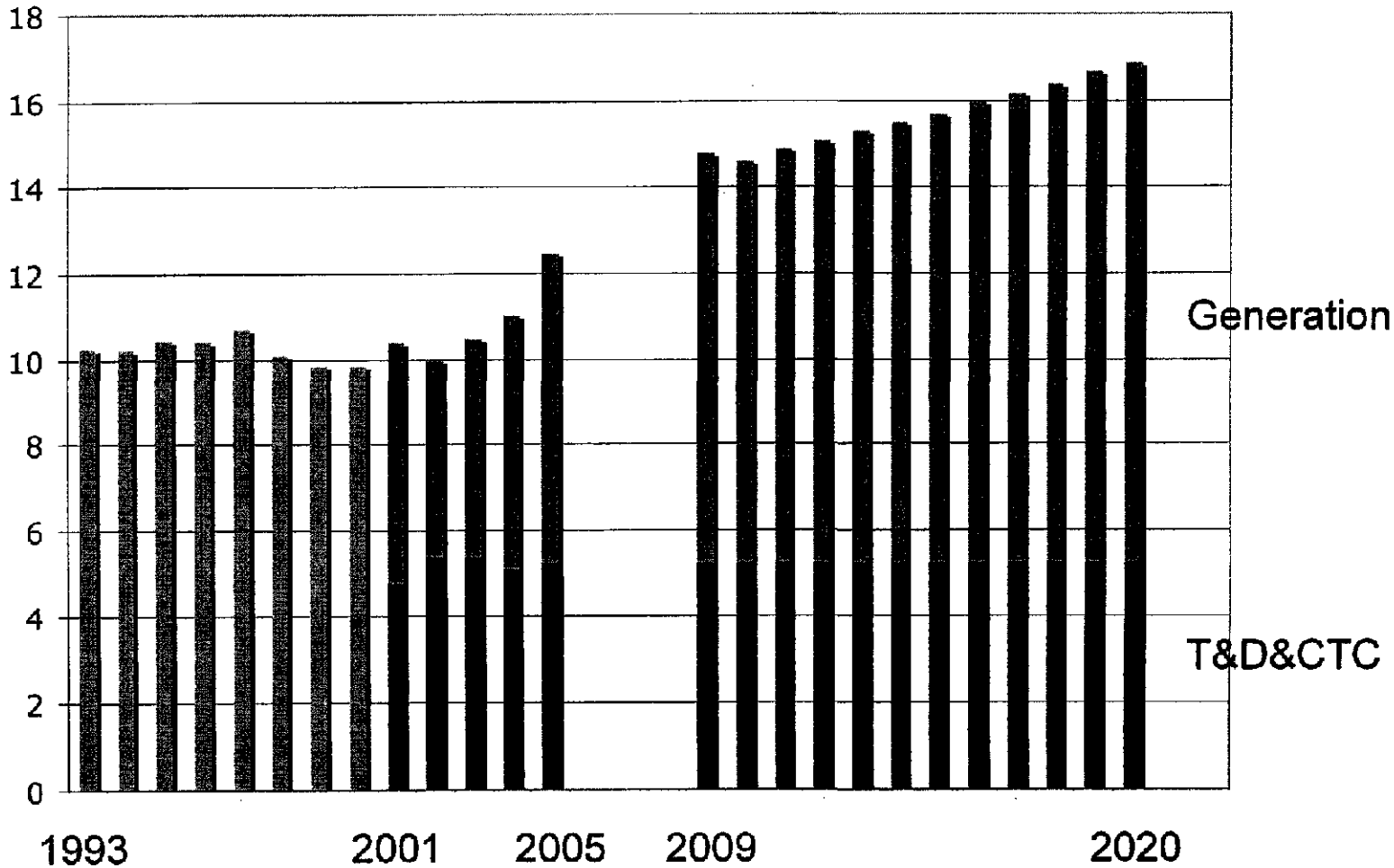
Average Electricity Price in New England for Retail Customers of IOUs (¢/kWh)



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Illustrative Calculation of the Effect of Gas Prices on Electricity Consumers (page 1 of 4)

Simplified system:

Electricity demand = 130,000 GWH/year
Gas units supply 50% of the annual demand
Gas units are "on the margin" 100% of the time
Heat rate of marginal gas units is 8500 Btu/kWh

Electricity capacity and related adders are 2.5 ¢/kWh in the "market" cases
T, D & other is 5 ¢/kWh on average ($6.5 billion/year)

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Illustrative Calculation of the Effect of Gas Prices on Electricity Consumers (page 2 of 4)

At burner-tip natural gas prices of $4/MMBtu

Regulated Electricity Supply (based on actual cost of supply from each type of generation)		**5.0 ¢/kWh**
Electricity supply market price		
energy	= $4/MMBtu x 8,500 Btu/kWh =	3.4 ¢/kWh
capacity	=	2.5 ¢/kWh
total	=	**5.9 ¢/kWh**

At burner-tip natural gas prices of $10/MMbtu

Regulated Electricity Supply (based on actual cost of supply from each type of generation)		**7.3 ¢/kWh**
Electricity supply market price		
energy	= $10/MMBtu x 8,500 Btu/kWh=	8.5 ¢/kWh
capacity	=	2.5 ¢/kWh
total =		**11.0 ¢/kWh**

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Illustrative Calculation of the Effect of Gas Prices on Electricity Consumers (page 3 of 4)

	Regulated Electricity Supply		Market Electricity Supply	
	Average Retail Rate (¢/kWh)	Cost to Consumers (billion $/year)	Average Retail Rate (¢/kWh)	Cost to Consumers Billion ($/year)
$4/MMBtu gas	**5** +5 10	**6.5** +6.5 13.0	**5.9** +5.0 10.9	**7.7** +6.5 14.2
$10/MMBtu gas	**7.3** +5.0 12.3	**9.5** +6.5 16.0	**11** + 5 16	**14.3** + 6.5 20.8

The first item in each cell is generation, the second is T,D & other, the third is total.

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Illustrative Calculation of the Effect of Gas Prices on Electricity Consumers (page 4 of 4)

	Regulated Electricity Supply		Market Electricity Supply	
	Cost to Consumers (billion $/year)		Cost to Consumers (billion $/year)	
$4/MMBtu gas	13	--	14.2	
$10/MMBtu gas	16	**23% increase**	20.8	**60% increase**

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Effect on the Regional Economy

- Synapse IL Study (2003): 10 to 20 jobs lost for every million dollars increase in annual electricity costs.
- An increase in annual electricity costs of $8 billion would result in loss of 80,000 to 160,000 jobs.
- Note: Electricity cost increases associated with new initiatives such as efficiency programs and carbon taxes would not harm the local economy since those revenues fund programs in the region and hence stay in the region. Also such increases are dramatically smaller.

Synapse
Energy Economics, Inc.

Electricity Price Increases: Causes, Effects, and Solutions

Restructuring Roundtable

May 19, 2006
Presented by Bruce Biewald

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Recent Electricity Price Increases for Small Customers in New England

	Price in ¢/kWh (prior period)	Price in ¢/kWh (new period)	Increase
Narragansett (RI)*	6.7 (8/04 to 9/06)	10.0 (1/07 to 5/07)	49%
CMP (ME)	6.9 (3/05 to 2/06)	8.4 (3/06 to 2/07)	21%
Bangor Hydro (ME)	7.1 (3/05 to 2/06)	8.7 (3/06 to 2/07)	22%
NSTAR/BECo (MA)**	7.7 (7/05 to 12/05)	12.7 (1/06 to 6/06)	65%
Granite State (NH)***	5.2 (7/05 to 4/06)	8.6 (5/06 to 10/06)	64%

Note: These prices are generation only (not including T, D, and CTC)
* Narragansett price for 10/06 to 12/06 was 8.2¢/kWh.
** NSTAR/BECo price is without the 12/6/05 Settlement which capped the increase.
*** Granite State price of 8.5 ¢/kWh is the simple average of monthly figures.

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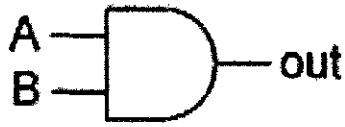
Cause and Effect: Boolean "AND" Function

Logical "AND" Gate



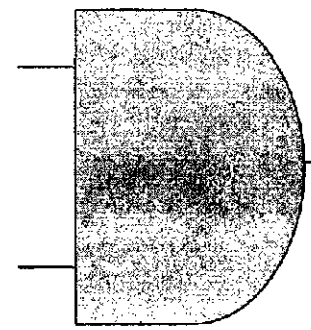
Truth Table

Input A	Input B	Output
0	0	0
1	0	0
0	1	0
1	1	1

Electricity Price Increases Cause and Effect

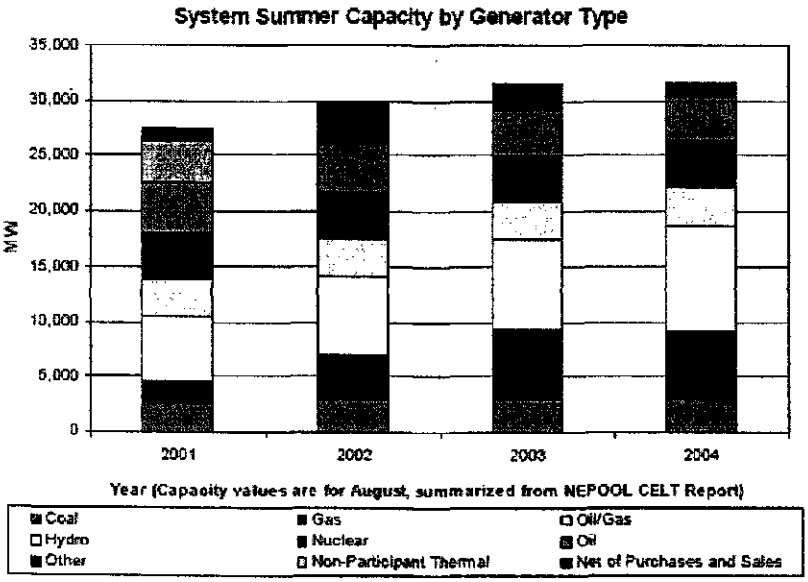
Gas price increases with gas "on the margin"

Electricity deregulation with reliance on "market"



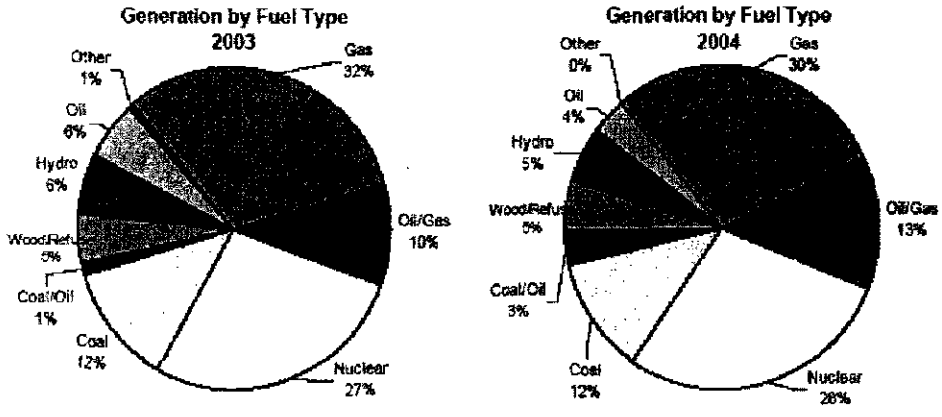
Electricity price increases with implications for the economy

New England Capacity Mix



Source: ISO-NE "2004 Annual Markets Report," page 22.

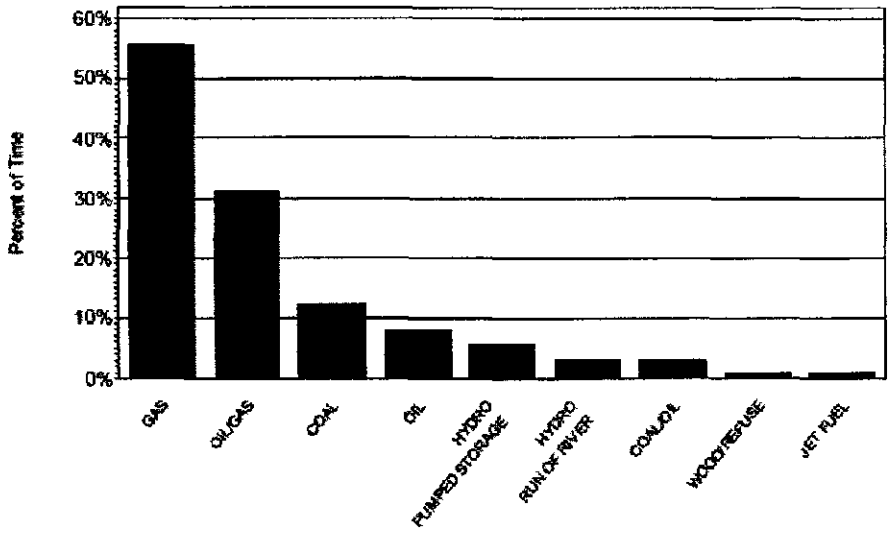
New England Fuel Mix for Electricity Generation



Source: ISO-NE "2004 Annual Markets Report," page 23.

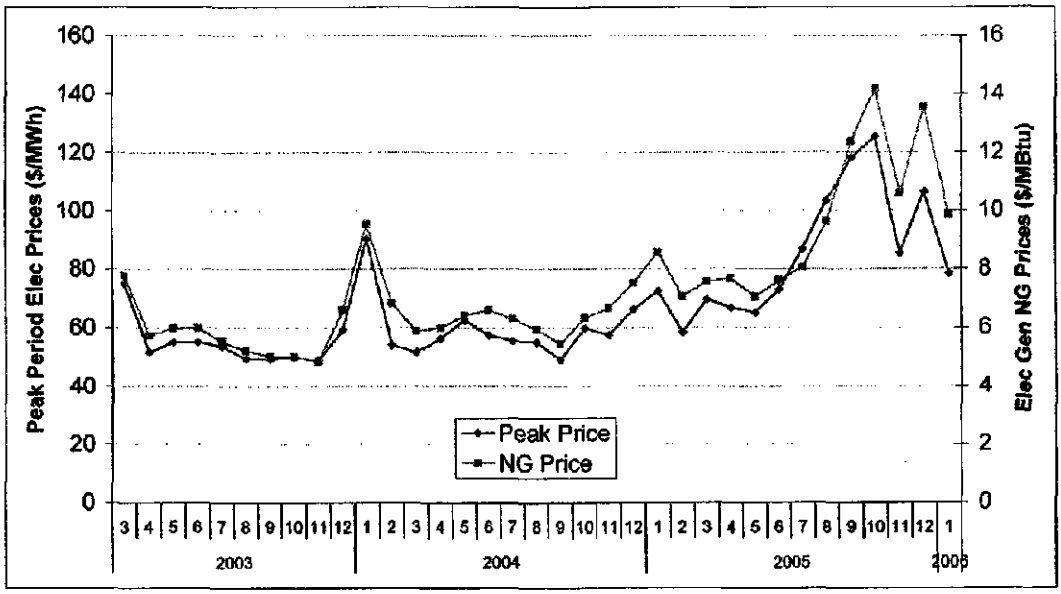
New England Marginal Fuel Mix for Electricity Generation

Marginal Input Fuels in Real-Time, 2004

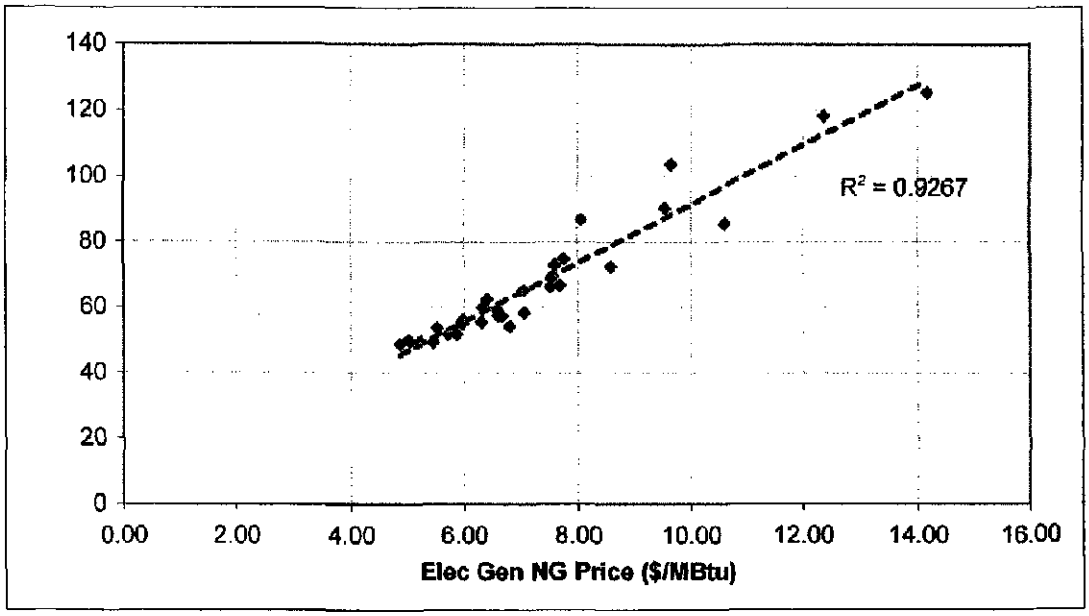


Source: ISO-NE "2004 Annual Markets Report," page 31.

Natural Gas Prices Drive Wholesale Electricity Prices in New England: Time Series



Natural Gas Prices Drive Wholesale Electricity Prices in New England: Scatter Plot



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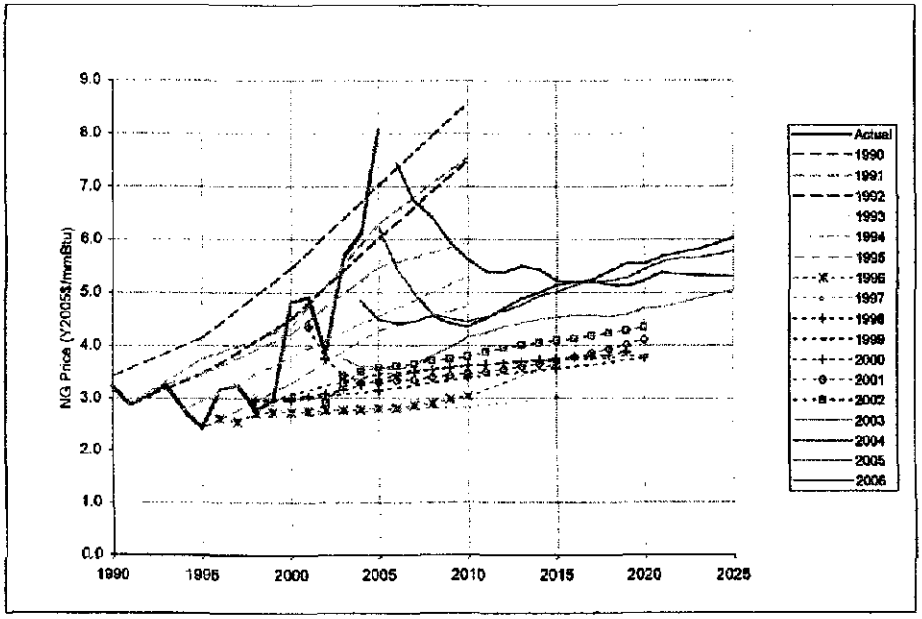
Forecasts of Natural Gas Prices Have a Poor Track Record



Source: Compiled by Synapse from EIA's Annual Energy Outlook reports.

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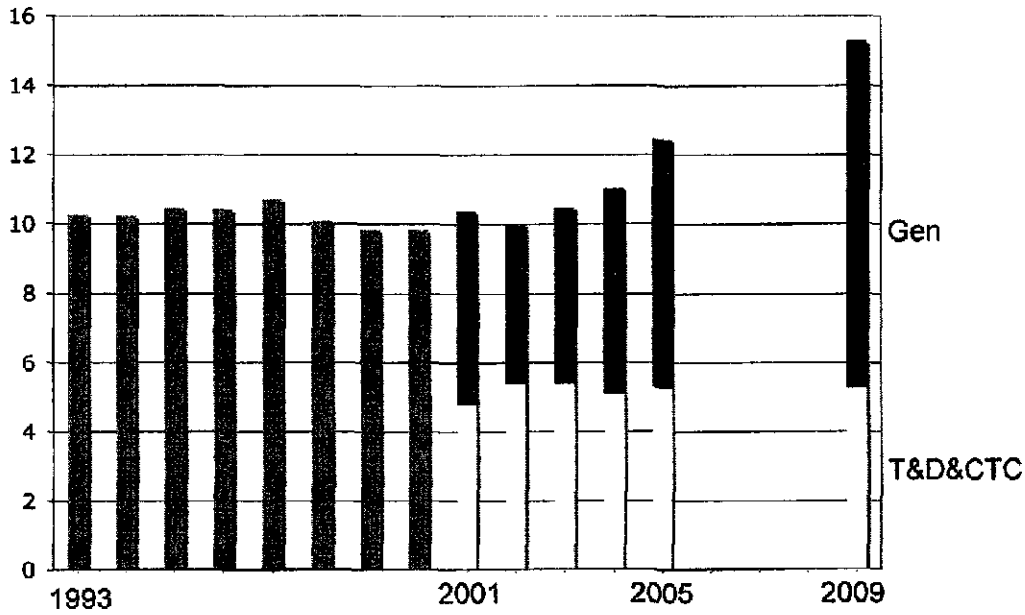
Natural Gas Prices

Gas prices on the rise:

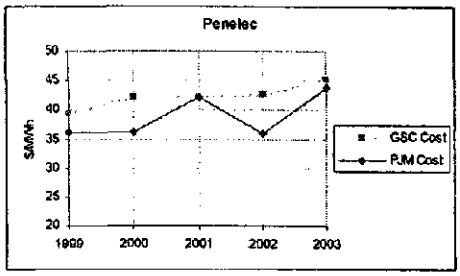
- 1995 = $2/MMBtu
- 2002 = $4/MMBtu

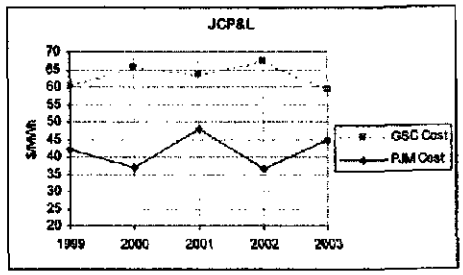
- 2009 expected $10/MMBtu
- Lots of volatility and uncertainty

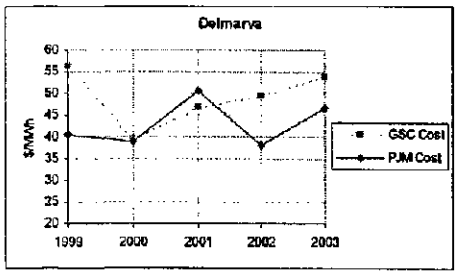
Average Electricity Price in New England for Small Customers (¢/kWh)



Synapse's price analysis for PJM through 2003 found mixed results







Source:

Electricity Prices in PJM: A Comparison of Wholesale Power Costs in the PJM Market to Indexed Generation Service Costs, June 3, 2004.

Illustrative Calculation of the Effect of Gas Prices on Electricity Consumers (page 1 of 4)

Simplified system:

Energy = 130,000 GWH/year
Gas is 50% of the generation mix
Gas is on the margin 100% of the time
Gas heat rate = 7500 Btu/kWh (average) 8500 (marginal)

Bundled generation at 5 ¢/kWh ($6.5 billion/year)
T&D&CTC at 5 ¢/kWh in all cases ($6.5 billion/year)
Capacity and misc adders at 2.5 ¢/kWh in market cases

Illustrative Calculation of the Effect of Gas Prices on Electricity Consumers (page 2 of 4)

Calculations:

Gas cost = $4/MMBtu x 7,500 Btu/kWh x 65,000 GWH/year
= $2 billion/year

Gas cost at $10/MMBtu = $5 billion/year

Energy market price = $4/MMBtu x 8,500 Btu/kWh = 3.4 ¢/kWh
+ 2.5 ¢/kWh
5.9 ¢/kWh

Energy market price = $10/MMBtu x 8,500 Btu/kWh = 8.5 ¢/kWh
+ 2.5 ¢/kWh
11.0 ¢/kWh

Illustrative Calculation of the Effect of Gas Prices on Electricity Consumers (page 3 of 4)

	Regulated		Market	
	¢/kWh	Billions of $/year	¢/kWh	Billions of $/year
$4/MMBtu gas	5 +5 10	6.5 +6.5 13.0	5 +5.9 10.9	6.5 +7.7 14.2
$10/MMBtu gas	5 +7.3 12.3	6.5 +9.5 16.0	5 +11 16	6.5 +14.3 20.8

In each cell, the items listed are: top = T&D&CTC
middle = generation
bottom = total

Illustrative Calculation of the Effect of Gas Prices on Electricity Consumers (page 4 of 4)

	Regulated		Market	
	Billions of $/year		Billions of $/year	
$4/MMBtu gas	13	--	14.2	9% *increase*
$10/MMBtu gas	16	23% increase	20.8	60% increase

Effect on the Regional Economy

- Plausible range of 10 to 20 jobs per million dollars of increase in electricity prices.
- Electricity cost increase of $8 billion per year results in loss of 80,000 to 160,000 jobs.
- Note: Electricity price increases from efficiency programs and carbon policy can *have benefits to the regional economy.*

What can be done?

- Longer term resources
- Portfolio management
- Renewables and energy efficiency
- Challenge rates and market structures (just and reasonable?)

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Resource Insight, Inc. • Five Water Street • Arlington, Massachusetts 02476
(781) 646-1505 • Fax (781) 646-1506

Integrated Portfolio Management in a Restructured Supply Market

A Report to the
Office of the Ohio Consumers' Counsel

Resource Insight, Inc.
Paul Chernick
Jonathan Wallach

Synapse Energy Economics, Inc.
William Steinhurst
Tim Woolf
Anna Sommer
Kenji Takahashi

June 30, 2006

Resource Insight, Inc. • Five Water Street • Arlington, Massachusetts 02476
(781) 646-1505 • Fax (781) 646-1506

A few states (e.g., California and Delaware) have recently mandated a return to some sort of deliberate resource planning for procurement of SSO supply. In this report, we consider the strategies adopted in those jurisdictions and the latest types of integrated resource planning in use in non-restructured states. We also discuss additional tools that could be used to address better the need of SSO consumers for reasonably and stably priced power while improving wholesale competition and maintaining the opportunity for effective retail competition in electric power supply.

5. *Advancing Generation Service for Ohio Consumers*

As discussed in more detail in Chapter II, Ohio faces a difficult situation at both the retail and wholesale levels of the electric industry. Most Ohio electricity consumers now receive their generation service through the standard service offer and are likely to continue to do so. Further, the way SSO supplies have been acquired and priced through the rate stabilization plans has not contributed to the development of either competitive wholesale markets or competitive retail supply. The uncertainty of how Ohio will frame its post-2008 SSO regime does not help move those markets in constructive directions.

Unless a new approach is taken to procuring power for SSO service, small consumers stand to suffer multiple losses. First, they have lost access to traditional, cost-based power in the transition to SSO service. Second, very few have been offered competitive retail supply. Third, SSO prices have been set at the prices that the incumbent utility has been willing to offer, rather than at competitive wholesale market prices. Fourth, the utilities have been allowed to make large parts of the SSO supply cost non-bypassable, and to adjust upward SSO rates for a variety of cost charges (including non-market prices, such as environmental-compliance costs at the utility's power plants), further discouraging competition.[7] Fifth, even these flawed transition-service offerings are likely to be replaced by more-volatile market-priced rates.

Moreover, in the post-transition regime, consumers will likely face prices based on *market clearing prices*, that is, all their power would be priced by reference to the cost of the *most expensive source* in any given hour. That clearing price is likely to be set much of the time by natural-gas prices that are at very high levels now and are likely to remain so for some time to come. To the extent that those markets are not completely competitive or have any other structural problems, the problem would be even more serious.

---

[7]The Ohio Supreme Court has recently remanded to the PUCO some of the cases imposing these rate stabilization plans, to address some of these problems.

As discussed in Chapter II, long-term purchases of SSO supply from new resources can contribute to ensuring the adequacy of regional power supply. In the current Ohio regulatory structure, no entity has responsibility for ensuring regional supply adequacy. The utilities are no longer responsible for power-supply planning, the generation owners (including utility affiliates) have no long-term responsibility to customers (and actually benefit from supply shortages), neither the Public Utility Commission of Ohio (PUCO) or the Ohio Power Siting Board (OPSB) is legally required to take on this function, and the ISOs only do transmission planning and occasionally offering incentives to keep existing power plants on-line.[8] Even if a shortage of power supply were emerging, it is not clear how Ohio could ensure construction of new generation, under current arrangements.

Ohio can best minimize costs and risks for ratepayers while creating an opportunity for a competitive retail market to develop, by pursuing the following steps:

- Revising the wholesale procurement process, so that customers who continue to receive SSO power pay prices that reflect the prudent procurement from the competitive market.
- Ensuring that the SSO rate recovers all categories of costs paid by competitive suppliers, and that all such costs are recovered in SSO charges bypassable by shopping customers, so that each customer pays for either SSO or competitive supply, but not both.
- Diversifying the SSO supply, to minimize costs and risks for SSO customers and competitive customers as well.
- Long-term planning, to ensure an adequate, low-cost, and stable regional power supply and the availability of those supplies for Ohio consumers.

In order to achieve those goals, Ohio must take the following steps:

- *Encourage wholesale competition* by reforming SSO procurement.
- *Level the playing field* for retail competition by pricing SSO to be consistent with the wholesale market on which retail competitors depend.
- *Encourage clean energy and energy efficiency* in a manner consistent with the further development of retail competition by (1) renewable-portfolio and

[8]PJM's Reliability Pricing Model and MISO's Scarcity Pricing Model are attempts to grapple with this issue, but would rely on raising prices to all generators to encourage construction when and where it is needed.

energy-efficiency-resource standards and (2) additional procurement of clean and renewable energy for SSO supply but with costs shared by all consumers.

- *Promote wholesale-market stability* and reduced retail volatility for all consumers by (1) Using SSO load as an "anchor tenant" for development of new clean baseload generation and (2) serving SSO with a managed portfolio of short and long term purchases of new clean or renewable generation.

Residential and small commercial consumers, so far, lack options for shopping and there is little reason to think this will change soon. Residential consumers in other states, with only a few, largely temporary, exceptions, have not seen substantially better opportunities to save money or control volatility through retail competition. Blumsack, Apt, and Lave (2005, 12) sum up the situation as follows:

> With a few exceptions, residential switching activity in the competitive retail market has been minimal at best. Even if residential consumers wanted to switch, many service areas simply don't have any competitors to the incumbent utility. Nineteen states currently offer some form of retail competition to at least some of its consumers, but in some areas (such as most of Pennsylvania) there are no alternatives to the incumbent utility. Residential activity in competitive retail markets has been low, with the exception of some traditionally high-cost urban areas.

As of mid 2005, among those states that had implemented retail choice, only Texas and the FirstEnergy companies in Ohio reported residential switching greater than 10%.[9] Residential switching was driven primarily by a statewide opt-out aggregation program in Ohio.[10] In Texas, the "price to beat" was set administratively but, despite the "price to beat" being adjusted upward an average of 43% in two years, only about 20% of residential customers had switched to competitive retail suppliers (Rose and Meeusen 2005, 36). Meaningful retail competition for residential consumers is rare and shrinking. Increases in default service prices are not simply a reflection of natural gas prices, but also strongly reflect structural difficulties with the relevant markets.

Residential switching has been very low all along—and that there is no reason to suspect that residential consumers' behavior will change, given the high transaction costs required to sign them up, the uncertainties and risks involved, and the small annual consumption of each customer. There is little reason to

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[9]Rose and Meeusen (2005, 2). Ohio's opt-out program no longer contains a large number of residential shoppers.

[10]Ohio residential aggregation has declined dramatically since late 2005, due to the below-market bypassable generation rates in the First Energy utilities' rate-stabilization plans.

expect this to change significantly. As Blumsack, Apt, and Lave (2005, 13) observe, default service providers and competitive retail suppliers "face the same market price for bulk power.... Particularly in the case of the residential sector, there is little room for efficiency gains (and therefore vigorous price competition)."

The problem of securing the power needed for adequate and reasonably and stably priced SSO service can be addressed through careful resource planning, updating traditional IRP with a more-extensive use of the financial-portfolio-management techniques that have been adopted in SSO procurement in many states. By adopting this approach, Ohio can develop adequate power resources, obtain lower, more stable prices, and reduce consumer risk, while continuing its progress towards competitive wholesale and retail electricity markets. We will call that combination of portfolio management and IRP integrated portfolio management, or IPM.[11]

Traditional IRP evaluates a wide variety of supply- and demand-side resources to identify the combination of resources expected to meet current and future needs at the least cost. Integrated resource plans typically looked at planning periods of twenty years and were updated every two to three years.

Financial-portfolio management comprises the guidelines that sophisticated investors and commodity purchasers utilize for determining their product mix. An investment manager must select the appropriate mix cash, stocks of various kinds (large cap, small cap, foreign, etc.), bonds of various maturities and issuers (corporate, municipal, federal, foreign), futures and hedges, mutual funds, and so on. State-of-the-art portfolio management uses detailed quantitative analysis, to assess how different combinations of investments with varied kinds of uncertainty affect the return and risk profile of the total portfolio.

Similarly, the managers of power portfolios have multiple options, including buying power under various contractual arrangements (long- and short-term, full-requirements or baseload, firm or unit-specific), building and running generation and of reducing need through Demand-side management (DSM). Traditional vertically integrated utilities used portfolio-management approaches for some fuel and short-term power transactions, but did not generally see portfolio management as relevant to their major efforts, focused on building or buying generation and on DSM. Two recent changes have made portfolio management techniques more

[11]Chapters II through IV explain in detail how the ISM approach can integrate with continued competitive retail marketing. Chapters V and VI detail the energy-efficiency and renewable-energy implementation part of the ISM approach recommended for Ohio.

relevant to power-supply planning. First, the growth of market trading of futures and options for power, natural gas, weather, and emission permits, has expanded utility choices in resource planning, in a manner that resembles the financial and commodity markets in which portfolio management is commonplace. Second, utilities that have divested their generation and must procure power for SSO service have begun to use elements of portfolio management, such as contract laddering.

Debates about how to structure electricity markets and retail SSO procurement often become very theoretical. Ohio does not face an exercise in theory; the problem of ensuring adequate, reasonably and stably priced SSO will affect real people with real problems. Failure to do careful, integrated resource planning on how to meet that need *is* a planning decision, but not a very sound one! Failure to carefully choose and actively manage an appropriate portfolio of resources for that purpose *is* a portfolio management decision, but not a well thought out one.

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DE-OHIO EX. 11

OFFICE OF THE GOVERNOR
207 STATE CAPITOL, SPRINGFIELD, ILLINOIS 62706

2005 AUG 31 P 2:51

ROD R. BLAGOJEVICH
GOVERNOR

August 31, 2005

Dear Commissioners,

I have been closely following the developments of Commonwealth Edison's ("ComEd") proposal before the Illinois Commerce Commission ("ICC") to approve a procurement process (in this instance, a "reverse auction" has been proposed) that will result in the purchase of wholesale power at market-based prices (docket No. 05-0159). Please make this document available to all parties to this proceeding and make it a part of the record of docket No. 05-0159 as the position of an interested party.

The road towards deregulation of the electric industry began in 1997 with amendments to the Public Utilities Act ("PUA"). Deregulation is based upon the predicate that regulation is unnecessary in a competitive market. A competitive market will drive down retail rates and make regulation unnecessary. However, in 2001, this transition period was extended because competition had not yet developed. To date, this competition has still not yet developed for most markets especially the market for residential ratepayers. Therefore, the principles of deregulation have not been achieved.

The PUA only authorizes the Commission to approve market-based rates for customers who take electric service that has been declared "competitive" pursuant to Section 16-113 of the Act. Rate increases are unjustified and the ICC is without authority to approve the market-based rates for the procurement of power, including the reverse auction, until this service has been declared "competitive."

I appointed members of the Commission to protect the consumer. It is your job to ensure that rates remain just and reasonable, and to reject filings that circumvent the law or the intention of the law. I consider an approval of a reverse auction procurement process of market-based rates for wholesale power either a serious neglect of duty or gross incompetence by the ICC.

I will take whatever action is necessary to protect the public and ensure that the law is followed. Unless and until a competitive market develops, the request for higher rates must be rejected.

Therefore, I urge you to uphold your duty to properly apply the law, protect Illinois consumers, and refuse to abandon the long-standing consumer protections provided by the PUA. I request that you dismiss ComEd's request for approval of the market-based rates of a reverse auction requested in Rider CCP of docket number 05-0159 and any current or future filing authorizing a reverse auction or any similar procurement process. I urge you to declare that competition does not exist in the residential market and therefore refuse to approve any retail rate filing or tariff that utilizes any such procurement process.

Sincerely,

ROD R BLAGOJEVICH
Governor

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%

PENGAD-Bayonne, N.J.
EXHIBIT
DE-OHIO
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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	61.8%
Fuel & Purchased Power	194,302,151	18.4%
Total Fully Bypassable	848,582,225	80.2%
Annually Adjusted Component	55,008,125	5.2%
Rate Stabilization Charge	114,747,660	10.8%
Total Partially Bypassable (25%)	169,755,785	16.0%
System Reliability Tracker (a)	8,682,875	0.8%
Infrastructure Maintenance Fund	31,549,495	3.0%
Total Not Bypassable	40,232,370	3.8%
Grand Total	$ 1,058,570,380	100.0%

(a) Reflects amount estimated to be recovered in 2007 with no true-up.

PENCAD-Bayonne, N.J.
EXHIBIT
OMG
2

CRES MARKET
EQUILIBRIUM

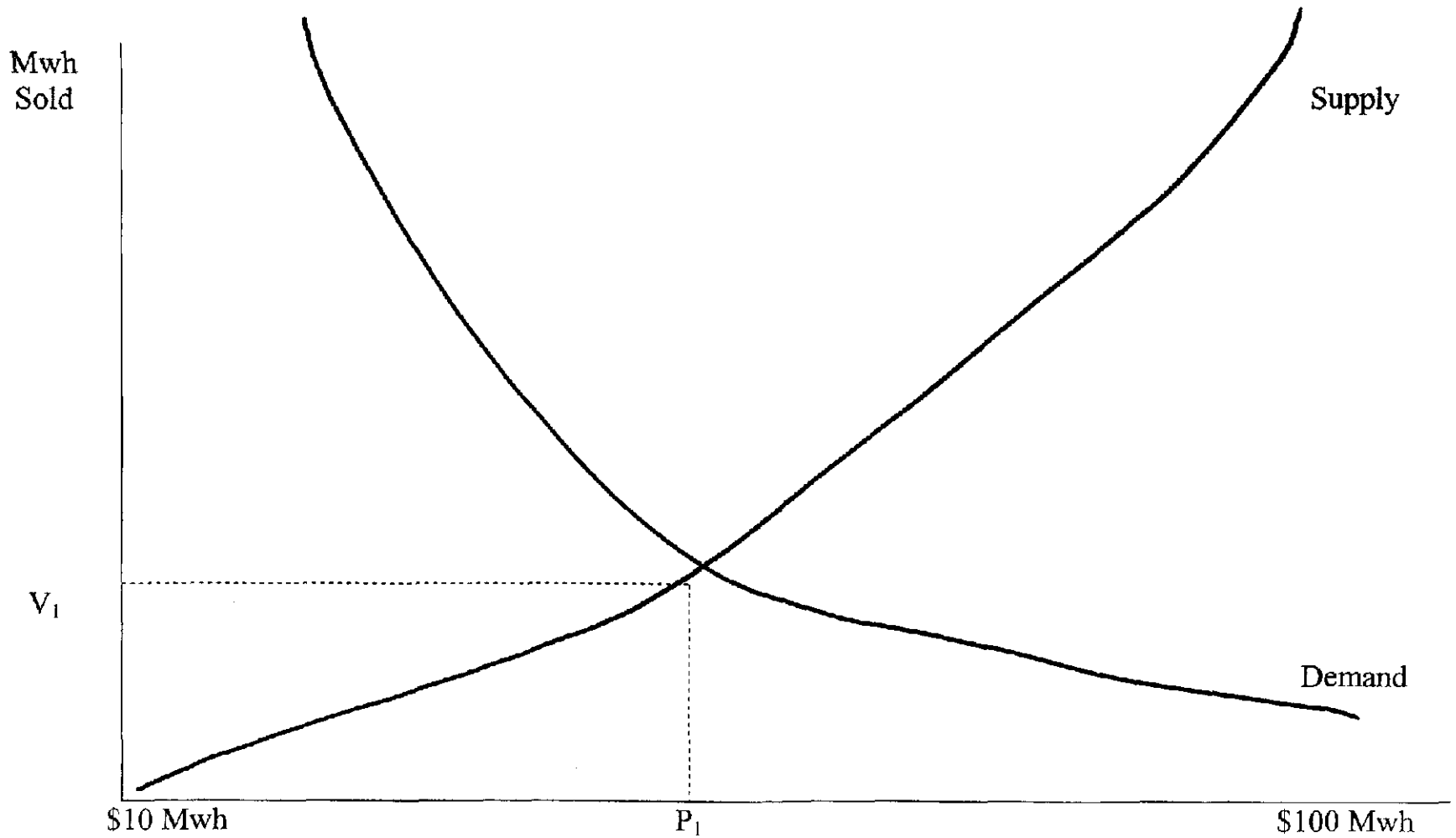
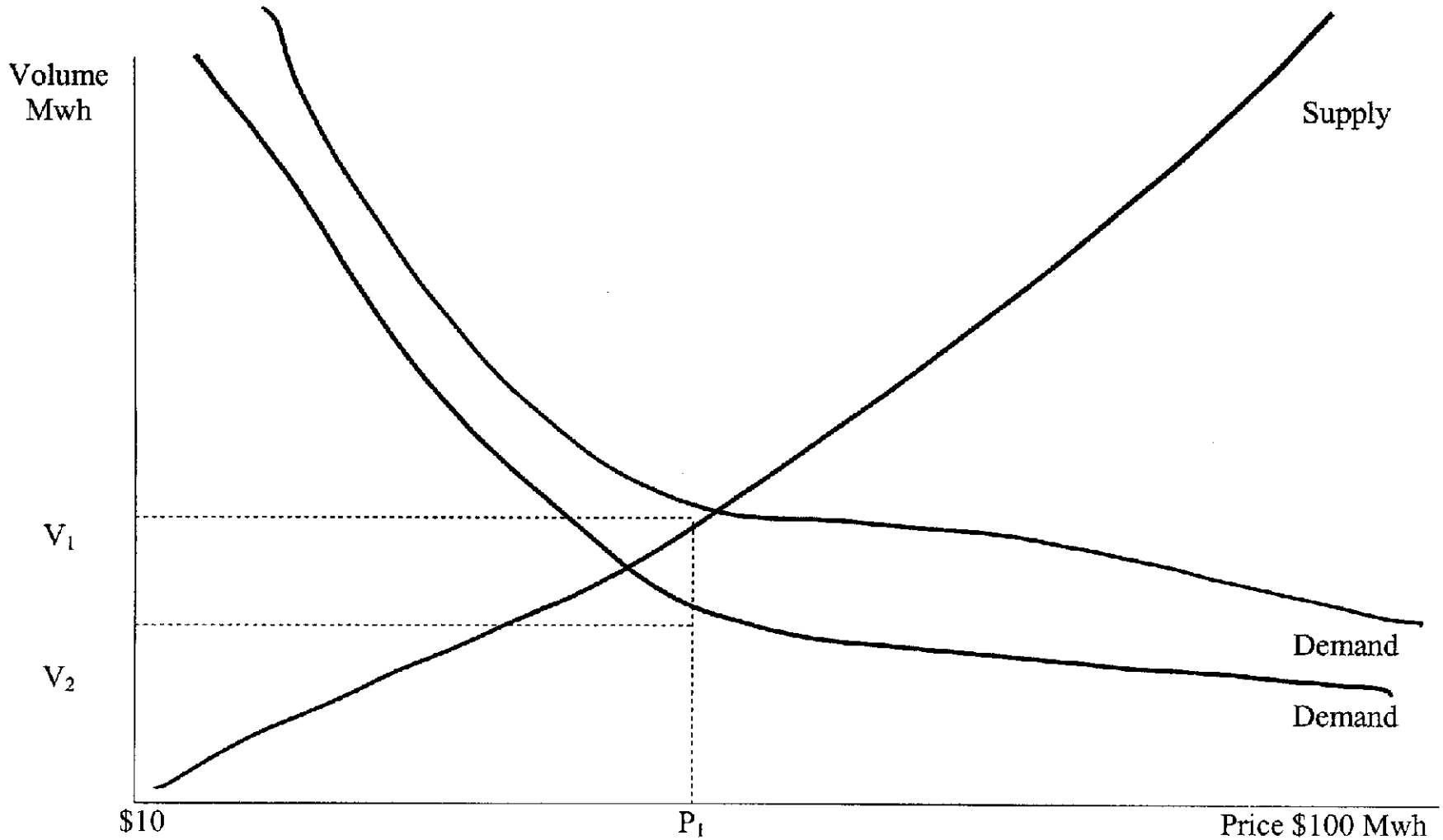


EXHIBIT
OMG
3
PENGAD-Bayonne,N.J.

CRES MARKET

~~CODE OF CONDUCT VIOLATION~~