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FILE

BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO

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

ADDITIONAL REBUTTAL TESTIMONY
OF
J. CRAIG BAKER
ON BEHALF OF
COLUMBUS SOUTHERN POWER COMPANY
AND
OHIO POWER COMPANY

December 8, 2008

THE PUBLIC UTILITIES COMMISSION OF OHIO
ADDITIONAL REBUTTAL TESTIMONY OF
J CRAIG BAKER
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COLUMBUS SOUTHERN POWER COMPANY
AND
OHIO POWER COMPANY
PUCO CASE NO. – 08-917-EL-SSO
PUCO CASE NO. – 08-918-EL-SSO

Q. Please state your name.

A. My name is J. Craig Baker.

<u>Cost-of-Service Arguments</u>

Q. Ms. Alexander and Ms. Smith have testified that SSO rates, or at least adjustments to current SSO rates must be cost based. Do you agree with this assertion?

A. No. These parties are attempting to convince the Commission that Senate Bill 221, as passed by the legislature and signed by the Governor, is a generation reregulation bill which returns Ohio to classic cost-of-service regulation.

Q. Can you provide examples of this?

A. There are many examples but a few include a) if the companies, are earning an adequate Return on Equity then all current costs are included in rates, b) the companies' ESP must be tested to see if it is the least cost approach, and c) if the companies are receiving non-retail revenues these must be credited to the SSO rate.

Q. Are these examples consistent with the legislative discussions leading up to the passage of Senate Bill 221 and the language of the bill?

A. No it is not. I was the Company lead representative in the legislative discussions and I am therefore familiar with many of the positions taken by parties. Many of the intervenor parties were lobbying the General Assembly to provide cost-of-service legislation with customer shopping. Many proposed using a "Just and Reasonable Standard" for evaluating costs incurred by the Companies in setting rates. Clearly the General Assembly chose a different approach in passing this "Hybrid" bill. There is no mention of cost-of-service in the bill and the only mention of the word "prudently" in the ESP portion of the Bill is in Section 4928.143(B)(2)(a).

Q. **Are the words "reasonably priced" included in the state goals outlined in Section 4928.02(A), Revised Code?**

A. Yes, they are. However, to me those words do not indicate a return to the "just and reasonable" standard associated with classic cost-of-service regulatory language. Further, this goal has not been changed from the language contained in Senate Bill 3 in the context of market rates for SSO pricing. If market rates were considered reasonable by the legislature in SB3 and if ESP rates are more favorable to customers than market rates then clearly ESP rates must be reasonable if they are in the aggregate more favorable to customers than the expected results under an MRO.

Q. **Please provide an example of action by another state to support that Senate Bill 221 is not true reregulation of generation.**

A. The State of Virginia, like Ohio, pursued deregulation of generation and customer choice around the beginning of this century. Like Ohio, Virginia unbundled and froze rates for customers. Further, they too had a date specific for going to market based rates for all customers and later delayed implementation in order to let the market evolve. At the beginning of 2007 the state passed legislation that virtually eliminated customer choice, specifically provided that the Virginia Commission set rates on a test year cost-of-service and required a sharing of off-system sales between customers and the companies' shareholders – all characteristics of reregulation of generation. Ohio did none of these things, so the representations being made by the intervenors would be appropriate in Virginia but not here in Ohio.

Q. **If this is not a classic generation regulation bill and not a pure market bill how would you describe how rates for an SSO should be determined?**

A. Section 4928.143(B)(2), Revised Code, makes it clear that a company may provide any provision in an ESP for approval by the Commission as long as the ESP in the aggregate is more favorable to customers when compared with the expected results under an MRO option. An ESP is in no way restricted from having the provisions included by the Companies such as a charge for POLR, implementation of FAC with the Companies' baselines, automatic increases, recovery of carrying charges on environmental investments and purchase power plans. No where in the bill does it suggest that in approving a company's ESP the Commission should evaluate cost-of-service, least cost planning or a just and reasonable standard.. Instead, the bill provides that in approving an ESP it should be an evaluation based on the ESP being more favorable in the aggregate than the expected results under an MRO.

Q. **In your opinion what are the circumstances that would warrant the Commission modifying an ESP?**

A. I could see a Commission modifying a Company's ESP a) if they find that the ESP in the aggregate is not better than the expected results under an MRO, b) if they did not want to approve a phase in proposed by a company to avoid the carrying charges, or c) if they wanted to provide for a phase in with deferrals and carrying charges to achieve "gradualism" in raising rates based on a company's plan.

Q. Should the Commission lower the economic value of a company's plan just to keep the customer's rates down?

A. No it should not. In considering the question, it is important to recognize that significant issues concerning matters such as the FAC baseline, the environmental baseline, and the carrying charges applicable to environmental investments and FAC deferrals, just to mention a few, are material issues which, as a group, comprise the Companies' ESP. Modifying the Companies' proposed treatment of such issues could result in the financial risk associated with the ESP being significantly increased so as to fundamentally change the Companies' ESP proposal.

<u>Purchase Power Proposal</u>

Q. A number of intervenors oppose the provision in the ESP whereby the Companies would supplement their generation portfolio with 5/10/15% purchased power over the ESP period. How do you respond to that opposition?

A. The intervenors use Section 4928.143(B)(2)(a), Revised Code, to claim that since this may not be the least cost option that such a provision is not prudent. Although the Companies propose to administer its slice-of-system purchases within the FAC mechanism the proposal was not made under that section and the Commission is not limited to that section in approving it. One needs to consider this as a two-step process. The plan to make purchases should be approved if the total ESP, including the purchases, is in the aggregate more attractive than an MRO. Then as part of the FAC quarterly process the Companies would be subject to showing that they executed the purchases in a prudent manner.

Q. **There has been testimony in this proceeding that the Companies' purchase power proposal is imprudent or is inconsistent with the Companies' request for authority to sell or transfer certain generating facilities and their stated position on the Commission's jurisdiction regarding the to selling or transferring of certain contractual entitlements to generating output from facilities owned by others. How do you respond to those concerns?**

A. Those concerns are based on attempts to link these two separate proposals even though the bases for the proposals are not related.

Q. **Please explain why the two proposals are not related.**

A. The purchased power proposals are not based on the Companies' need for power to serve the Ormet load or the load of the customers formerly served by Monongahela Power Company. If it were then that proposal would seem inconsistent with the proposal to sell or transfer generation facilities. Instead, the purchased power proposal is tied to the changes to the Companies' certified service territories related to the two loads I have mentioned that the Companies agreed to in order to assist the State of Ohio in its economic development activities. The Companies believe, and it was their expectation when it agreed to supply service to these two loads, that they should be able to continue to recover market-priced power after 2008 in relation to these loads.

Q. **Why should that recovery structure continue when neither the Ormet nor Mon Power Commission orders specifically provided for that level of recovery beyond 2008?**

A. While I cannot speak to what the Commission intended at that time, it is important to recognize that at the time of both orders the prevailing regulatory structure was that after the expiration of the Companies' Rate Stabilization Plans the Companies' Standard Service Offer (SSO) would be fully market-based - - not based on some "more favorable" (for customers) Electric Security Plan or partial market-based Market Rate Offer.

Q. **Does this mean that the Companies are entitled indefinitely to SSO pricing based on these past events?**

A. I cannot speak to how long this expectation should be honored by the Commission and I do not think that is the proper focus for that question Instead, I think the question before the Commission at his time is whether that expectation should be reflected for the three-year period of the ESP. My answer to that question is that it definitely should be reflected in the ESP.

Q. **The Staff suggests that the proposed power purchase levels should be at the level of 5%, 7.5% and 10% for each of the three years of the ESP. Do you think these power purchase levels are appropriate?**

A. No. While I note that the Staff conceptually agrees with the Companies' proposal on this issue, I think they are overlooking another of the Companies' justifications for their proposed purchase levels. Purchases at the Companies' proposed levels will help the Companies encourage further economic development in their service territories. Much has been mentioned in these hearings about the current economic situation in Ohio. Those conditions make it all the more important to promote economic development in Ohio. Given all these circumstances, the Companies believe this aspect of their ESPs should be approved.

OSS Margins

Q. **During the hearing and in pre-filed testimonies there have been various references to Off-system Sales (OSS) margins, please describe what is meant by the term "OSS margin."**

A. First, OSS margin is also referred to as OSS net revenue. Off-system sales are opportunity wholesale sales made by the AEP system and the revenue from the sale is recorded in FERC account number 447 – Sales for Resale. The margin on OSS is calculated by taking the revenue less the variable costs of making the sale including fuel and purchased power. OSS margin is used in managerial reporting and analysis by AEP but is not identifiable on FERC or SEC income statements since revenues and expenses are recorded separately.

Q. **Witnesses Higgins and Kollen recommend that OSS margins be credited to the retail FAC. Do you agree with their proposal?**

A. No. My disagreement starts with the provisions of SB 221 Sec. 4928.143(B)(2)(a) which states:

> Automatic recovery of any of <u>the following costs</u> of the electric distribution utility, provided the cost is prudently incurred: the cost of fuel used to generate the electricity supplied under the offer; the cost of purchased power supplied under the offer, including the cost of energy and capacity, and including purchased power acquired from an affiliate; the cost of emission allowances; and the cost of federally mandated carbon or energy tax. (emphasis added)

OSS margins do not fit under this portion of the statute since they are net revenues from sales, not costs. (Note that the company has excluded from the retail FAC any fuel, purchased power or environmental expense associated with making an OSS.) OSS margins do not relate to FAC costs generally and have not been part of the previous fuel clause, the EFC, in Ohio. Further, under the ETP and RSP plans, the Companies retained all OSS margins over those already included in rates.

Second, in the entirety of SB 221 OSS margins are not mentioned. It may be appropriate to implement OSS margin sharing in a state with a cost-based regulatory regime that includes the traditional regulatory compact. By contrast, it is no longer certain that the regulatory compact exists in Ohio given the passage of SB 221. For example, Staff has recommended against the Companies' proposal to defer any costs for early plant closure that may occur during the ESP. SB 221 does not give any indication that OSS margins should be reflected in SSO rates. Yet, the bill in Sec 4928.142(D)(4), the MRO provision, requires a credit for emission allowance credits, an item of much less significance. (Even though the ESP in Sec. 4928.143(B)(2)(a) did not mention the same requirement to credit emission allowance gains, the Companies have provided such credit in the FAC.) If the General Assembly in Ohio had intended to require a more significant item like OSS margins be credited against fuel they surely had the opportunity to incorporate a sharing mechanism in S.B. 221. But the General Assembly did not so indicate.

Third, the Companies were at one time expecting to make all their generation sales at market. In a hybrid market such as Ohio, with neither cost-of-service regulation nor full market based prices, it does not make sense to take what market-based sales the Companies now make and credit them to the cost-based FAC.

<u>**Competitive Benchmark**</u>

Q. The OCC has recommended using forward energy prices from the month of October instead of using the methodology of looking at multiple periods proposed

by the Companies for determining market prices during the ESP period. Do you believe the OCC's proposed energy prices represent a reasonable forecast of future electricity prices?

A. No, I do not. I believe the approach suggested by the OCC is flawed in many respects. OCC's recommended approach is premised on the fact that the recent prices from October are the most accurate measure of where energy prices will be for the 2009-2011 period. However, if the OCC argument against the usefulness of the Companies' forecasted energy prices are accepted, then by the same standard, their prices from October would also have to be found lacking by the time the Commission issues an order.

Q. The OCC also argues that the price decline seen in the market from August-October 2008 is an unusual event which it argues makes the "recent" market quotes from October even more appropriate to use. Do you agree with the assertion that the recent price decline marks the beginning of a trend?

A. No. There will always be speculation as to where power prices will be in the future as there is with the stock market. What is known is that over the last ten years, wholesale power prices have proven to be one of the most volatile commodities traded. I also know that the fall in power prices from the August to October period was not an unusual occurrence. In fact, the chart below illustrates that similar increases and decreases in power prices is not uncommon.

Trading Period	Contract	% Change
March 2001 - July 2001	Calendar 2002	(-47%)
July 2001 - September 2001	Calendar 2002	+33%
January 2004 - October 2004	Calendar 2005	+47%
April 2006 - December 2006	Calendar 2007	(-31%)
January 2008 -July 2008	Calendar 2009	+38%
July 2008 - October 2008	Calendar 2009	(-37%)

Electricity prices are so volatile that basing a three-year forecast on one point in time, or actually acquiring a significant electricity supply in an MRO at a single point in time, are not an appropriate methodologies.

Q. **In what way does the methodology proposed by the Companies represent a more sound approach than that proposed by the OCC?**

A. The primary difference between the Companies' pricing proposal and OCC's proposal is the Companies focus on a sound methodology (an achievable goal) rather than modifying the methodology in a manner which identifies the lowest market price for a competitive benchmark. The staggered auction schedules utilized by the many deregulated states are an attempt to remedy short-term volatility that may be exhibited during a specific period in time and to recognize the fact that utilities, the size of OPCo and CSP, could have a dramatic impact on the market if they attempted to fulfill their entire load obligations in one auction. The Companies would as part of an MRO establish a staggered collection of multiple pricing points at various times of the year to take into account the volatility of price and size of the loads of each utility. The need to provide a forecast for the competitive benchmark robust enough to be relevant during a five-month regulatory proceeding also supports a staggered collection of pricing points. Even Ms. Medine agrees that producing an estimate based on the pricing quotes from one day is not likely to produce good results. However she attempts to justify her approach because prices have fallen recently, completely ignoring the impact that a one-time auction would have on the bid prices. The table below illustrates the value of the Companies' methodology for forecasting the ATC energy price by taking a broad sampling of data points. The first line shows the ATC price included in the Companies initial filing, and the second line shows the impact of updating the calculation to reflect the October data in a three quarter average.

Quarters 1-3	On-Peak Average	Off-Peak Average	ATC
	$74.19	$43.52	$57.84
Quarters 2-4	**On-Peak Average**	**Off-Peak Average**	**ATC**
	$72.65	$44.22	$57.50

Q. **If the Companies' Competitive Benchmark were adjusted lower, as Staff Witness Johnson and OCC Witness Medine have proposed, what impact would that have on the valuation of the Companies' POLR obligation?**

A. In considering only the Competitive Benchmark, the smaller the gap between the ESP price and the Competitive Benchmark price, the higher the cost of the POLR obligation. The tables below show the relative POLR impacts of the Staff's and the OCC's recommendations.

Proposed Competitive Benchmark	CSP POLR Cost
As Filed by the Companies	$4.83
As Proposed by L. Smith	$7.10
As Proposed by D. Johnson	$6.95

Proposed Competitive Benchmark	OP POLR Cost
As Filed by the Companies	$2.16
As Proposed by L. Smith	$3.47
As Proposed by D. Johnson	$3.36

POLR Risk

Q. **Mr. Cahaan testified that the risk of customers switching to a competitive supplier is not really a POLR risk, but is a migration risk. Do you agree?**

A. No, I do not. To my way of thinking, migration risk for an EDU is the risk traditionally facing the Companies that customers, as a whole, tend to come and go on a continuous basis. That traditional migration risk, however, was in the context of bundled service. New customers took bundled service and departing customers left the system entirely.

The "migration risk" we are talking about now, however, is in addition to that ebb and flow of the customer base. Now, customers can stay on the Companies' systems, but switch to a competitive generation supplier. That is a much different risk and should be recognized as such regardless of what terminology is used. Mr. Cahaan, Mr. Baron and Ms. Medine agree that this risk exists. Mr. Cahaan also acknowledges that this component of risk would be reflected as part of the price in the context of competititve bidding for a power auction in a deregulated state.

Q. **Do you agree that the Companies, according to Mr. Cahaan, can eliminate the portion of the POLR risk associated with customers returning to the Companies SSO?**

A. No, I do not. His testimony is based on the possibility of either requiring returning customers to pay market prices instead of returning to the Companies' SSO rate or the Commission agreeing that the Companies would be entitled to flow through their FAC mechanism the cost of market power purchased to serve the load of those returning customers.

Q. **Are either of those alternatives sufficiently adequate to reduce the POLR risk associated with returning customers?**

A. No. First, I have been advised by counsel that customers who return to the Companies' SSO upon the default of their competitive supplier are statutorily entitled to service at the SSO rate. If that is correct I do not understand how the Commission could rule otherwise and how such a legally questionable order would reduce the Companies' risk. Moreover, even in the context of governmental aggregation, those customers also would be entitled to return at the Companies' SSO rate. While governmental aggregations could notify the

Commission that the aggregation customers are willing to avoid POLR charges with the understanding that upon their return to the Companies they will pay market rates, I think it is unlikely that many aggregation customers, if they understood the potential financial exposure associated with market rates in comparison to the SSO, would authorize such a decision by the aggregator.

The second possibility discussed by Mr. Cahaan would not be effective in reducing the Companies' POLR risk. It is my understanding that this current Commission can not bind some future Commission which would have to decide whether the Companies could flow through their FAC the market price costs of serving the loads of returning customers. This concern is particularly acute since Mr. Cahaan's suggestion would result in non-shopping customers subsidizing the customers who did shop and then return to the Companies' SSO. Even Mr. Cahaan agreed that the assurance of recovery through the FAC must be complete in order to eliminate this aspect of the POLR risk.

Q. **Some parties have argued that historically low switching rates in Ohio mean that the cost of the Companies' POLR obligation should only be recovered if significant switching actually occurs. Do the Companies agree that this approach would work?**

A. No. Trying to recover the costs of the Companies' POLR obligation retrospectively would fail, because it ignores the very nature of the POLR obligation. The value of the customers' right to switch under S.B. 221 comes from the *option* customers are given to switch suppliers, while still having the safety net of the ESP rate to come back to, *if* electricity prices move in a way that makes switching back to the Companies an economically attractive choice or if their supplier defaults.

The value of that option exists at the beginning of the ESP term, independent of the actual outcomes. The Companies are committing now, based on current circumstances and uncertainties, to provide an SSO price for the full three-year period of the ESP. The seller of that option, in this case the Companies not a third party supplier responding to an auction, assumes the *risk* of customer switching. The consequences leave the Companies exposed to costs far in excess of the amount customers paid for the option. The source of the value for customers, given to them through the right to switch providers, comes from the choice they have in the future to switch if it is to their benefit, and to return to the ESP price when that option is to their benefit. The cost of the POLR obligation for the Companies arises from the fact that the Companies must manage their portfolio recognizing the options given to customers – or face much higher costs when the option is exercised. Such a "heads I lose, tails I lose" proposition, which would result from not compensating the Companies for the risk, is fundamentally unfair.

Finally, the assertion that it appears unlikely customers will exercise their right to switch, given existing market prices, and therefore that risk can be ignored, is very dangerous. One lesson that the current economic turmoil painfully demonstrates is that ignoring the risk of unlikely events can result in staggering losses if the unexpected occurs. SB221 reemphasizes Ohio's commitment to customer choice. The potential benefits of customer choice have corresponding risks that should be recognized and managed *before* they occur.

Q. Certain intervenors have suggested that the Companies could purchase power if customers return and include the market costs in the proposed fuel clause as an

adequate way for the Companies to recover any costs associated with its POLR obligation. Do you agree?

A. No. Attempting to recover the cost of the Companies POLR obligation though the FAC is fundamentally flawed. The proposed use of the FAC to recover POLR costs is inappropriate because:

1) The approach ignores the "put" portion of the Companies POLR obligation (the right of customers to leave the SSO.)

2) The FAC fails as a mechanism to recover the cost of the Companies' POLR obligation associated with customers returning because it is a violation of the cost causation principle. The portion of the POLR cost that might be captured in the FAC would essentially localize the benefits to switching customers, but socialize the cost among all customers.

<u>**POLR/Black-Scholes Model**</u>

Q. The OCC has stated that the London Inter-Bank Offered Rate (LIBOR) is not a valid rate to use in the Black-Scholes model. Where is the Risk-Free Interest Rate component of the Black-Scholes model found?

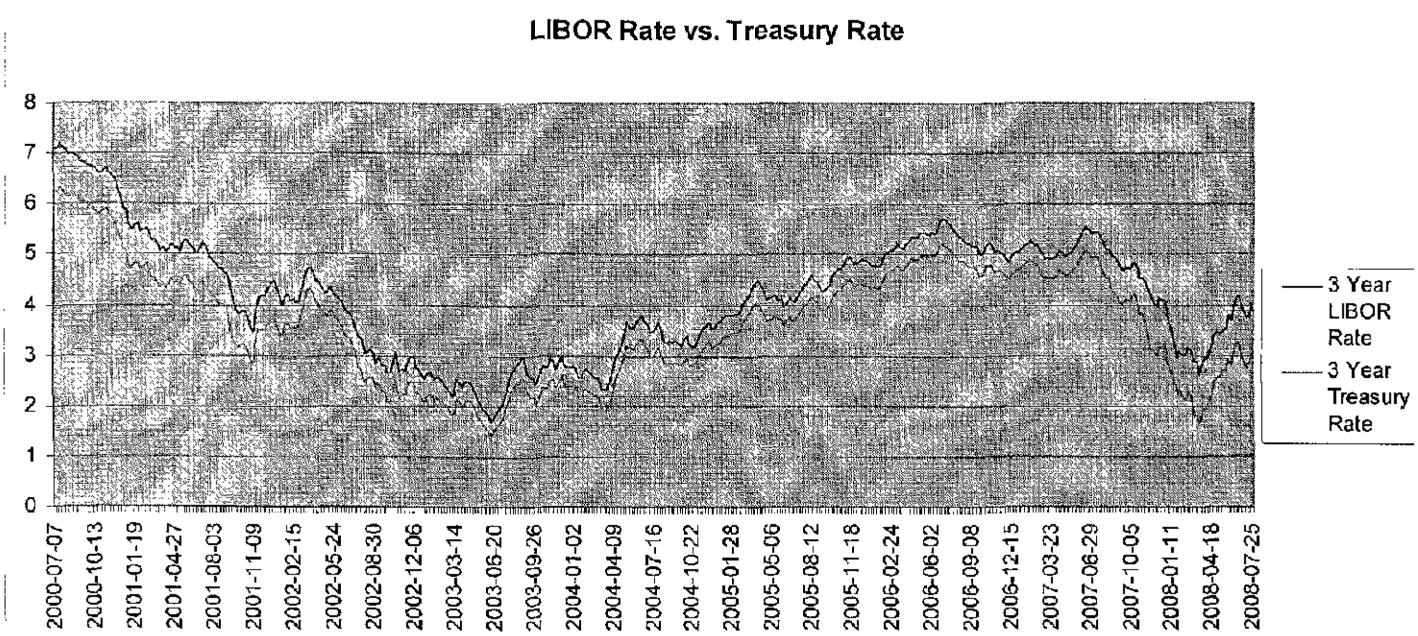
A. You cannot simply scan the Wall Street Journal or watch CNBC to discover the current risk-free interest rate. There is no interest rate product traded or quoted that carries the label "Risk-Free Interest Rate." Even U.S. Treasury securities carry some level of risk that the government could default. The risk-free interest rate must be determined by observing the interest rate charged to the most credit worthy borrowers under the 'safest' terms available – *i.e.*, the rate charged on debt that has the lowest risk of default. In other words, the risk-free interest rate component of the Black-Scholes model is determined by using a market proxy.

Q. Which interest rates are most commonly used in the Black-Scholes model?

A. U.S. Treasury rates and the LIBOR are the two most commonly used proxies for the risk-free interest rate. Treasury rates are sometimes viewed as representing a more 'theoretical' rate, as the Federal government is the only entity able to borrow funds at that level. Alternatively, the LIBOR rate is often viewed as a proxy for the actual level of risk-free interest rates because it is the rate at which the world's most creditworthy companies are able to borrow money.

Q. What is the relative relationship between Treasury rates and the LIBOR rate?

A. Treasury rates and LIBOR rates have historically been very tightly correlated, with the LIBOR curve consistently higher then the Treasury curve. Therefore, if anyone considers LIBOR to be highly volatile then so must be the treasury rate. The difference between the two rates is charted below.



Q. How would the cost of the Companies' POLR obligation change if the Treasury rate, instead of the LIBOR rate, had been used as the risk-free rate component of the Black-Scholes model?

A. Over the last 8 years, the average spread between the LIBOR rate and the Treasury rate has been 54 basis points (.54%). It has ranged from a high of 107 basis points (1.07%) to a low of 26 basis points (.26%). Holding all other inputs constant, using the Treasury rate would have increased the valuation of the Companies' POLR obligation. However, the interest rate variable is one of the least sensitive inputs used in the Black-Scholes model. For example, decreasing the risk-free rate from 3.5% to 2.5% would only have resulted in a $0.14 increase for CSP and a $0.06 increase for OP in the cost of the option – an increase in price of only 3%.

Q. Does AEP use LIBOR rates for any other purposes?

A. Yes. LIBOR can be found as a pricing component in the Companies' short-term borrowings as well as their long-term, variable rate financing. The LIBOR rate is also used as the discount rate for AEP's mark-to-market portfolio. And finally, the LIBOR rate is used by AEP as the risk-free input in the Black-Scholes model for a variety of commercial purposes, including bidding on auctions in deregulated states where as part of the wholesale service the supplier takes on a POLR retail risk.

Q. Several intervenors have quoted the phrase from one of the Companies' data responses, that "the Black-Scholes model was run an indeterminate number of times." Have the intervenors accurately reflected the Companies' intended meaning of that phrase?

A. No they have not. It appears to me that many intervenors have inaccurately tried to read into that phrase a complete description of the Companies' overall approach to valuing the cost of its POLR obligation.

Obviously we did not set up the model, run it once, and then file our testimony. The Companies' ESP filing is extensive, with many interrelated elements. The ESP price naturally changed as all of the pieces came together. The same holds true for the Competitive Benchmark calculation since we began the process before the market prices for July were available. Both the ESP price and the Competitive Benchmark forecast were elements of the POLR calculation. As more complete estimates of the ESP price and the Competitive Benchmark were calculated, the inputs into the Black-Scholes model were updated. However, the methodology itself (*i.e.*, the Black-Scholes model) was not modified.

The decisions on how to value the POLR obligation, and how to define the inputs used in the model, were established at the beginning of the process and did not change. The method of valuing the Companies' POLR obligation was determined by the Companies' belief that this approach would yield the most accurate quantification of that obligation. Intervenors have implied that the Companies simply chose the POLR number it wanted, and then created whatever modeling inputs were needed to achieve the desired result. That characterization is without basis and is incorrect.

Automatic Adjustments to non-FAC generation rates

Q. Ms. Alexander and Ms. Smith have testified that the Companies' proposed annual increases to the non-FAC portion of the SSO must be cost-based. Do you agree with that assertion?

A. No. An ESP is significantly different from the former cost-of-service rate making process. Under the former process, as unanticipated generation cost increases were experienced, a utility was free to come to the Commission with an application to change rates to reflect those cost increases. Under an ESP, as I understand it, the utility's SSO rates are determined by the terms of the ESP. Therefore, I think it is appropriate to include a provision in an ESP that provides an opportunity for recovery during the ESP period of generation costs that at this time are unforeseen and consequently unquantifiable. Revenues associated with those increases would not be cost based.

Q. If such a provision were not cost-based, how can it be structured?

A. The best way I can think of is a flat percentage increase on non-FAC generation rates that the Companies included in the ESP.

Sale or Transfer of Certain Generation Assets

Q. Mr. Baker please respond to the position advanced by OEG witness Kollen and others that the Companies should not be able to transfer the OVEC and Lawrenceburg power contracts and the gas plants owned by CSP.

A. I do not understand this opposition, since as I stated in my direct testimony these power entitlements and plant assets have not been included in rate base. Generation rates have not reflected the CSP owned Darby or Waterford plants' return requirements or the expenses of operating and maintaining them. Likewise the demand and energy charges for OVEC and Lawrenceburg have not been previously included in rates. If the Companies through a Commission order are prohibited from transfering these plants or entitlements then any expense not recovered by the FAC should be recovered in the non-FAC rate. This would include carrying costs on and expenses of Darby and Waterford of about $50 million annually. With respect to the OVEC entitlements the demand charge should be included in the FAC and be recoverable from internal load customers. The demand charge is about $70 annually.

<u>**Criticism of JCB-2**</u>

Q. Ms. Smith has challenged your Exhibit JCB-2, which compares the ESP to MRO option, with one of her criticisms being the treatment of the FAC in your comparison. Have you considered that criticism?

A. Yes. I reviewed the impact of including a treatment of FAC costs in my calculation. I determined based on that review that the ESP is still more favorable in the aggregate for customers than the expected results under an MRO.

Q. Does that conclude your testimony?

A. Yes.

CERTIFICATE OF SERVICE

I hereby certify that a copy of Columbus Southern Power Company's and Ohio Power Company's Additional Rebuttal Testimony of J. Craig Baker was served by electronic mail upon counsel identified below this 8th day of December, 2008.

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