BEFORE THE PUBLIC UTILITIES COMMISSION OF OHIO

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

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PROCEEDINGS

before Ms. Kimberly W. Bojko and Ms. Greta See, 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 Friday, December 5, 2008.

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Friday Morning Session,

December 5, 2008.

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EXAMINER BOJKO: Let's go on the record.

Good morning. This is a continuation of 08-917 and 918-EL-SSO, being In the Matter of AEP's Electric Security Plans.

My name's Kim Bojko.

EXAMINER SEE: And I'm Greta See.

EXAMINER BOJKO: Let's take abbreviated appearances.

MR. RESNIK: On behalf of the companies, Marvin Resnik, Dan Conway, and Steve Nourse.

MR. O'BRIEN: On behalf of the Ohio Hospital Association, Rick Sites and Tom O'Brien.

MR. LINDGREN: On behalf of the staff of the Commission, Werner Margard, John Jones, and Thomas Lindgren, assistant attorneys general.

MR. PETRICOFF: On behalf of Integrys

Energy, Constellation NewEnergy, and Constellation Commodity Energy Group, Howard Petricoff and the law firm of Vorys, Sater, Seymour and Pease.

MS. GRADY: On behalf of the residential ratepayers of the company, Janine L. Migden-Ostrander, Maureen R. Grady, Michael E.

Idzkowski, and Jacqueline L. Roberts.

MR. RANDAZZO: Lisa McAlister, Joseph Clark, and Sam Randazzo for the Industrial Energy Users of Ohio.

MR. BOEHM: On behalf of the Ohio Energy Group, David Boehm and Michael Kurtz.

MR. YURICK: On behalf of the Kroger Company, John Bentine, Mark Yurick, and Matt White.

EXAMINER BOJKO: Let's go off the record.

(Discussion off the record.)

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

Mr. Cahaan, you realize that you are still under oath.

THE WITNESS: Yes, I do.

EXAMINER BOJKO: And we will begin cross-examination with Mr. Conway.

MR. CONWAY: Thank you, your Honor.

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RICHARD CAHAAN

having been previously sworn, as prescribed by law, was examined and testified as follows:

CROSS-EXAMINATION

By Mr. Conway:

Q. Mr. Cahaan, can you hear me?

A. Yes, I can.

Q. Good morning.

A. Good morning.

Q. Mr. Cahaan, do you recall a portion of your testimony where you discuss the manner in which the FAC, the F-A-C, baseline should be constructed?

A. Yes, I do.

Q. And yet during your cross-examination you explained your position and you also described the company's approach to doing that that Mr. Nelson has sponsored. Do you recall that?

A. Yes.

Q. And I think you referred to Mr. Nelson's approach, the company's approach, as a bottoms-up approach for identifying the portion of the existing rate that's the proper basis for the FAC. Do you recall that?

A. Yes. I had also characterized it as an accountant's approach, until our accountants got angry at me for doing that. It's basically an accounting-based perspective.

Q. Mr. Cahaan, putting aside just for the moment your recommended approach for doing this, if one were to use Mr. Nelson's approach, the bottoms-up approach or the accounting approach, however you would describe it, for identifying the baseline rate for the FAC, would you agree that the approach that Mr. Nelson used, the steps that he took to do that, were an appropriate way to perform that kind of an approach to calculating FAC baseline?

MR. RANDAZZO: Your Honor, just a clarification. When you say "approach," are you including in that the numerical values?

MR. CONWAY: Not at this point, no.

MR. RANDAZZO: Thank you.

Q. I'm talking about the process, the individual steps that he took. Would you agree that those steps in sequence that he undertook would be an appropriate way to implement the approach that he sponsors?

A. The overall approach is a reasonable approach, and it starts out at a point where there can be a certain amount of, I'll say, agreement in clarity known and measurable to 1999 numbers. It then makes certain adjustments. These adjustments are a matter of judgment as to what's the best way of making these adjustments.

The various mechanisms that he applies are, in famous words, not unreasonable. They're valid methods. Other methods -- excuse me, not methods. Other choices of variables could be used that would also be reasonable, but I certainly would not say that the approach taken by Mr. Nelson is unreasonable. It was discussed -- variations on this were discussed by the staff as well.

Q. Thank you, Mr. Cahaan.

I have a few questions on a different subject, the dedicated purchased power amounts that the company has proposed to include within the fuel adjustment clause.

A. Yes.

Q. And, again, I think there were some questions regarding this topic yesterday, but let me just lay some foundation and then ask you a few additional new questions about it.

The company's proposal is to purchase power on a slice-of-system basis in increments of 5 percent for 2009, 10 percent for 2010, and 15 percent in 2011, and 5 percent of their native load requirements; is that right?

A. I'm sorry, everything but the last part of that sentence.

Q. And the last part of the sentence was just to clarify, which I didn't do a very good job of, that the percentages that the company proposed to -- proposes to purchase and include within the -- the costs of which to include within the fuel adjustment clause are percentages of their native load requirements.

A. Okay, yes; 5, 10, and 15 percent of the native load requirements, yes.

Q. And then they would -- under their proposal they would recover the cost through the fuel adjustment clause, correct?

A. Yes.

Q. And one basis that the companies offered as a rationale for the dedicated purchased power slice-of-system amounts that they would include in the FAC is that, in part, they reflect additional load responsibilities for the Ormet and the Mon Power service area, right?

A. That's correct.

Q. And you indicated that the staff concurs with that basis for including some amount of purchased power costs within the FAC, right?

A. Yes.

MS. GRADY: Objection.

EXAMINER BOJKO: Grounds?

MS. GRADY: Friendly cross.

MR. CONWAY: This is just --

EXAMINER BOJKO: I'll give you the same courtesy that I gave --

MR. CONWAY: Thank you.

EXAMINER BOJKO: -- Ms. Roberts yesterday that I'm assuming this is foundational and we're getting somewhere.

MR. CONWAY: Absolutely.

EXAMINER BOJKO: That's not friendly.

Q. (By Mr. Conway) But the staff recommends that the amounts that be included be reduced to the percentages that you have reflected in your testimony, right?

A. Correct.

Q. Those are the 5 percent, 7-1/2 percent, and 10 percent levels for the three years, correct?

A. Yes. It's basically an average of 7-1/2 percent.

Q. Would you agree that the company's proposal to include the 5 percent, 10 percent, and

15 percent increments in the FAC is consistent with a continuing transition to market rates?

A. Certainly any market-based procurement as passed through the FAC is going to be consistent with market-based rates. A 90 percent procurement, for instance, would be more consistent with market-based rates. A hundred percent procurement would be market-based rates.

So although, I mean -- how to put it? I would agree because it's tautological, I must agree because if you go to the market, that's market rates.

Q. Okay. And the staff's proposal also would have that attribute then, correct?

A. Of course.

Q. Let me ask you a few questions --

A. And I would say subject to the same reasons that we are trying not to go to market-based rates in terms of stability and certainties and other sort of things.

MR. CONWAY: Could you reread that last additional part of the answer for me?

MR. RANDAZZO: That was the unfriendly part.

(Record read.)

Q. We're not trying to go to market-based

rates at least in anything close to a full manner in
the ESP; is that right? Is that what you're saying?
A.   Yes, definitely. In terms of principles,
you can always talk about one extreme or another
extreme, and we're sort of somewhere in between. The
idea of market procurement is one of these things

that's somewhere in between, and the only question that we have is should it be more or less? And we think an appropriate number is less than the company is asking for, but we're willing to admit, given the situation, particularly with respect to Ormet and the Monongahela responsibilities, that the number should be or can reasonably be allowed to be more than zero.

Q. And the reasonable amount that you came up with was 7-1/2 percent per year but phased in at 5, 7-1/2, and 10 over the ESP.

A. Yes.

Q. Let me ask you a few questions about the company's phase-in proposal and related deferral proposal for the FAC costs. Yesterday, again, there were a number of questions about your position, the staff's position, on the efficacy of the appropriateness of a phase-in approach and the use of deferrals. So my initial questions I think you've already answered, which is that the staff is not

completely opposed to the idea of using a phase-in
approach and deferrals to accomplish the phase-in or
such a phase-in. Is that right?

A. Yes. We have shifted our outlook from
something akin to a radical temperance perspective to
allowing for a certain amount of social drinking. We

view phase-in as something that certainly could be abused and is dangerous in excess.

Q. But in moderation could be healthy, right?

A. Yes.

Q. Okay. If the Commission were to approve the company's ESPs with the requested rate increases, would you agree that a phase-in and cost deferrals in order to accomplish -- might be appropriate in order to moderate the increases?

A. I think that's what I agreed already.

Q. And if the Commission decides that such a phase-in is appropriate, along with the deferral mechanism that the company has proposed -- well, strike that.

Do you agree that if the Commission decides that a phase-in is appropriate, would you agree that the company's deferral mechanism and recovery of the deferrals, as Mr. Assante has

proposed to be done, would be a reasonable option for
the Commission to adopt?

A. I'm agreeing with the idea of deferrals
and recovery in principle. I would rather let
Mr. Hess speak to the specific mechanism because it's
heavily dependent upon appropriate accounting

processes.

Q. Related --

A. I assume also that you're not talking about the idea of securitization.

Q. I am not.

A. Okay.

Q. I'm talking about the proposal that's in Mr. Assante's testimony for deferring certain fuel costs, fuel adjustment clause costs, and then recovering them over a future period.

A. Yes. I view that as basically a question of appropriate accounting processes.

Q. I don't want to push you too far in this area beyond your comfort zone, but you did get into a discussion with Ms. Roberts at the end of the day yesterday regarding another aspect of the company's proposed phase-in and deferral proposal. Do you recall that?

A. Yes, I do.

Q. And specifically Ms. Roberts was trying to get you to clarify your views about the impact of the deferrals on earnings, and then, as I understood it anyway, what would happen as far as the significantly excessive earnings test as a result of those earnings. Do you recall that?

A. I recall a lot of discussion. I'm not sure I can recall exactly what it was about.

Q. Fair enough.

There was a question that was asked, or that you recasted it, which went something like the following -- and I have a follow-up for you about this question and answer if you'd just bear with me. The question that was posed to you, and maybe that you posed yourself, was something like: If the Commission approves the company's plan as proposed, which has as part of the plan fuel adjustment clause costs above a certain level that would be deferred and a regulatory asset is created, because authority is given for the companies to book the deferrals as a regulatory asset, would they then have a reasonable expectation that the regulatory asset would be recovered.

Do you recall a question pretty close to that being posed?

A. Yes.

Q. And when you answered your question after you had recasted it in that fashion, you ultimately said: "I would have to say yes." Do you recall that?

A. I was that brief?

Q. No, you were not. But I'll ask you a follow-up question now about the answer "I would have to say yes."

A. There are and have been sort of a tension, especially I remember back in the good old days of Perry and Beaver Valley and the phase-ins there, between what is a regulatory policy and commitments, which has always been that granting deferrals is an accounting issue but the recovery of deferrals is separate from it, so that there are no guarantees that the deferrals will be, in fact, recovered. That has always been the position of the Commission in granting the accounting treatment.

Then on the other side of this tension or this balance there is the expectation on the part of both Wall Street and the accounting profession which says that you can't allow -- a company can't book something unless there's a reasonable assurance or reasonable expectations of recovery, and Wall Street similarly, by its very behavior, obviously, believed that the deferrals will be recovered because they don't go ballistic when deferrals are granted, which they easily could do and certain people have threatened to that they would do, but this has not in fact occurred.

So there is this dance between the regulatory lack of commitment and the financial community expectation of commitment sort of like a high school prom, and so we are not, I think in this case, giving a commitment, but, on the other hand, if there is an expectation that this will -- this lack of commitment means a lack of some degree, some significant degree, of that but for good reason they would get recovery, then the whole dance is over.

Q. If Wall Street were to go ballistic or even short of ballistic, if they didn't believe that the deferred costs would be probable of recovery in a future period through rates, then the accountants would not allow the companies to defer the costs and deferral would not occur, right?

A. Something like that. It's not -- you know, it's not exactly causative in one direction or the other. The accountants have their standards, and the people who basically buy stock and bonds have their standards, but the two are interrelated.

Everyone recognizes that there may be some possibility of some reason for nonrecovery of anything. You know, there's prudence issues involved in regulation all over the place, but when something is booked, whether it's an asset or construction work in progress or a deferral, there is an expectation of recovery unless there's reason that this recovery should not be allowed.

Q. And is it your understanding that the company's plan -- let me back up.

When you refer to the plan in your testimony on this subject, you're referring to the electric security plans of the company, correct?

A. Yes.

Q. Is it your understanding that the company's electric security plans would exclude from the earnings test the paper earnings that would result from the deferrals that Mr. Assante has proposed a mechanism for accomplishing and then recovering?

A. I'm aware that the plans do propose that certain items be excluded from the earnings test, and I think the deferrals are one of them. They're also proposing off-system sales and maybe some others. My testimony does not address these issues.

Q. But focusing on the exclusion of the noncash earnings that would result from the cost deferrals from the earnings test, okay, are you -- do you have an understanding that the companies have a concern if that is not done, that is, those kinds of earnings are not excluded from the test, that it would jeopardize their ability to record the deferred cost as a regulatory asset in the first place?

MR. RANDAZZO: I object.

EXAMINER BOJKO: Grounds?

MR. RANDAZZO: It's beyond his testimony. He just indicated he didn't address it, and I think we're getting into a dangerous area of friendly cross.

EXAMINER BOJKO: I'm going to sustain it because he just told you he didn't address this, and then you said "but" and went on. He didn't address it in his testimony and he said he doesn't address it.

Q. And, Mr. Cahaan, you did not address that in your answers to the questions by Ms. Roberts yesterday then, I take it.

A. No; I actually did, this particular issue in terms of what I'll call the timing aspect of this.

EXAMINER BOJKO: You did address it yesterday? I don't recall that line.

THE WITNESS: I addressed the problem that would occur if -- if the deferrals are counted at one period of time -- let me back up a second.

Just assume that there's no problem in

the earnings test over time, that the average of whatever years we're talking about does not have a problem in terms of earnings, but because of the deferral mechanism there's an imbalance between costs and outlays at one time so that you have sort of earnings are padded up at this point and sunk down at that point.

Because the earnings test doesn't look over time explicitly, then the company would be in jeopardy in terms of the period of time when there was the imbalance that padded its earnings and not have any recourse, in effect, when its earnings were down on the other end, if this occurs.

So I'm simply saying if the act of deferrals creates this temporal pattern where earnings are pushed upward, then that action should not be considered -- that's a distortion and that distortion should be evaluated and eliminated. The idea of the earnings test I would think is not to --

is to be based upon what the company is actually earning, but not necessarily, as we know, what its books might have in one particular year if it's known that a different year's going to be -- offset that.

EXAMINER BOJKO: Mr. Cahaan, while --

You can base cross-examination on that

portion of his testimony.

Q. (By Mr. Conway) If you have an opinion, or if there's anything you think you can constructively comment on, please do so, and if you can't, please tell me you can't, but the jeopardy that you just referred to, is it your understanding that that jeopardy, that is, of being stuck with a distortion of overearnings, that simply the product of the deferral mechanism, which is a temporal problem, that that jeopardy -- is it your understanding that that jeopardy also could affect the company's ability to book the deferrals in the first place?

And if you can't answer the question, you don't have an opinion about it, that's fine, I'll move on.

MS. GRADY: Objection.

MR. RANDAZZO: That was what I objected to. The question is an accounting question. It is

not a question about how the excess earnings
mechanism may distort the measurement. It's an
accounting question, and it's beyond the scope of
this witness's testimony.

MR. CONWAY: And, your Honor, I really am
happy with that if Mr. Cahaan insulates himself from

that issue and he tells me that he hasn't rendered an opinion about that, then I'm happy to move on and let Mr. Resnik ask Mr. Hess about it if he thinks it's still necessary.

EXAMINER BOJKO: Miss Grady, what was your objection?

MS. GRADY: That is my objection. He is not an accountant. He's asking for an accounting opinion. That would be Mr. Hess's realm, and I think it's more appropriately directed to Mr. Hess.

MR. CONWAY: And if that's the limitation on what he said yesterday, then I'm happy to move on.

EXAMINER BOJKO: Mr. Cahaan, I think you did say yesterday that you were not an accountant and you didn't want to go into accounting principles. Can you answer the question without going into accounting principles?

THE WITNESS: The only -- the furthest I can go is to say that this issue, like a number of other issues, needs to be decided before the application of the earnings test is actually done based upon the situation that exists on the company's books.

I'm pointing out a problem, but I am not discussing a solution to the problem.

Q. (By Mr. Conway) And the problem you're discussing is that the temporal distortion that -- including the effect of the deferrals on earnings in one period to suppress the -- to increase the earnings and then later on not having the converse impact -- well, strike that. Strike that question.

You're simply commenting on the anomalous consequences of the cost deferrals on earnings and the inappropriate distortion of the earnings test that such anomalies might have.

A. Yes. I am pointing out that in the aspect of deferrals there may be, I'm not sure there is, but there may be some distortions that should be taken into consideration, and a simple automatic mechanical, arithmetic approach to grabbing numbers out of financial statements and doing long division is not sufficient.

Q. Okay. Let me move on to provider of last resort, okay?

A. Yes.

Q. And again, I apologize if I repeat some of the material that's already been discussed, but at pages 5 to 7 you have your discussion in your testimony of the company's POLR obligations and the risk that they face and a regulatory regime where the customers may switch to alternate suppliers for their generation service and then, if they switch, return to the companies' standard service offers. Is that an accurate recap of the subject of your testimony?

A. Yes.

Q. And I believe that you have identified two risks in your testimony and also in your cross-examination testimony yesterday. There are two risks that are involved: One is the risk that customers will leave the companies' standard service offers, and then the second one is the risk that a customer who switches subsequently will return, right?

A. Correct. These, you know, this identification of these two risks was made by the company, and I am adopting this as -- what the company is representing as the risks, not that I see these as both POLR risks.

Q. Well, you regard the second risk as a

POLR risk; is that right?

A. Yes. The idea that the company -- that the provider-of-last-resort obligation is to take people back who have left has been the main focus, in fact, I think the only focus in the discussions regarding POLR for quite a long time, and so that is definitely a POLR question.

The basic confusion about that has always been are we talking about physical juice or are we talking about financial obligations. But taking people back has always been the focus of POLR.

Q. And you described the first risk yesterday as the migration risk, right?

A. Yes. It was not quite clear to me when I was drafting my testimony exactly what this was. It didn't seem to be what we had ever talked about as POLR. And later, after listening to the discussion here in this room, it became clear that the idea that the company has some kind of risk of people leaving, what has always been termed migration risk, and it's been -- the topic came up in terms of the standard service offer under an auction system.

And it's been discussed there. I don't think it's been discussed anywhere else and wasn't part of what is considered a POLR obligation in previous cases.

Q. Let me ask you a few questions about the second risk, the return risk first, okay?

A. Yes.

Q. Your suggestion for addressing that risk is to avoid that, right?

A. Yes. The focus has always been in this discussion what price should the returning customers pay, and the company has made a point that it doesn't feel that any representation that the customers are going to pay a market price can be relied upon, that the risk will remain because, especially for residential customers or aggregations, there's a feeling this would not be allowed to happen.

However, it doesn't matter what the customer himself pays when they come back as long as the company is allowed to procure that power on the market, so that it doesn't bear the risk in a financial sense of having to provide juice for that customer but rather can either charge the customer a market price, if that's what's allowed, or it goes through the purchased power part of the FAC and so it is picked up in that fashion.

Q. And that --

A. So that avoids the problem, yes.

Q. And that approach to avoiding the risk would require the Commission to specifically authorize such a mechanism as part of the ESPs, would it not?

A. Yes; an understanding. I'm not sure in the legal sense as to what would be required, but there would have to be some degree of assurance that returning customers, the generation requirements would not have to be provided by the company's resources but could be provided by market.

Q. Well, to the extent that the assurance is not complete, then there would still be some risk for that obligation, right?

A. Yes.

Q. Okay. And if the Commission did not provide the authorization to be made financially whole in the event customers switched and then returned to the company's standard service offer, would you agree that they would not have an avoidance mechanism?

MR. RANDAZZO: I object, unless there is a clarification on what "financially whole" means in this context.

MR. CONWAY: I'm talking about in the sense Mr. Cahaan just described.

EXAMINER BOJKO: He can answer if he knows.

I'm sorry?

MR. RANDAZZO: The "financially whole" compared to what?

MR. CONWAY: Your Honor, he discusses in

his testimony that the avoidance of the risk could be accomplished by having the company go out and buy power on the market and then either charge the customer who has returned the market price to recover the cost of that power purchase or to run through the fuel adjustment clause the purchased power, and that is the financially whole that I'm speaking of.

EXAMINER BOJKO: I said he could answer if he knows.

MR. CONWAY: Okay. I'm sorry.

THE WITNESS: I know, but I lost track of the question.

(Record read.)

Q. "They" meaning the companies.

A. Yes. The company's argument that they have put forward has merit that if people come back, there's a high probability they're going to be coming back at what is, from the company's perspective, at the worst possible time when prices were high. The company would have to either use its own generation resources and, therefore, lose the revenues it would otherwise receive from the market for those high priced periods, or it would have to go to the market and purchase it.

One way around this is that the returning customers would have to pay a market price. That's what's always been suggested. The company says: "We don't believe you, we don't trust you." And, well, I'm trying to figure out a way that we can get out of the issue of the company not trusting the Commission or the state legislature and is there any way of avoiding this trust issue, and that is to simply give some assurance that the company does not have to use its own generation resources.

If the assurance is felt to be a high degree of insurance, then the risk remaining for the company are very low. If the insurance was complete, then the risk is completely gone. If the assurance is iffy, then the risk is sure there. The more assurance, the less risk.

Q. What if the Commission simply declines to adopt the assurance or insurance proposal that you've suggested?

A. Then the migration risk exists.

Q. Okay.

A. However, I want to point out that this is not a POLR risk. This is a risk -- part of the standard service offer and not a POLR risk. So the key thing here is the question of avoidability.

Q. Your position is that the migration risk is going to be avoided? I thought it was the second, the return risk was going to be avoided if your recommendation were adopted.

A.   Okay. Let's back up and see if I can unconfuse myself.

Q.   Okay.

A.   Which risk are we talking about at the present time?

Q.   We're talking about the second risk, which I understood your proposal to be designed to avoid, that is, the risk of a returning customer sticking the company with having to provide power at a point in time when market prices are low.

A.   Okay. My previous answer, whatever I said, should be stricken because I was confused.

Based upon that risk, the one returning --

Q.   I'm sorry.

A.   -- that's POLR.

Q. And -- jeez. The second risk is a POLR risk, right?

A. The second risk is a POLR risk.

Q. And your recommendation for avoiding risk is directed towards that second risk, right?

A. My recommendation for avoiding the second risk by having the company authorized to procure power at market is to avoid that, the second risk of the returning customer.

Q. Okay. Just to tie it up, if the Commission doesn't adopt your recommendation but simply allows customers to return to the fixed standard service offer, then there is no avoidance of that second risk.

MR. RANDAZZO: I object. I can't help myself.

EXAMINER BOJKO: Grounds?

I know it was asked and answered, but we got a little confusion in there so I'm letting him redo it.

MR. RANDAZZO: Well, the question is based upon avoiding risk and what everybody's talking about is transferring risk. I object.

EXAMINER BOJKO: I'm going to allow the question because I think it was asked and answered, but again, we had some confusion.

So you can answer it, Mr. Cahaan.

THE WITNESS: Can you read it?

(Record read.)

Q. By the companies.

A. If the Commission allows customers to return to the standard service offer without any conditions or barriers, and if they can take the standard service offer price, then the company is bearing a risk that has been traditionally identified as a POLR risk, yes.

Q. Let me turn to the migration risk you've identified which you choose not to term as a POLR risk, okay?

A. Yes.

Q. The mitigation measure that you have identified for the second risk, if it were adopted, it would not affect that first risk, would it? It would simply mitigate that second risk, correct?

A. Can you -- I'm having trouble with the first and seconds.

Q. First risk is the migration risk that you have characterized and the second risk is the return risk.

A. So the mitigation idea of allowing the

company to procure power at market for returning
customers, the question is does that have anything to
do with the migration risk. Is that the question?

Q. Well, the question is, it doesn't have
anything -- it does not manage the first risk, what
you have termed as the migration risk.

A. Yes. That's a separate issue.

Q. And at page 7 of your testimony at the top you address "the optionality of allowing customers to leave when market prices are low." Do you see that?

A. I do.

Q. Now, as I understand it today, that's the first risk, that's what you've been describing as the migration risk, right?

A. Correct.

Q. And your last couple sentences of that final paragraph of your POLR discussion indicates that if a POLR charge is considered to be appropriate, it would be significantly below what AEP is requesting and the current level of the POLR charge would be more reasonable. Do you see that?

A. Yes, I do.

Q. And that's referring to the charge to cover the cost of the first risk, which you've been

describing today and yesterday as the migration risk;
is that right?
A. Yes. I should not have characterized it as a POLR risk in that last sentence, but the POLR charge, the level of that, would be a more reasonable charge. There's actually in a sense two arguments

here. One is an argument for what the staff thinks is right, and the other is an argument against what the company thinks is right.

Q. The argument against what the company thinks is right is an argument that it's too much?

A. That it's too much and it's not a POLR charge in the first place so, therefore, should be avoidable.

Q. And the argument in favor of the staff position is that --

A. There is migration risk.

Q. -- there is migration risk. There should be a charge. It should be the amount of the current POLR charge but not be called a POLR charge.

A. Yes.

Q. Okay. And that's the staff's position.

A. Yes. And I just want to focus on the avoidability because if a customer leaves, then there's no more migration risk. They've migrated so it should be avoidable.

Q. And that leads to your recommendation to manage the risk by having the cost of returning customers at times when market prices are high borne by the customer who returns or all the other customers through the fuel adjustment clause.

A. Well, that's a separate issue but we agree on that point.

Q. I have just a few questions, I think, about the significantly excessive earnings test portion of your testimony. With regard to the construction of the comparable risk groups, if I might term it in that fashion --

A. Comparable group's good.

Q. -- would you agree that the EDUs in Ohio could have different financial risks and business risks?

A. Than what?

Q. Than each other.

A. Oh.

Q. Compared to one another.

A. Yes.

Q. Okay. So would you agree that the composition of the comparable group for one EDU could be different than the composition of the comparable group for another EDU in Ohio?

A. Definitely.

Q. The methodology might be the same but the results of the methodology for selecting the comparable group could be different for comparable groups, right?

A. Yes. I thought -- that's the point I was trying to make in my testimony.

Q. Sometimes I'm a slow learner. I just wanted to confirm it.

And similarly, over time you could apply the methodology for -- in the same firm and come up with a different comparable group, right?

A. If things changed, then the results will change, yes. I would point out that any methodology is going to provide different results if there's a change in the underlying reality. My objection to some methodologies is they used numbers that seem to change easily and frequently without any change in the underlying reality.

So the mere fact that the comparable group could change over time is not a -- is a necessary part of any analytical method.

Q. Let me ask you, if you will, a few questions about the return characteristics of the comparable groups, all right? And I want you to assume we have a group of publicly traded firms, each of which has a different ROE, return on equity, for the year that we're looking at which, let's assume, is 2007, okay?

A. Okay.

Q. And we could compose an average return on equity for the group, right?

A. Certainly.

Q. And we can call it the mean or the average, but for purposes of the discussion, assume it's the arithmetic mean, okay?

A. Okay.

Q. Would you agree that the mean that we have developed is itself a statistic?

A. Any number that is used to provide information about a group is a statistic. That is one number that is used to provide information about this group that you've developed the mean from, assuming that -- well, I'm just going to stop there.

Q. I think the net of that is that the mean ROE of the group is a statistic.

A. It is a statistic.

Q. And the manner in which the ROEs of the group's members are distributed about the mean, that can be described statistically also, correct?

A. You know, there's different properties, different statistics that can be derived from looking at the information about a population. I've heard testimony here by other witnesses to put this in terms of central tendency and dispersions. It's definitely true, these are all statistical measurements, so the mean is a statistical measurement, definitely. The variance and the standard deviation are also statistical measurements.

Q. What is the --

A. The maximum is a statistical measurement. The minimum is a statistical measurement. The size of the sample is a statistical measurement.

Q. And what is the variance?

A. It's the standard deviation squared.

Q. And the standard deviation, what is that?

A. It's a measure of the dispersion.

Q. How do you calculate it?

A. I would have to get my book out.

Q. And what does it describe about the data within the group that you're looking at, the data of the group that you're looking at?

MR. RANDAZZO: Are we still in a hypothetical context?

MR. CONWAY: If it helps to answer the question, yes.

A. Well, the problem in answering the question is it describes -- what it describes depends upon what are the various assumptions you're making about the underlying reality of the population you're dealing with. So in a sense, as far as I'm concerned, without specifying a lot of assumptions that are built into the whole thing, it doesn't describe anything more than what it is. It is what it is. It's a mathematical number that you have to then put meaning to. The mathematics does not provide meaning.

Q. I was just asking for a general description of it.

A. I can't give a general description of that.

Q. Let me give you a specific example, all right? Let's take group A and let's assume that it has six members, and the members have returns on equity of 5 percent, 10 percent, 15 percent, 20, and 25 percent, okay?

A. Okay.

Q. I'm sorry, six, add a 30 percent of return on equity to it, okay?

A. Well, you've got a batch of observations
you're labeling as a group and you're giving me some
numbers, I'm not writing them down.

Q. Well, let me slow down. A six-member
group and it has members whose returns on equity are,
they start at 5 percent and they end at 30 percent.

A. Okay. So these numbers have a range from 5 to 30.

Q. And they increase 5 percent by 5 percent.

A. Okay.

Q. Can you tell me off the top of your head what the mean is for that group for the ROE?

A. I'd have to write it down and -- used to be I would be able even if I wrote it down, I could tell you, but I have to put it in a calculator now.

Q. Let me suggest to you that it's 17-1/2 percent.

A. I'll accept that, subject to check or something.

Q. If you took the 5 and the 30, you kept pairing them up and dividing by 2 each time, you get 17-1/2 percent, right?

A. Okay. Yes.

Q. So that indicates to you that it's 17-1/2 percent for the whole group?

MR. RANDAZZO: I object. I don't know where this mathematical exercise is going.

MR. CONWAY: Well, just keep -- if we could allow a little more time for it, I'll bring it to a point.

EXAMINER SEE: Okay. Let's see where

you're going.

Q. 17-1/2 percent is the mean, correct?

A. I will accept 17-1/2 percent is the mean of the numbers you provided.

Q. Now, that's group A. Let's now compose group B and it also has six members and its members have returns on equity of 15, 16, 17, 18, 19, and 20, if I got six there.

A. So you're presenting me with a group B that has a different mean.

Q. No, it has the same mean.

A. Oh, it has the same mean, okay. I'll accept that, subject to --

Q. 17-1/2 percent.

A. 17-1/2, okay.

Q. So the mean for the ROEs for each of these groups is the same. That's the first point, okay?

A. Okay.

Q. And would you agree with me that the distribution of the ROEs of each group is significantly different one from the other?

A. No. I don't know what the word "significant" means.

Q. Well, different.

MR. RANDAZZO: I object. Counsel has asked the witness to assume different returns on equity and is now asking the witness if they're different.

MR. CONWAY: No, that's not --

MR. RANDAZZO: Where is this going?

MR. CONWAY: If you could just take a seat and listen. I didn't interrupt your cross-examination.

EXAMINER SEE: Okay, gentlemen.

MR. RANDAZZO: I object. It's not relevant, your Honor. I'm sorry.

EXAMINER SEE: Did you want to respond to the Bench, Mr. Conway?

MR. CONWAY: Yes, your Honor. I am constructing a hypothetical and asking the witness questions about it to test his testimony that the variance measurement is not something that should be considered by the Commission in applying the significantly excessive earnings test, and I'm getting to it.

EXAMINER SEE: Okay.

Go ahead and answer the question, Mr. Cahaan.

A. I'm having trouble in the sense that

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481 you're using -- you're asking me questions of a statistical nature to question whether I think a statistical approach is a reasonable approach, and since I don't think the question of --

Q. That is not my -- excuse me. That is not my question.

A. I thought that's what you just said that you were doing.

MR. RANDAZZO: Your Honor, I ask that the witness be allowed to finish his answer.

EXAMINER SEE: And he certainly should.

Go ahead, Mr. Cahaan.

A. So I can give you answers to these questions only within a statistical framework, a framework which I disagree with as being appropriate. I don't disagree that a statistical framework exists. I don't disagree that one can discuss this in statistical terms. I disagree that it is appropriate to discuss it in statistical terms.

So that's my problem in answering the questions, that it's asking me to assume that my view as to appropriateness is in error in the very nature of the question.

Q. Well, Mr. Cahaan, you start off with in your approach agreeing that looking at the mean

statistic is appropriate, correct?
A. I believe in my reading of SB 221 when it says, and I don't have it with me, but it says the -- something about the average of a comparable group, a group of comparable risk. I'd like to --
Q. Would you like me to read it to you and ask you questions?
A. Yes, the specific words there.
Q. If you can accept subject to check, but at least a portion of the provision in 4928.143(F) states, quote: "Whether the earned return on common equity of the electric distribution utility is significantly in excess of the return on common equity that was earned during the same period by publicly traded companies, including utilities, that face comparable business and financial risk."
A. Yes.
Q. Is that what you're recalling?
A. It is. And it's my interpretation of

that sentence that the appropriate way to read that is whether the earned return is significantly in excess of the word "average."

Q. And the word "average" is not there.

A. It's not there. One could say that -- argue that the legislature meant that the earned return is significantly in excess of the highest of all the observed returns of that group. You also possibly could say the lowest of all that group.

Generally in practice when you talk about the returns of a group, you're talking about the average of that group, and the only argument that has appeared about this is whether it should be an unweighted average or a weighted average. But the idea of using -- the idea of the average has been I think implied by the ordinary English of the term.

Q. But the word "average" is not actually in there.

A. It is not there.

Q. And if someone were to come up with a different interpretation in the statute, that might also be reasonable.

A. If someone came up with a different interpretation, then it would be something for lawyers to argue as to what's the appropriate interpretation of the statute.

Q. Let me ask you about the return of the comparable group, which the statute does refer to specifically.

A. Yes.

Q. Okay.

EXAMINER BOJKO: Mr. Cahaan, do you need a copy of the statute? I can give you mine.

THE WITNESS: Okay. It was only that one question, but -- okay.

Q. And I want to go back to the example, the hypothetical I gave you of the two comparable groups, group A and group B, one which had a fairly widely dispersed collection of ROEs and the other which has a much more tightly concentrated group of ROEs, okay?

A. Okay.

Q. And they each have a mean ROE of 17-1/2 percent.

A. That's the hypothetical you presented. I understand that.

Q. And would you agree that whatever the variance statistic is that one might develop for the two groups, that it would be a statistic that would describe the tightness or the more widely divergent nature of the ROEs of the groups?

A. Could you repeat that?

MR. CONWAY: Could you read it back, please?

(Record read.)

A. Yes. You're taking a batch of observations, and if you used the measure of variance, you are seeing how tightly bunched that particular variable is assuming that the other variables, whatever they are, if there are other variables, are irrelevant.

Q. Are you talking about the ROE variable here?

A. Well, you're limiting it to that.

Q. Okay.

A. I mean if we have, for instance, a group and we look at the size of the height, for instance, of the group, we could get a variance, but we have to pay attention to what is the group in the first place. If it's a batch of kindergarten students and a batch of college basketball players, you will get various measures, and whether those measures are useful depends on what you're trying to do with them. If you used IQs, they may be different.

Q. But getting back to the hypothetical which is based on ROEs of six firms in each group, let's assume that each group has members whose business and financial risks are comparable to one another, okay?

A. Okay.

Q. It's a comparable risk group in each case, okay?

A. Starting from that assumption.

Q. And I believe that the answer that you gave to my prior question before the explanation was that was yes, the variance statistic that you would develop for each of those two groups would be different and would describe the manner in which the ROEs of the group are tightly or widely dispersed.

A. As has been presented by other witnesses, including your own, I believe, the variance is a measure of dispersion. So when -- the question basically is asking for the definition of variance. Does it measure dispersion? Yes, it is a measure of dispersion.

Q. And it would provide some information for the specific group from which it's applied or for which it's developed about the quality of the dispersion, the nature of the dispersion, correct?

A. I don't know that. I know it provides information about the degree of dispersion based upon a batch of other assumptions, for instance, normality, nonskewedness. Based on those assumptions it provides a statistical measure which provides statistical information as opposed to quality, which is a meaning term, and I don't know what meaning one is getting from the statistical measures. I must

emphasize that numbers don't provide meaning.
Q. Let me ask you one more question. Would you agree that the mean return by itself does not describe as well the returns of the members of the group as would the mean coupled with a variance statistic?
A. I don't know what that question means.
Q. Okay.
A. I especially don't know what a variance of 2,600 basis points would mean in terms of providing information about a group, or 50 or 5,000 basis points. If you have a variance that's huge, you have a certain statistical interpretation, but what is the meaning of that?
MR. CONWAY: Your Honor, I would move to strike the portion of the answer after "I don't know what the question means." And I am finished with my cross-examination.
I thank you very much, Mr. Cahaan.

EXAMINER SEE: Let me have the question read back and then the answer.

(Record read.)

MR. CONWAY: It's not responsive, that's the basis of my objection, your Honor.

EXAMINER SEE: I'm sorry, Mr. Lindgren,

did you want to respond?

MR. LINDGREN: I believe Mr. Cahaan was just trying to clarify his -- the problem he had with understanding the question.

EXAMINER SEE: And I'll agree. Your motion to strike is denied, Mr. Conway.

And if you are finished with your cross-examination, Mr. Conway?

MR. CONWAY: Yes, I am.

EXAMINER SEE: Any redirect?

MR. LINDGREN: No thank you, your Honor.

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EXAMINATION

By Examiner Bojko:

Q. Mr. Cahaan, earlier this morning you were talking about migration risk, and as I understand your testimony, the only risk that you think the company should be compensated for is that migration risk; is that right?

A. I'm using the company's -- I'm starting
with the company's definitions in the sense of a risk of coming back and the risk of going. The risk of coming back is, I agree with the company, it's a POLR risk; I think it can be avoided.

The risk of going I don't think is a POLR risk, and I think -- but I do think it exists and that's the risk I'm calling migration risk.

Q. And that's the risk you think the company should be compensated for?

A. I'm accepting that if this were an auction situation, that risk would be built into the standard service offer, so it is not unreasonable to compensate the company by building this risk into the standard service offer. The magnitude, though, is in question.

Q. Okay. So if they were to be compensated, you believe that it should be something along the lines of what's in the current rates today which is -- I know you don't believe it's a POLR charge, but it should be at the same level as the POLR charge that's in the RSP today.

A. That seems to be working today so I think that's a reasonable charge.

Q. And then did I also understand you to say that it should be avoidable?

A. Yes. Definitely.

Q. And then I have another, just one more subject matter, and this goes back to yesterday. There was a lot of discussion about AEP's proposal for -- to purchase slice of the system in percentage increments in their plan, and when you were discussing with Mr. Kurtz the Ormet and the Mon Power situation, you made a statement that Ormet, that the company only received compensation for those situations for the two or three years that they were in place during the RSP. Do you recall that?

A. Not exactly. I mean, I'm not fully aware of the mechanisms by which they're compensated for the additional responsibilities. It's my assumption that I'm not sure is correct that these are tied to the RSP period.

Q. Okay. What other costs do you believe that, if that happened, I think it was discussed yesterday, early in 2006, possibly even maybe late-2005, what other costs do you think the company will continue to incur for either the former Mon Power customers or Ormet?

A. Above what is already being incurred or including what is already being incurred, because I basically am saying what is already being incurred is the cost of serving those customers. That's the reason we're advocating the 7-1/2 percent of purchase.

Q. Okay. And you believe, I guess, that that's above what would otherwise be collected from those customers via the company's tariff.

A. No, it's not with respect to the company's tariff. It's with respect to the company's obligation at the time that the SB 3 went into effect.

Q. Okay. And so three years later the company has had these customers for three years, two or three years, what costs do you see occurring to the company on a going-forward basis in order to serve these customers?

A. The costs that come out of the -- viewing it from the staff perspective are simply the difference between the market price and whatever they're able to charge these customers. So that's why taking it at market price and building it in eliminates the costs.

Q. But why do they need to go to the market to purchase these costs -- or, to purchase the power for these particular customers?

A. They don't.

Q. I maybe understand in the beginning when it was -- an obligation was imposed on the company immediately, and we can argue whether they accepted it or whether it was a forced obligation, which there's been a lot of testimony about that debate here the last few weeks, but now that it's known and now that they could plan, what going-forward costs do you believe the company has to serve those customers?

A. What we have here is another example of setting what amounts to a baseline. One can argue and I'm sure it will be argued, that the situation now, as it stands now, is it's been internalized, assimilated, they can plan for it, and so the baseline should be the situation now in terms of their responsibility for serving customers.

It's history. It's a done deal. The Ormet is what it is. The Mon Power has been fully a part of the company's service territory. Planning should be made on that basis. So the baseline should be what it is now. That's an argument that I'm sure some people will be making.

The staff is saying that the baseline in effect is when generation was unregulated, or whatever they did with it in terms of price regulation, and that baseline did not include, for the responsibility of AEP, the Ormet or the Mon Power. It's a question of which baseline is more appropriate.

We're basing it on the idea that, in a sense, a situation was created with the baseline of year 1999 or year 2000, and that situation carries forward over time and still exists. Other people may argue, well, that situation has been obviated and is no longer important.

Q. So under your theory they need to go out to market to procure the power because they don't have adequate resources to do it.

A. No, not saying they don't have adequate resources. Obviously, Ohio Power has more than adequate resources. The question is whether it's appropriate to insist that those resources be dedicated to an obligation that did not exist at the time that this what I'll call system was created.

We have a perspective on that. Other perspectives -- these are essentially decisions or arguments that will have to be decided. Our perspective is that in a sense the legislature, in a sense, cut a deal or the company was put in a situation in 1999-2000 period under SB 3 and the

additional responsibilities which were pushed upon
the company should be dealt with by allowing the
company not to have to use the generation resources
of its own, even though it has them.

Q. So under the new ESP do former Mon Power
customers have the right to shop?

A. Certainly.

Q. And assuming that there's no contractual obligation and Ormet is just taking service via standard tariff, would they have the right to shop?

A. Yes.

Q. And so what happens with this power that's procured on the market that's not -- no longer needed for that incremental baseline if all of these customers shop?

A. Well, if all those customers shop in the same way as if other customers shop, if any customer shops, then the power that the company was provided -- providing, rather, would be available for sale or for provision through the AEP pool. So it's not different --

Q. But in your mind if they shopped, it would be just like the baseline was previously and that there would be no need to procure this power and blend it with the standard service offer.

A. To construct a hypothetical to keep this clear, if the Mon Power service territory formed a big aggregation and that whole aggregation shopped, then, according to the logic that the staff is putting forward in its position, I think I would have to agree that the necessity of going to the market for that power would be gone based upon the reasoning that we are using in justifying and arguing for the 7-1/2 percent.

Q. And until -- if that situation would ever happen or governmental aggregation or just whether Ormet would shop, until that situation happens, those customers are on the company's standard tariff -- well, I guess debatable whether Ormet is. But the Mon Power customers, anyway, are on the standard tariff and they are paying revenues to the company, or the company's receiving revenues, they're paying rates.

A. Yes.

EXAMINER BOJKO: Thank you, Mr. Cahaan.

THE WITNESS: Thank you.

EXAMINER BOJKO: Mr. Lindgren, would you like to move the admission of Staff Exhibit 10?

MR. LINDGREN: Yes. Thank you, your Honor. I would like to move the admission of that exhibit.

EXAMINER BOJKO: Any opposition to the admission of Staff Exhibit 10, Mr. Cahaan's testimony?

Hearing none, it will be admitted.

(EXHIBIT ADMITTED INTO EVIDENCE.)

EXAMINER BOJKO: You may step down, Mr. Cahaan.

THE WITNESS: Thank you.

EXAMINER BOJKO: I know you don't want to leave.

THE WITNESS: It's been a pleasure.

MR. RANDAZZO: That is a statistically significant tie.

EXAMINER BOJKO: Let's go off the record.

(Recess taken.)

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

Would staff like to call its next witness?

MR. LINDGREN: Yes, thank you, your Honor. The staff would like to call J. Edward Hess.

EXAMINER BOJKO: Mr. Hess, would you please raise your right hand?

(Witness sworn.)

EXAMINER BOJKO: Please be seated.

MR. LINDGREN: May I approach the witness?

EXAMINER SEE: Yes, you may.

MR. LINDGREN: Let the record show I'm handing the witness what has been previously marked as Staff Exhibit 1.

EXAMINER BOJKO: Staff Exhibit 11 it will be marked?

MR. LINDGREN: Staff Exhibit 1, it had previously been marked at the time of his previous testimony.

EXAMINER BOJKO: I apologize. Mr. Hess has been doubly sworn in and his testimony's been marked twice just to be extra safe.

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J. EDWARD HESS

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

DIRECT EXAMINATION

By Mr. Lindgren:

Q. Mr. Hess, is this your prefiled testimony?

A. Yes, it is.

Q. Did you prepare this testimony?

A. Yes, I did.

Q. You had previously made two corrections to this testimony. Did you have any additional corrections you would elect to make today?

A. No, I do not.

Q. Thank you. Is everything in this testimony true and accurate?
A. Yes, it is.
Q. Thank you.
MR. LINDGREN: I have no further questions for this witness and he is available for cross-examination.
EXAMINER BOJKO: Okay. Let's begin with Mr. Maskovyak.
MR. MASKOVYAK: Thank you, your Honor.
- - -
CROSS-EXAMINATION
By Mr. Maskovyak:
Q. Good morning, Mr. Hess.
A. Good morning.
Q. I would like to take you to page 3 of your testimony, question and answer 7 beginning at line 4.
A. I have that.

Q. Thank you. Your description of Exhibit JEH-1 that is formatted in a manner similar to Mr. Baker's JCB-2. In line 7 and 8 you mention including the 75 million Partnership with Ohio. Do you consider that one of the recommended modifications that you refer to in line 6 just above?

A. Yes. Mr. Baker did not reflect that in his exhibit.

Q. That was my next question. So you are aware there's no comparable line in JCB-2?

A. Oh, yes. Absolutely.

Q. In fact, I did not find any reference to it in JCB-2 anywhere, did you?

A. No, sir, I did not.

Q. By including the $75 million as a line in Exhibit JEH-1 you have actually enhanced the value of the ESP taken in the aggregate; is that correct?

A. That's correct.

Q. And the companies --

A. As compared to Mr. Baker, yes.

Q. Correct.

A. And it was part of the application.

Q. And the companies could have done something to evaluate the value of their ESP, correct?

A. Yes, sir they could have, and I believe they should have.

Q. Why do you think that occurred?

A. I don't have an answer to that.

Q. Do you think the omission is intentional?

MR. RESNIK: Objection.

EXAMINER BOJKO: Grounds.

MR. RESNIK: He just said he doesn't know why it occurred. Now he's asking him to guess.

EXAMINER BOJKO: Yeah, he can't say the intention of the company. Sustained.

Rephrase.

Q. The fact that the company did not include such a line on Exhibit JCB-2, do you think it's because that they did not intend to include it as part of the ESP?

MR. RESNIK: Your Honor --

EXAMINER BOJKO: Sustained.

MR. RESNIK: -- same objection.

MR. MASKOVYAK: I have no further questions, your Honor.

EXAMINER BOJKO: Mr. O'Brien.

MR. O'BRIEN: I have no questions, your Honor.

EXAMINER BOJKO: Mr. Petricoff.

MR. PETRICOFF: Thank you, your Honor.

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CROSS-EXAMINATION

By Mr. Petricoff:

Q. Mr. Hess, if you would, let's continue looking at your Exhibit JEH-1. At the top line, actually it's the second row, you have estimated market prices. Do you agree with me that these are projections?

A. Yes. I believe I took those from, hopefully, Johnson's testimony.

Q. Okay. It is likely that the actual cost, market cost of power in 2009, 2010, and 2011 could be different than those numbers?

A. Absolutely.

Q. Is it possible that the actual cost of power in the market in 2009, 2010, 2011, could be substantially less than the numbers that are listed on your chart?

A. It's possible it could be substantially less. It could be substantially greater. I could add Mr. Johnson could have actually hit the number right perfectly.

Q. Now, if you would, I'd like you to turn to page 3 of your testimony and, if you would, focus

in on lines 15 to 17. And there you -- let me stop.
Have you found that?
A. Yes, sir, I have. Thank you.
Q. And there you carry over the suggestion
from Mr. Cahaan and make it on behalf of the staff
that the percentages should be -- the percentages of

the native load that should be put out to bid ought to be reduced from 5, 10, and 15 percent, ranging from years 2009 to 2011, to 5, 7-1/2, and 10 percent.

A. Yes, sir, that's correct.

Q. Okay. If after the first bid it is found that the market price is actually lower than the price that AEP has for generation, would the staff still object to the company's suggestions of a 10 and 15 percent market portion for the years 2010 and 2011?

A. Could you give me the timing of that again? When would we have the opportunity to object?

THE WITNESS: Is this working?

EXAMINER BOJKO: Yes.

A. Yeah. When do we have the opportunity to object? I don't understand.

Q. Let's go back and explore it in more detail. First, is the reason that the company opposes using the percentages of bid to meet native load because the staff anticipates the price for the bid power will be higher than the otherwise available legacy generation?

MR. RESNIK: Can I have the question read back.

THE WITNESS: Yeah. You said the

company, something about the company.

Q. Let's go back. Is the reason that the staff opposes AEP's percentage of market generation, market-acquired generation, because the staff believes that the market generation will be more expensive than the legacy generation that AEP has available?

A. No.

Q. And what is the reason that the staff opposes the company's percentage?

A. Well, I think Cahaan was the witness on that, but to the extent he wasn't clear on it, his basis was that the Ormet and Monongahela Power load is approximately 7-1/2 percent, the average of his numbers were 7-1/2 percent, and for all the other reasons Rick testified to that. We feel strongly about that.

Q. I understand and appreciate your feelings. But I want to explore to see if we might be able to change that opinion. What if after the 2009 auction -- when I say "2009 auction," that is the auction to supply power for 2009 -- it turns out that the bid price comes in under the legacy generation price for AEP? Would you still hold the same view that you ought to use legacy generation?

MR. RESNIK: If I just may inquire, when
Mr. Petricoff is referring to "legacy generation,"
are you talking about the standard service offer that
is going to be set in this proceeding?
MR. PETRICOFF: Well, not -- because the
standard service offer that's going to be set
includes the generation that's going to be purchased,
you have a problem of how to filter that out, and
when I say "legacy," I mean the cost of generation
that would be supplied by the company were the
company using the generation that they -- that they
would use for the standard service offer.
MR. RESNIK: And I'm reluctant to talk
directly to counsel, but does he mean --
MR. RANDAZZO: He's looking at the Bench
but pointing at Howard.
THE WITNESS: He's cheating.
MR. RESNIK: It still is not clear to me
whether the term "legacy generation cost" is a cost

to the company or the cost to the customer, what's
included, what isn't included, and so I object.

EXAMINER BOJKO: How about you try to rephrase, Mr. Petricoff.

MR. PETRICOFF: I think so. If Marv is confused, I really do need to start again.

Q. (By Mr. Petricoff) Let's go back and take this in parts, okay? In 2009 is it the recommendation of the staff that 5 percent of the native load that has to be met by the AEP operating companies will come as a result of an auction?

A. In 2009?

Q. In 2009.

A. I believe that's correct, yeah. I think we were hoping more for an auction or an RFP of some sort, some kind of public documentation instead of administratively established. I'm not sure we can do that before 2009, though. I think the Commission needs to clarify that for 2009, 2010, and 2011.

Q. When I say "auction," assume that it will be some type of market acquisition and not necessarily a descending clock or an RFP. I understand that that's yet to be determined, but basically we go out for a publicly acquired bid of some sort.

A. Something other than an administratively established rate.

Q. That is correct.

The other 95 percent for the target year of 2009, how will that be procured?

A. The company provides that.

Q. Let's refer to that portion as the legacy generation, okay --

A. Okay.

Q. -- for purposes of the next question. If it turns out that the legacy generation is more expensive than the bid price that we get in the first auction in 2009, would the staff be willing to review its position as to whether the 2010 auction should be for 7-1/2 percent as they have suggested or the 10 percent that the company has suggested?

MR. RESNIK: Can I have the question read back, please?

EXAMINER BOJKO: You may.

(Record read.)

A. No. But, Mr. Petricoff, let me make sure you understand this. What I'm doing with the $74 is comparing it to the $30 that's in the FAC. So you're telling me in your hypothetical situation that the market rate is going to get below $30. I mean, that's where the delta revenue gets built. It's not a comparison to the overall rate. They go out and procure --

Q. Let's go back and revisit the question because maybe you didn't clearly understand the question. When the auction is held for 2009, you'll agree with me that it will be for the complete package of generation that's necessary to supply standard service offer, the standard service offer; isn't that correct?

A. Yes.

Q. And we can likewise compute what the full cost of generation would be to supply the SSO that would be coming from what we have labeled before as the legacy rate; isn't that correct?

A. That's correct.

Q. Now I'm asking you after we have the 2009 auction, if we compare -- when I say "we," I mean the Commission or the Commission staff at that time -- if it compares the results of the auction with the results of the legacy rate and finds that the auction was actually a lower price for the generation, would it be -- if that comparison was made, do you think it would be in the best interest of the public to amend the amount of power being auctioned in 2010 and use

the company percentage of 10 percent of the native
load?

A. No. I think the best interest of the general public is to stand with a plan and stay with it for three years. I think there's importance in consistency. I think that when the Commission authorizes something, and if it authorizes 5, 7-1/2, and 10, or 5, 10, and 15 -- that for the three-year period, I'm not sure in the middle of it you should change that.

But I could also direct you to -- and maybe this is where I don't think we even contemplated anything like that. If you go to my Exhibit JEH-2, the average price of the generation is quantified there for the three-year period, and I guess under your hypothetical situation the price would have to get below $58.40 for Columbus & Southern in 2009.

Q. Yeah. But these are comparisons of an MRO to a price. I was just looking at the price of generation.

A. No; I'm sorry, let me direct you there. This is under the ESP. This is the results of what their generation prices would be. This is not an MRO. JEH-1 compares the MRO. This is the quantification of the generation, transmission, and distribution rates under the ESP.

So, you know, we had never really contemplated anything like that because the rates that are produced under the ESP as proposed by the company and adjusted by the staff are relatively low.

EXAMINER BOJKO: Mr. Hess, that's what I wanted to make clear. JEH-2 is proposed as modified by staff.

THE WITNESS: That's correct.

EXAMINER BOJKO: Okay.

THE WITNESS: Yes.

Q. Well, I understand your point.

A. So, very generally, no. I really do think that if the Commission authorizes 5, 7-1/2, and 10, or 5, 10, and 15, it probably ought to stay with that. There would be economics to the utility company that would have to be considered in all of that, and I think to change the plan midstream like that would -- I'm not sure it would be terribly fair.

Q. Even if the resultant effects of that might be a lower price for the standard service customer.

A. Yes. Again, there's the balance here. It's not just a consumer. It's the balance with the utility company, too. It is a fair price to the customer as well as the financial stability of the utility company that needs to be considered.

MR. PETRICOFF: I have no further questions. Thank you, your Honor.

EXAMINER BOJKO: Ms. Grady.

MS. GRADY: Thank you, your Honor.

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CROSS-EXAMINATION

By Ms. Grady:

Q. Good morning, Mr. Hess.

A. Good morning.

Q. Go to page 2 of your testimony. At the bottom of the page --

A. Could you give me a second to get there.

Q. I'm sorry. I'm a cup and a half ahead of you.

A. You all look like you're a cup and a half ahead of me.

I've got that, thank you.

Q. Line 17 through 19 you indicate there you're recommending that the Commission adopt the ESP plan, essentially with the staff modifications.

A. That's correct.

Q. Now, what is your understanding of what

happens under SB 221 if the company should determine
that the modification -- if the Commission would
adopt the staff's proposal with the modifications,
what is your understanding of the company's options
at that point in time?
A. It can reject the Commission's final

authorization.

Q. And then what process do we go into?

A. I believe they have the opportunity to refile an ESP or they can file an MRO.

Q. And if they go through that process, Mr. Hess, is there a new time line set for the staff -- or for the Commission to make this determination or issue a decision? If you know.

A. I think the second time around there was 275 days. I believe that's correct.

Q. Thank you.

Now, I want to focus your attention on your testimony on the distribution rate case. I believe that begins on page 5.

A. I have that.

Q. And on lines 18 through 19 you state that the staff recommends that the AEP companies file a base rate case in 2009 to recover the cost of additional reliability programs, along with other things. Do you see that?

A. Yes, I do.

Q. What additional reliability programs are you focusing on there?

A. The ones that were proposed in the ESP.

Q. That would be Mr. Boyd's testimony? If you know.

A. I don't know the answer to that. It isn't really just programs, it's the incremental cost of the programs, and to the extent they are new programs, then it would be the additional costs on the new programs.

Q. Now, on page 6 of your testimony, lines 15 through 18, you indicate that there's been a lot of accusations and public discussions about the AEP companies management of its system. Can you tell me what accusations you're referring to there?

A. Yeah. We went through about a two-year formal and informal discussion. I may even have the case number that it ended up in --

Q. Is that 06-222?

A. Tell me the last three digits.

Q. EL-SLF.

A. Yes. Thank you. And there were a lot of public accusations that went back and forth there.

It was started with a report that came out from the
staff of the Commission. That went public about the
time of the, I think, the '03 blackout, and there was
a Wall Street Journal article about AEP at that point
in time. I think it was on there. It wasn't on the
paper copy. It was on the electronic copy, and that

just started a lot of public discussion about the reliability of the system.

Q. You are not saying --

A. There were accusations by the Ohio Consumers' Counsel. There were, you know -- when storm damage issues came in, I don't have press releases or quotes that I could take you back to, but that was another incident that caused quite a bit of accusations about past reliability issues and costs that had either not been spent or should have been spent.

Q. Are you familiar with the Staff Report that was issued in 06-222?

A. I probably read it back then. I have no memory of it at this point in time.

Q. Would that report have had discussions about --

MR. LINDGREN: Objection. The witness says he has no memory of that report at this time.

EXAMINER BOJKO: Sustained.

MS. GRADY: I didn't even finish my question, but --

EXAMINER BOJKO: Rephrase.

MR. RANDAZZO: Yes, you did.

EXAMINER BOJKO: Maybe if you rephrase

and not begin it the way you did, we'll let you finish.

MS. GRADY: Okay.

THE WITNESS: I can cut this short, Ms. Grady. I really remember nothing about that report.

Q. (By Ms. Grady) I appreciate that, Mr. Hess. It's like shooting a dying horse. Thank you.

Now, on page 7 of your testimony you refer, and I'm looking at lines 15 through 16, you say there that the Commission should allow the applicants to defer costs and allow the opportunity to recover these costs in the next base rate case. Do you see that?

A. Yes.

Q. Are you then referring back to the base rate case that we've -- that was earlier discussed on page 5?

A. To be filed, yes, in the future.

Q. And that would be filed in 2009, is that --

A. My recommendation is that it be filed sometime in 2009. If it were up to me, I would suggest the first quarter of '09, but I was asked to give, by other staff people, to give some additional time there.

Q. Now, you also recommend that the Commission should allow the application to -- the applicants to defer these costs. Are you envisioning an application for authority to defer being filed by the company?

A. No. I think the Commission can give them the authority to do it in this case.

Q. In this case, okay.

And then in the next -- in the base rate case that we talked about in 2009, the analysis would be whether there was a material impact on their ability to recover a reasonable return for the distribution service as the test to determine whether deferrals were appropriate?

A. Yes, that's correct, the deferrals and then, of course, recovery of it.

Q. Now, you discuss briefly the possible early plant closures, and you begin that discussion on page 7, it carries over onto page 8. Are you aware of whether or not AEP has actually targeted plants for early closure?

A. I'm not aware of that, no.

Q. And you indicate --

A. I think there was some discussion in one of the witness' testimonies about targeting a couple of the plants.

Q. Do you know whose testimony that would have been?

A. I think Baker was the witness, so to the extent it isn't in there, then I can't refer you to any other comment.

Q. Now, you indicate on page 8, lines 12 through 14, that you are not recommending that the Commission have customers bear the costs of "these uneconomic plants without accounting for the offset of the positive economic value of the rest of AEP companies' generating fleet." Do you see that reference?

A. Yes.

Q. How would you go about doing that, determining a positive economic value for the rest of their fleet?

A. We did it in the ETP cases. We all hire professionals to estimate what the market values of electricity would be for 40 years and compared that -- present-valued it back to a date certain and compared it to the net value of each generating plant.

Q. And that would have been done in -- you would have filed testimony in that case, if you know, on that?

A. Would I have filed testimony?

Q. The staff. Would the staff have filed testimony? If you know.

A. I don't remember whether we litigated that case or whether it was -- chances are I probably would have filed testimony if we would have litigated. I don't remember if we litigated it or settled it.

MS. GRADY: Thank you, Mr. Hess.

That's all the questions I have.

THE WITNESS: Thank you. Shooting a dead horse?

MR. MASKOVYAK: Dying.

EXAMINER BOJKO: Dying.

THE WITNESS: Not dead.

EXAMINER BOJKO: Mr. Randazzo?

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CROSS-EXAMINATION

By Mr. Randazzo:

Q. Mr. Hess, just a few questions which I think are more of a mechanical nature. Your testimony is really summarizing positions that have been articulated by other staff members relative to numbers and then assembling the numbers in one place, as I understand.

A. For the most part. There are one or two issues that I addressed.

Q. Okay. And one of the mechanical questions I have for you, and I know you're attached to the slice-of-system approach so I'm not suggesting one way or another anything that should -- that questions your recommendation on there. What I really would like you to address is what the percentages are applied to.

In the context of the MRO, the blending that's contemplated by statute is a percentage relative to standard service offer requirements. In this proceeding we've heard suggestions that it's a percentage of native load.

What is the -- in your -- in the staff's recommendation, what is the 5 percent applied to to determine the quantity that should be bid out?

A. We did that calculation, and I believe it was to retail sales.

Q. For what period?

A. For, for example, when I'm trying to quantify 2008, it would be for the 12 months ended

12/31/08.

Q. Okay. So is the percentage applied to a static value, or does the percentage reflect the prior year's load, or --

A. That's probably -- it probably is the projection. The percentage would have to be applied to the projection of what the retail sales would be in that upcoming period.

Q. So if there is load growth year to year, you would end up with something that would average more than 7-1/2 percent mathematically, correct?

A. Well, as compared to what? As compared to 2008?

Q. Yes. As compared to current 2008 or 2007, anything.

A. Yeah, that's the only way you end up with a percentage that's bigger, if you fix the denominator and then compare the additional sales to it.

Q. All right. But in any event, there would have to be some clarity around what the percentage is applied to for purposes of determining the quantity that is bid out, right?

A. Yeah. And that's -- yes.

Q. Okay. Now, on your JEH-1 you say in your testimony that you've used the similar format to Mr. Baker's Exhibit JCB-2, and that's on page 3 of your testimony, Staff Exhibit 1.

Before I ask you a question about this, just as a housekeeping thing, I was busy doing something and I may not have heard your counsel, but if I were to ask you the questions that are set forth in your testimony, would the answers that you would offer today be the same?

A. Yes, they would.

Q. Okay. Thank you.

If you would turn to JEH-1, you say that that's the same format that was used by Mr. Baker, and again, using the same approach, what you're trying to do there is adopt an incremental analysis of the difference between the MRO and the ESP.

A. That's correct.

Q. And were you here when I discussed with Mr. Baker the treatment of fuel for purposes of conducting that incremental analysis?

A. I don't believe so. I was here for quite a bit of your cross of Mr. Baker, but I don't remember that.

Q. Okay. If in the MRO context you were purchasing 10, 20, and 30 percent of your standard service offer requirements. Do you understand that it would be necessary to reflect that escalating percentage of purchased requirements for purposes of reflecting the ESP fuel? Strike that, let me ask it a simpler way.

A. No; I'm trying to do this as an accountant would. Are you referring to the -- under the estimated cost of company's ESP, the first line there?

Q. Let me try it a different way.

A. Okay.

Q. A simpler way, Mr. Hess. If there are differences in the fuel as a result of the format that was used by Mr. Baker, you've not reflected that in your incremental analysis.

A. That's correct. I tried to duplicate Mr. Baker's format.

Q. All right. Easier way to get there.

Now, for purposes of this schedule your

estimated market price -- and you indicated earlier that you took that from Mr. Johnson, and that is what my understanding is as well, for what it's worth -- but the numerical values that you show estimated market price, would you accept that the numerical values, for example, the $74.71, would you accept, subject to check, that that's the simple average of the values that were used, for example, in 2009 as identified by Mr. Johnson? Would you accept that, subject to check? If you know.

A. I have no problem accepting it subject to check. I'm just trying to figure out what you mean by a "simple average." I have Mr. Johnson's calculations here.

Q. Yeah, it's on Exhibit DRJ-1.

A. I actually have the spreadsheet, the printout of the spreadsheet.

Q. I'll withdraw the question. The math will -- speaks for itself.

Mr. Hess, if you would turn to JEH-2.

A. Yes, sir, I have that.

Q. There you're showing on a year-by-year basis the effect of what I understand to be the staff's recommendations on how the increases year to year would end up.

A. Yes.

Q. Am I understanding that?

A. Correct; in a cent per kilowatt-hour.

Q. And in your testimony and Mr. Cahaan made reference to this as well, there's some indication the staff might be willing to look at a mechanism that would levelize or smooth out the year-to-year increases otherwise known as a phase-in --

A. Yes.

Q. -- is that correct? So that if conceptually, you know, without being too precise on the numbers, instead of having in the case of Ohio Power Company a 24 percent increase under the staff's recommendation in 2009, conceptually what you would be talking about or willing to consider is something that would smooth that increase out over the three-year period of the ESP, correct?

A. Yes. I think Mr. Cahaan also testified to the fact that given the current economic situation we're in, I think additional consideration needs to be considered -- additional items need to be considered.

Q. Okay. And if that were to be done, I think section 4829.144 and regulatory principles would suggest that there might be a cost associated with levelizing that or phasing in that increase as well, right?

A. As in a carrying cost --

Q. Yes, sir.

A. -- associated with the deferral of the recovery?

Q. Yes, sir.
A. Yes. Right.
Q. And it would be appropriate to recognize that as well --
A. Yes.
Q. -- correct?
MR. RANDAZZO: That's all I have, your Honor.
Thank you, Mr. Hess.
THE WITNESS: Thank you.
EXAMINER BOJKO: Mr. Boehm.
MR. BOEHM: Just a few questions, your Honor.

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CROSS-EXAMINATION

By Mr. Boehm:

Q. Mr. Hess, I would like to address the subject matter that you were discussing on cross-examination about the purchased power for, I believe -- purchased power for the companies that I believe you attached in some way to the Ormet and Mon Power situations.

A. Yes.

Q. Now, you said you believed in this very strongly; is that right?

A. Yes, sir, I do.

Q. Okay. Would you agree with me, Mr. Hess, that there is nothing in the orders relating to Mon Power or to the Ormet situation which indicates that beyond 2008 there was any sort of an obligation of other ratepayers to pay for that, for the cost of those loads?

A. Explicitly? There probably is no explicit.

Q. Well, now, the Public Utility Commission is a public agency, right?

A. Yes, sir.

Q. Okay. And so everything the Public Utility Commission does has to be done explicitly on the record, doesn't it?

A. Let me say -- let's also consider the fact back when those two were done, too, Mr. Boehm, that the assumption was that at 1/1/09 we were going to go to a market rate.

MR. RANDAZZO: Could I have the answer read back?

EXAMINER BOJKO: Yes, sir.

(Record read.)

Q. And whose assumption was that, Mr. Hess?

A. It certainly was mine.

Q. Okay. When you say "not explicit," was there some side deal or secret agreement with the company that they would continue to receive market price or delta revenues associated with those loads?
A. No, sir, and I'm sorry if I even --
Q. Okay.
A. -- that could even have been assumed from anything that I said.
Q. Well --
A. No, absolutely not, there were no side deals. There were no -- there was nothing that was ever discussed about what would happen 1/1/09.
Q. Okay. Do you think that it's possible that if the ratepayers who were involved in those cases realized that the deals would go on beyond 2008, that they may have taken different positions?
MR. RESNIK: Your Honor, I'm going to object for a couple of reasons. For one thing, I don't think that Mr. Hess should be asked what other

parties might have been thinking.

But beyond that, we're talking -- you know, the cross-examination has talked about an assumption of what was going to happen 1/1/09 and whose assumption was it. It was in the law. I don't think that it's even an assumption. That's what the law said, we were going to have market-based rates. And Mr. Boehm seems to be confused why anyone would have thought that.

MR. BOEHM: I'm sorry, I thought that was three questions ago.

MR. RESNIK: It is all wrapped up together. This whole line of cross-examination, assuming that there was something other than what the law provided I think is inappropriate. So for both those reasons I object to this particular question.

MR. BOEHM: May I respond?

EXAMINER BOJKO: Sure.

MR. BOEHM: I don't know how the question of whether there was going to be market rates is tied up in the idea that there was some sort of moral obligation now on the part of the Commission or, rather, upon the ratepayers because it's going to be their burden to continue to pay market rates to the company. I don't understand why that's settled, and

I'd like to explore that, if that's in fact the underlying assumption here.

EXAMINER BOJKO: Mr. Randazzo.

MR. RANDAZZO: I'd just note, your Honor, there was nothing in the law at the time that said we were going to market 1/1/09. So it's an interesting theory, but the fact of the matter was that we were in rate stabilization plans at the time, and whether that's right or wrong, that was the case. But I think maybe the coffee has kicked in here and --

MR. RESNIK: I don't even drink coffee.

MR. RANDAZZO: Well, maybe you should.

MS. GRADY: That's a good thing.

EXAMINER BOJKO: Let's go back and reread the question.

(Record read.)

THE WITNESS: I don't know the answer to that, Mr. Boehm.

MR. RESNIK: I'll withdraw the objection.

Q. (By Mr. Boehm) as Mr. Randazzo asked you before, whether you believe that what you're doing essentially is taking the different positions of previous staff witnesses and sort of tying them all together and presenting a package; isn't that correct?

A. That's correct. In addition to that, I have a couple of items I've directly addressed.

Q. Let me ask you something, Mr. Hess, in your recommendation that the company be allowed to buy power at the levels that you talked about, that recommendation had nothing to do with the need or the shortage of the company of that power; isn't that right?

A. That's absolutely correct.

Q. So the recommendation to buy power is merely a device to allow the company to receive a delta revenue, if you will, for those loads; isn't that right?

A. It's a device to keep the current standard service offer, 95 percent of it at the current rate. It's an attempt to do that.

Q. Okay.

MR. RESNIK: I'm sorry, could I have that answer read back?

(Record read.)

Q. I'm sorry, I was distracted here because the Bench was distracted by my pen.

MR. RESNIK: How did that turn out?

EXAMINER BOJKO: Your Christmas presents will all be no-clicking pens. They'll be regular pens.

MS. GRADY: I think that's his problem.

MR. BOEHM: Okay.

EXAMINER BOJKO: Could you reread the question.

(Record read.)

Q. And when the company made -- or, when the Commission staff was thinking about this recommendation, did they take into consideration, for instance, with respect to Columbus & Southern what their current rate of return on equity was?

A. No.

Q. All right. It didn't matter to the staff that they're currently making I think approximately 23.5 percent rate of return on equity?

MR. RESNIK: Objection. The witness just answered the question.

EXAMINER BOJKO: Sustained. Sustained.

You did just --

MR. BOEHM: I understand.

Q. Let me ask you this question, do you know that the company has a rate of return on equity of approximately 23.5 percent?

MR. RESNIK: Objection on relevance.

EXAMINER BOJKO: Overruled.

A. I think Mr. Cahaan has done that calculation, yes.

Q. And if, in fact, the allowance of the company to buy this additional power and essentially to realize additional profit would put the company in excess of a 23.5 percent rate of return on equity when the yearly excessive earnings test is brought to bear on the company. Is it your interpretation of the law that the company would have to give that money back?

MR. RESNIK: Your Honor, can I have the question read back, please?

EXAMINER BOJKO: You may.

(Record read.)

MR. RESNIK: Your Honor, I'm going to object. The testimony that Mr. Boehm is asking about or the situation is a return that's historic. To say that something that might happen in '09 will put the return in excess of that assumes that that return that is historic is going to continue through 2009 so there's no basis for that assumption.

EXAMINER BOJKO: The witness can answer and/or clarify his answer as he deems necessary.

MR. BOEHM: Thank you, your Honor.

Q. Do you understand the question, Mr. Hess?

A. Yeah, I think so. I'm seeing if I can just quote the law because I believe there was something in the law about --

Q. I believe you're right.

A. -- specific to adjustments and I do believe that there was something specific to refunds.

Q. Yes, sir. And I'm afraid I don't -- for the first day I didn't bring my copy with me, but --

MR. BOEHM: Oh, thank you.

Q. I think we go to one forty --

A. I don't remember whether it was (E) or (F). One of them is the fourth year plan. I think it's (F).

MR. MASKOVYAK: I believe we're looking at (F).

Q. 143(F). Do you have that section, Mr. Hess?

A. Yes, I do.

Q. Okay. And it talks about, doesn't it -- well, let's read it together. "With regard to the provisions that are included in a electric security plan under this section, the commission shall consider, following the end of each annual period of the plan, if any such adjustments resulted in excessive earnings as measured by whether the earned

return on common equity of the electric distribution
utility is significantly in excess of the return on
common equity that was earned during the same period
by publicly traded companies, including utilities
that face comparable business and financial risks,"
et cetera. Do you see that?

A. Yes, that's the first sentence of section (F).

Q. Okay. Does that refresh your memory about what the law provides concerning the excessive earnings? Oh, I'm sorry. Then it says: "If the commission finds that such adjustments" --

A. There we -- yeah. "If the commission finds such adjustments . . . did result in significant excess earnings, it shall require the electric distribution utility to return to consumers the amount of the excess by prospective adjustments." Yeah.

Q. Okay.

A. That's clear.

Q. I thought so too. So let's assume as a hypothetical, shall we, Mr. Hess, that Columbus & Southern is making, say, 23.5 percent rate of return on equity, that the allowance of the company to purchase this additional purchased power and essentially then to sell the displaced power into the market at a greater profit, that adjustment means that the company's rate of return goes up from, say, 23.5 to some level, let's call it 25, okay, 25 percent rate of return on equity, and let's assume that the Commission has determined that a significantly excessive rate of return is 23.5. What would happen at the end of the year after that review?

MR. RESNIK: Your Honor, maybe it's more of a clarification. Are we talking about earned 23.5 in 2009?

MR. BOEHM: Yes.

EXAMINER BOJKO: Did you follow that, Mr. Hess?

THE WITNESS: I did.

But I think, Mr. Boehm, there's other considerations. There was the capital expenditures consideration in here. You know, I mean, if you're taking me all the way to the assumption where the Commission has decided --

Q. Yeah.

A. -- that something has to happen --

Q. Well, won't they do that?

A. Absolutely they will in a year, yes.

Q. Okay.

A. What I'm a little reluctant to do is try to decide that issue now without knowing everything that the Commission's considering.

Q. Well, let's try this, this is always a dicey thing, but let's say all other things being equal -- we're trying to isolate how this part of the law works. All other things being equal, the allowance of this purchased power proposal raises the rate of return on equity of the company from 23.5 to 25 percent. And let's assume at the same time that the Commission has determined that anything over 23.5 percent, God knows how they'd do this, but is significantly excessive earnings. Would the company have to give that money back at the end of the year?

A. Again, Mr. Boehm, I think there's other considerations that need to be taken into account for and the law allows for that. There's capital expenditures, there are -- I don't know the answer to that question at this point in time. I don't think your hypothetical is complete enough.

Q. You won't agree with me that it's possible in some fashion to isolate one of the components of this and look at what the effect is?

A. I didn't see that as a part of your

hypothetical. Can you isolate it and determine what
this item would -- what the effect of this item would
have on earnings?

Q. Well let's --

A. If you took the revenues minus the costs
associated with this one item, yeah, you could

probably estimate what the effect on income was.

Q. And that's what I'm asking you to do. I'm asking you to assume that that effect was to raise the income and, therefore, the rate of return on equity. Now, isn't it true at the end of the year, given the various postulates that I gave you, that the Commission would have to order the company to return that money?

MR. RESNIK: I'll object, your Honor. For one thing, I think the witness has indicated there is more to be considered. I think that the assumption that's built in that there are earnings that were derived from the adoption of the company's 5, 10, 15 percent proposal, if they are, those would be wholesale earnings in any event, and I would raise the legal issue as to whether this Commission can order refund of revenues associated with wholesale transactions. I just -- I think we're going very far afield.

EXAMINER BOJKO: Well, I think we're finally getting to a place of an agreement on a hypothetical, so under the hypothetical situation that I think Mr. Hess has agreed he will consider at this point, and if he can't, let us know.

But you can answer the question if you

can on that.

THE WITNESS: I'm sorry, I have to have the question reread. I wasn't sure we were getting any closer to an agreement.

(Record read.)

A. And again, Mr. Boehm, I will answer again, I don't know because there are other considerations that need to be taken into account which the law provides for.

Q. Will you agree with me, Mr. Hess, that what the law says that it is -- that if at the time of the annual review under the excessive earnings provision the company's rate of return as a result of the various adjustments to its plan exceeds some level that is determined by the company to be excessive, that the company has to refund that money? Will you agree with me that's what the law provides?

A. No, sir, I won't. There are other provisions in here, for example, the provision about capital expenditures. It is -- I don't believe it to be just a straight return. And, by the way, it's a return on equity. I assume that was assumed in your question.

Q. Yes. I'm sorry, I thought I said that. Yeah.

A. Well, you said rate of return. It was a return on equity.

Q. Okay. I'm sorry.

A. No, I can't agree with that. Again, there are other considerations that I think the Commission has the legal authority to consider.

Q. Okay.

MR. BOEHM: I don't think I have any other questions, your Honor.

EXAMINER BOJKO: Mr. Yurick?

MR. YURICK: I have a few, your Honor.

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CROSS-EXAMINATION

By Mr. Yurick:

Q. Can you hear me, sir?

A. Yes, sir, I can.

Q. I'd like you to turn, if you would, please, to Exhibit JEH-1?

A. Yes, sir, I have that.

Q. And in the middle of the page under the first underlined kind of heading there's a row of numbers titled Estimated Purchase Cost of 5 percent, 7.5 percent, and 10 percent. Do you see that?

A. Yes, sir, I do.

Q. And the numbers you have there are 85, I'm assuming that's million.

A. Yes, sir, it is.

Q. 127 million, and 170 million for Columbus Southern Power for a total of 382 million over the three-year period; is that correct?

A. That's correct.

Q. Then for Ohio Power Company you have 104 million, 155 million, and 207 million for a total of 466 million; is that correct?

A. Yes, sir.

Q. So the total there would be 848 million for both the companies over the three-year period; is that correct?

A. I haven't done the math out.

Q. Would you accept that subject to checking the math?

A. Yes.

Q. Okay. Now, if you look at JEH-2, please.

A. Yes, sir, I have that.

Q. You have there calculated the increase in the rate for the two companies over the three-year period; is that right?

A. Yes.

Q. And I'm assuming that the 11 percent number, the 2 percent number, and the 1 percent number for Columbus Southern Power Company, you're taking $187,614,325 and dividing that by your base number which is $1,778,632,737; is that right?

A. Again, I don't have the cell in front of me, but hopefully that's what was done. That's what should have been done.

Q. So what should have been done is you take the increase, 187,614,325 and divide it by the 1,778,632,737; is that right?

A. Yes.

Q. That's what should have been done?

Same process used for 2010, the $31,394,019 divided by the 1,778,000, et cetera, number; is that right?

A. If that was done, that's probably not what should have been done. I should have taken the 31 million in 2010, divided it by 1 million 778, plus the 2009 increase.

Q. Okay.

A. It is intended to be a -- it was intended
to be a percentage increase over what 2009 rates
would have been.

Q. Okay. So can you tell if that's what
you've done there? I tried to work --

A. Yeah. You know, for the first time since

I have testified I didn't bring a calculator up here with me and I don't have a computer to check the Excel spreadsheet that created it.

THE WITNESS: Yeah, that would be helpful.

MR. BOEHM: National Cash Register.

MR. RANDAZZO: When you get old, it gets bigger. It's consumer friendly. It drops everything in half, so multiply it by two.

MR. BOEHM: You want to make sure the cash drawers are empty there, Ed.

THE WITNESS: I can't figure out how to turn it on.

MR. RANDAZZO: Just hit on it.

THE WITNESS: I got it.

MS. GRADY: The big red button.

A. Yeah. The math of that ended up being .015966, and I think that rounds to 2 percent.

Q. Okay. So I'm correct in that's the way you've calculated what you have as a 2 percent increase, you took the 31,394,019 and divided it by the 1 million 778, or is that not --

A. No.

Q. I'm sorry, could you explain what you did?

A. Yeah. I took the 31 million and divided it by 1,778 plus 187.

Q. Okay. And the 22,225,455 for the 1 percent, you did the same thing?

A. I would have taken 22 million, divided it by 1,778, plus 187, plus 31.

Q. Okay. I understand. I appreciate you going through that.

And is that the same for Ohio Power Company on the bottom, you used the same methodology?

A. If it isn't, it should be.

Q. Okay. Well, my next question is, the numbers from the opposite page, the estimated purchase costs, those were not reflected in the 187,614,325, the 31,394,019 or 22,225,455, are they?

A. Wow, I'm sorry. You'll have -- the next page you said?

Q. I'm sorry if I was going too fast. Yeah, if you go back to JEH-1 and you go to the estimated purchase cost line.

A. Yes.

Q. That 85, to use an example, in '09 the 85 million for Columbus Southern Power for estimated purchase cost in 2009, that's not reflected on the JEH-2, the 2009 increase, 187,614,325.

A. The first column is the 5 percent, I did that in the math on JEH-2, but you're right, the incremental 2-1/2 percent is not for '10 and '11.

Q. So you did it in '09 but you didn't do it in '10 or '11.

A. Correct. I wasn't going to try to estimate what the fuel number was in '10 and '11.

Q. Okay. But if you could bear with me for a second, for instance, in 2010 for Columbus Southern Power Company, if you added that 127 million to the 31,394,019, instead of a 2 percent increase you would come up with roughly a 9 percent increase.

MR. RESNIK: Can I have the question read back, please?

EXAMINER BOJKO: Sure.

(Record read.)

A. First of all, the math of what you suggested I think is incorrect. I have to think of how these numbers were quantified on JEH-1. I don't think that it's the incremental increase. I believe it's just the 5 percent of the retail sales times the market rate. That would have to be offset by the fuel rate without sales, so it would have to reflect this -- I don't believe that this reflects the incremental increase. I think this is the total value of what 5 percent times the market rate is. So you would only reflect the incremental increase, and then as you moved to year '10, it would only be the additional 2-1/2 percent; it wouldn't be the total value.

MS. GRADY: Your Honor, for clarification purposes, when he said "this," are you talking about JEH-1 or only reflecting the incremental? I'm getting confused here.

THE WITNESS: JEH-1 I believe reflects the total amount. I don't believe it's incremental, which would have to be reflected on JEH-2.

MS. GRADY: Thank you.

Q. Fair enough. I should say, I should have prefaced this, I'm not necessarily trying to go anywhere, I'm just trying to understand, and I appreciate your patience, but I'm just trying to understand what it is that the exhibits reflect.

A. Sure.

Q. So for Columbus Southern Power in 2010
there's a 127 million number there.

A. Correct.

Q. If I understand you correctly, Columbus
Southern Power would be spending some amount on
purchased power in 2010, and the incremental

difference would be the difference between what they're spending -- what they would have spent in 2010 absent the ESP, minus the 127 million. Is that right? Or, I'm sorry, 127 million minus whatever they would have spent in 2010.

A. Could you give me a second. Let me see if I can figure out how I did the 127.

EXAMINER BOJKO: You said absent the ESP rate. You meant absent any market rate option that they would have spent under a --

MR. YURICK: Correct.

EXAMINER BOJKO: -- FAC calculation?

A. Mr. Yurick, I'm sorry, I'm not coming up with these numbers. I've completely forgotten how I did it. I do believe that these are the gross. I don't think they're incremental.

You are correct that JEH-2 does not reflect the incremental increase of the 2-1/2 percent in 2010 and 2011. That is correct.

Q. Okay. I guess my next question, maybe this is where I may have a point, then again, I may not, is that to the extent that those numbers are not reflected in 2010 and 2011 for the two companies, this JEH-2 doesn't really reflect the total incremental impact of the package; is that correct?

A. Yeah. Again, I didn't try to adjust the fuel for 2010 and 2011. I don't know what the other part of the FAC calculation would go to, and I did not reflect the additional 2-1/2 percent in there, I don't believe. I'm sure I didn't.

Q. Okay.

MR. YURICK: I don't have any further questions. Thank you very much.

THE WITNESS: Thank you.

MR. YURICK: Mr. Hess, I appreciate your testimony.

I have no further questions of this witness at this time, your Honor.

EXAMINER BOJKO: Mr. Resnik?

MR. RESNIK: Thank you, your Honor.

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CROSS-EXAMINATION

By Mr. Resnik:

Q. Mr. Hess, good afternoon.

A. Good afternoon.

Q. And this is -- I think before I get into what I had contemplated asking you, there's one question I want to follow up on. When you were talking about the 95 -- the 5 percent purchase and retaining the 95 percent. I thought you said something about there was a device to keep the 95 percent SSO at the current rate.

A. Yeah; exclusive of the other adjustments that we've recommended, yes.

Q. You're not trying to keep --

A. No.

Q. -- the SSO at the current rate. Great.

Now, you are the chief of the electricity and accounting division of the staff; is that right? For electricity and accounting division.

A. Yes.

Q. Were you involved in the preparation of the staff role in either the Duke or FirstEnergy standard service offer proceedings?

A. No, I wasn't.

Q. Okay. You have members of your team who work under you?

A. They don't necessarily report to me, but there are other staff members that did it, yes.

Q. And those other staff members would have been involved in these other proceedings?

A. Yes.

Q. Okay. And you had a sense of whether those other folks that worked on the other case and people who were working on this case agreed to whether they were just sort of taking it easy or actually busting their backsides to get everything done in time?

MS. GRADY: Objection.

MR. RANDAZZO: We'll stipulate that everybody's been dizzy.

MR. BOEHM: I think I heard an objection from back there, actually.

EXAMINER BOJKO: I mean, the witness can answer if he knows, I don't know the relevance.

Short leash, Mr. Resnik.

MR. RESNIK: That's fine. Thank you.

A. Mr. Resnik, I believe everybody's been busting their asses through Senate Bill 221, through the litigation with FirstEnergy, through the negotiations with Duke, through the litigation with your company.

Q. Okay. And just to complete it, as far as you're concerned, the staff did all that was reasonably possible to process this case on a timely fashion. Would you agree with that?

A. I hope we did, yes.

Q. Thank you.

I want to start with a discussion about the early plant closure and I think that that particular issue you address, at least initially, on page 2, line 10, and you refer there as it being a request to recover undepreciated value of certain generating plants. Do you see that?

A. Yes.

Q. Just to be clear, we're talking about, and as you understand it, the request is talking about the remaining undepreciated value, would that be right, as opposed to some original cost that had never -- without any depreciation netted against it?

A. I don't know the difference between remaining undepreciated value and undepreciated value.

Q. Okay.

A. As compared to -- what was --

Q. An original cost that had no depreciation netted against it.

A. Yeah. It is not the original cost. It's not the original value of the plant. It is the original value minus depreciation expense that has been accrued on that plant --

Q. Thank you.

A. -- over the years.

Q. Now, at page 8 of your testimony, lines 6 through 9, you refer to an agreement of the companies, as you say, not to impose lost generation charges on switching customers during the market development period.

A. Yes.

Q. And are you talking there about stranded costs?

A. I believe the statute referred to them as transition costs.

Q. Okay. But it was essentially the cost that was associated, to the extent it existed, would have been associated with the diminished value of generation assets due to the enactment of Senate Bill 3?

A. I don't believe Senate Bill 3 diminished the value of any assets.

Q. But that was -- I mean, that would be an issue to have been litigated back in those electric transition plan cases. What I'm asking you is was that what the focus was of an agreement not to impose lost generation charges on switching customers?

A. Yeah; transition charges, stranded costs, yes.

Q. Okay. And are you saying that those transition charges or stranded costs are comparable 1.

To a situation where a plant just has to be because of some event that occurs at the plant?

A. Well, my vision of what you were requesting was, yes, let's take this one plant which was going to have stranded cost, was not going to be available to us in a market, which is why you were going to retire it, due to the revenue flow that was generated by that plant, and let's just focus on that one plant and ask the customers to bear the burden of that.

Q. Now, you mentioned that you think there should be some sort of an offset, if I understand it correctly, that if such a request were made for recovery of the undepreciated cost of a plant that was prematurely retired, that that should be offset based on the market value of the other plants or the growth in the market value of the other plants?

A. No. The negative stranded cost from the other plants.

Q. And that's based on the market value of
those plants?

A. Yes.

Q. And you would make that recommendation
even though the companies are not -- will not be
permitted to charge in their standard service offer

the market value of those plants?

A. Yes. I mean, there is a short-term benefit that's being passed on to the customers, three years, and my point is it's just not long enough for me to consider asking the customers to bear the burden of this one -- these one or two plants that are retired during this period.

Q. But if one of those -- if that event occurs and there's an early retirement, would it be reasonable to at least during this three-year period defer the cost and then allow -- during this period, and then allow the Commission when it is establishing its next standard service offer to determine what should be -- how that deferral should be treated?

MR. RANDAZZO: I'm going to object. How is a deferral being created by early retirement of a plant?

MR. RESNIK: Well, that's what the application's requesting.

MR. RANDAZZO: Okay.

EXAMINER BOJKO: Answer if you know.

A. No. Again, I think I would recommend against that. It's just, the three-year plan here really doesn't give me enough confidence that -- enough assurance that, you know, there's -- that the

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481 value of the rest of the plants are being -- the positive plants are being used to offset it.

Q. And the positive value as you see it is based on the market value of the other plants; is that correct?

A. Well, as compared to what the standard service offer is, yes, that's correct.

Q. And, again, even though the market value is not being authorized in this proceeding.

A. Again, Mr. Resnik, it's too short of a period for me to suggest that.

Q. Well, I know you said that, and that's why I was trying to see what the problem was with a deferral within this period of time which you say is too short so that the Commission at the end of this period when we are proposing another standard service offer would have an opportunity in a broader scope of time to make that determination whether there should be recovery.

A. Again, there's just too much uncertainty for me to make that recommendation that the Commission should consider that in the next offering.

Q. Okay. At page 3, line 19 of your testimony you're talking about the portion of the proposal for the companies to earn a carrying charge on the incremental environmental investment.

A. Yes, sir, I see that.

Q. What is the process that you envision for this annual update to which you refer?

A. Probably similar to what we do with the AAC annual update in Duke. I think they make a filing in about October. It's reviewed by the staff or we make a recommendation to the Commission. The Commission decides whether or not to set it for public hearing.

Q. Okay. Now, I want to look at page 4 of your testimony where you discuss the recommendation for a distribution rate case in 2009, and in particular, you I believe testified that the enhanced service reliability program initiatives would be considered in that distribution base rate case.

A. Yes, sir.

Q. And at page 5, line 19, you're discussing the distribution rate case. You refer to in this case that the company would recover the cost of the additional reliability programs. Do you see that?

A. Yes, sir.

Q. Now, I'm just trying to figure out, are you saying that -- I want to make sure that I understand the proposal. Is it that the company go ahead, start the program, spend the money, defer the recovery of that, and apply for the recovery in the 2009 distribution base rate case?

A. Yes.

Q. And would it just be for those dollars that were spent within, as far as O&M, within the test year for that case, and to the extent that there are capitalized expenditures, that those would only get into rate base if they were used and useful at the date certain for that rate case?

A. Yes.

Q. And then at page 6 of your testimony, lines 19 and 20, we're still talking about the distribution base rate case, and you said that the companies and intervening parties would have the opportunity to publicly discuss these issues, that is, reliability issues, as well as plan a course for future expenditures with public input.

What did you have in mind by the concept of planning a course of future expenditures?

A. Well, we have a program going on in the gas industry where they're replacing mains, and there's a long-term plan that's authorized in an ALT case in the gas industry, so it's possibly a program like that.

I don't know that we have the legal authority to do that in an electric case, so the Commission may need to consider some kind of authorization out of this case to do something like that.

Q. Right. Is that latter part of your answer, is that based on the notion that the ESP statutory provision allows for what I'll refer to as single-issue item consideration within the context of distribution service?

A. Yes. And annual updates to that, yes. I don't think we have the authority under the ALR statute to do that.

Q. Okay. And so is it your recommendation to the Commission as part of its resolution of this case it should provide some mechanism for recovery by the company, perhaps some future -- determined ultimately with Commission approval, I suspect, but future determined course of expenditures?

A. Certainly to consider that in this case, yes.

Q. Okay. Now, as far as the dollars that are spent, let's say, starting today and then for consideration in the distribution base rate case, without asking you to assign a percentage of likelihood, but would those -- in your mind as far as you see this working out, would those expenditures and the recovery of those expenditures be subject to, say, the views of the service monitoring branch of the staff, arguing that either the proposed achieved improvements in reliability indices weren't enough to warrant any particular expense?

A. Well, I would hope you would be working with them during the period, but yeah, to the extent that, yeah, they would be included in that overview.

Q. Okay. The overview in this distribution base rate case you're talking about.

A. Yes. And as you continue with those expenditures even through today, even starting today.

Q. Thank you.

Now, I think that -- I'm not sure I noted -- well, I think it's on page 7 that you refer to that the company should defer these costs associated with the service reliability plans.

A. I believe there were two programs that either Baker -- I think Baker or Roberts were going to recommend to be begun, tree trimming and pole inspection programs. And I know there have been arguments from the company that we don't have the money to do that right now, so to the extent you begin those programs now, I think the Commission should authorize you the authority to defer those costs to be reviewed in the next distribution rate case.

Q. Okay. And they would be reviewed apparently not just in the context of whether those programs were reasonable and should have been undertaken, but, as you say at page 7, line 17, "whether there was a material impact on the Applicant's ability to recover a reasonable return for the distribution service."

A. Yes.

Q. Now, given those two standards, if you will, that would be applied to the recovery when we come in for a distribution rate case, do you believe as an accounting matter that if the Commission authorized us to defer these dollars associated with these programs now, that there would be a sufficient probability of recovery for us to actually defer them?

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

Q. Is that an issue, though, that you think the company and the Commission would need to consider?

A. Certainly the company needs to consider it as to whether or not they can book it.

Q. And I gather that you believe that putting aside for a moment the probability of recovery, do you have an opinion as to whether or not the deferral of distribution-related dollars would be permissible because under FAS 71 because distribution service is on a cost-of-service basis? Let me rephrase it.

A. I believe because it's a regulated entity, one of the criteria under 71.

Q. All right. Do you know whether it needs to be regulated on a cost-of-service basis?

A. I believe that's correct, yes.

Q. Okay.

A. Twenty-some years since I read that.

Q. Now, in the same distribution rate case, if I've got this right, you suggest that the companies at that time should seek recovery of the regulatory assets that Mr. Assante addressed in his testimony, the what I'll call historic regulatory assets.

A. Yes.

Q. Do you recall offhand what the groupings of those are?

A. No, sir, I don't.

MR. RESNIK: If I may give the witness a copy of page 36 from Mr. Assante's testimony where those categories are set out.

EXAMINER BOJKO: You may.

Q. Do you see those, Mr. Hess?

A. Yes, sir, I do.

Q. And I'd like to go through each of these to see whether or how you characterize them -- these particular categories as being either generation related or distribution related, okay?

A. Yes, sir.

Q. The carrying charges on distribution line extensions.

A. Distribution, most certainly.

Q. Okay. And the Mon Power integration expenses.

A. Distribution.

Q. What about the Ohio Voluntary Green Power Pricing program?

A. I don't know much about that.

Q. Okay. Let me just try to refresh your recollection on it, and if it you still don't remember, then just let me know. But do you recall that that program arose out of a remand from an Ohio Supreme Court opinion back to the Commission from the company's rate stabilization plan proceeding? Again, if you remember.

A. I don't know. Was this the REC program?

Q. The what?

A. The REC program.

Q. Yes.

A. Tammy's REC program.

Q. Tammy's REC program, yes.

A. She left.

I think the distribution company was required to do that, so I would have to say it was a deferred distribution company cost.

Q. Okay. What about the top one there, customer choice, consumer education, customer choice implementation, transition plan filing costs, how would you characterize that?

A. To me that would be a distribution company.

Q. Now, those costs, for instance, customer

choice implementation, those would have been in order
to implement the opportunity for customers to switch
generation providers; is that right?
A. I believe that, yes.
Q. And even though it's dealing with being
able to prepare or respond to generation customer

choice, you characterize that as a distribution expense.

MR. RANDAZZO: I object. Asked and answered.

MR. RESNIK: Your Honor, it seems to me I should be able to test the witness's thinking on this to some extent.

EXAMINER BOJKO: To some extent. I think the question's slightly different based on his prior response.

So you can answer if you can.

MR. RESNIK: Thank you.

A. I think it was a requirement of the distribution to inform its customers about choice.

Q. Okay. Now, is provider of last resort a duty that's imposed on the distribution function?

A. Yes.

Q. Okay. If the Commission were to determine that some of these regulatory assets that we've been reviewing from page 36 of Mr. Assante's testimony are generation in nature, would it be your recommendation to recover those as part of the distribution rate or as part of the non-FAC generation rate?

A. I'm sorry, could you ask me the question again?

MR. RESNIK: Could I have that it read back?

(Record read.)

A. Again, I think I've testified to all of them are distribution related.

Q. I understand that.

A. I don't see how the Commission could determine that they were generation related or why the Commission would determine they were generation related.

Q. Can you assume with me, I'm just asking the question, that if that determination were made by the Commission, would your recommendation then be that if the Commission found some of these were generation related, that they should be recovered through distribution rate or through the non-FAC portion of the generation rate?

A. I believe I remember something in the statute that said that the distribution company couldn't recover generation costs, so yeah, I think the generation rate would probably be the better mechanism for them.

Q. Okay. Thank you.

And do you recall the timing of the

company's proposed recovery of these reg assets?

A. No, sir.

Q. And again, if I can refresh your -- hopefully refresh your recollection, Mr. Baker testified that the company's proposal was to begin recovering these in 2011.

A. I do remember that, yes.

Q. Okay. Your proposal would -- assuming the case were filed in 2009, and just based on the 275 day period for ruling on base rate cases, your proposal would have the recovery of these reg assets starting sooner than what the company is proposing; is that right?

A. Yes, sir, that's correct.

Q. Okay. Let's talk about line extensions for a moment. Are you suggesting that the companies not collect any up-front charges associated with line extensions from the persons requesting the line extension?

A. I am suggesting the companies keep their current line extension policies in place until they are revised by the Commission in a distribution rate case.

Q. Okay. I want to just make sure I understood an answer that you gave Mr. Randazzo, and it had to do with this concept of levelization, just using the numbers that you had on your Exhibit JEH-2, say for Ohio Power, which total up, if you just total those three percentages, is 28 percent.

If I understood it correctly, you're not suggesting that you levelize it in some way so that at the end of the -- if it's three steps, at the end of the three steps the increases just total up to 28 percent, are you?

I think you were talking about --

A. No; there's economic considerations of carrying costs that would have to be accounted for.

Q. So it would be something greater than those numbers, of the 24, 2, and 2.

A. Because as Mr. Randazzo pointed out, there are additional costs associated with timing issues like that, the carrying costs on them, yes.

Q. Okay.

MR. RESNIK: I think that's all I have.

Thank you, Mr. Hess.

THE WITNESS: Thank you.

EXAMINER BOJKO: Any redirect?

MR. LINDGREN: Could we take a two-minute recess?

EXAMINER BOJKO: Two minutes, yes.

MR. RANDAZZO: Your Honor, I'd like to do this on the record. I meant to do this earlier.

On a personal privilege basis I'd just like to thank Mr. Hess for his service to the state of Ohio just in case this is the last time we get to talk to each other when he's under oath.

THE WITNESS: Maybe not.

MR. PETRICOFF: I think we all join in that, your Honor.

EXAMINER BOJKO: If you assume that this is the last time.

MR. RANDAZZO: It's a hypothetical, your Honor.

EXAMINER BOJKO: Take a recess.

(Recess taken.)

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

Do you have any redirect, Mr. Lindgren?

MR. LINDGREN: Thank you, your Honor, the staff has no redirect, but I would like to ask to have the revised Exhibit JEH-1 marked as staff Exhibit 1A to eliminate any confusion on the record.

EXAMINER BOJKO: Staff Exhibit 1A will be JEH-1.

(EXHIBIT MARKED FOR IDENTIFICATION.)

EXAMINER BOJKO: Is JEH-2 revised as well?

THE WITNESS: No.

EXAMINER BOJKO: It was just sent along with the revised 1?

THE WITNESS: Yes. That's correct. That was a little confusing.

MR. McNAMEE: That's the confusion we're trying to fix.

EXAMINER BOJKO: Thank you.

I have just a couple clarifying questions.

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EXAMINATION

By Examiner Bojko:

Q. Mr. Hess, you just had a nice discussion with Mr. Resnik about a distribution rate case and what would be in it and what not. And I must have misunderstood your testimony because I thought your

testimony was to wait and decide many of these issues
in that rate case, but what I thought I heard you say
to Mr. Resnik is some issues needed to be decided by
the Commission in this case.
            I guess can you clarify what exactly you
think the Commission needs to address in this case?

A. To the extent -- I know at one point in time the SMED group was talking about a continued reliability recovery mechanism like we have in the gas cases, like we have the AMRP, specifically in the AMRP with Duke, and I've tried to explain to them that I don't think we have the authority to do that under a typical base rate case -- under our typical base rate case authority.

I think that you do have the authority to establish some kind of a rate here at zero and the costs to be determined in the base rate case.

Q. Well, that's one of my other questions. So the zero rider, that's what you referred to on page 4 when you referenced Baker and Scheck and you talk about gridSMART. You're talking about that --

A. GridSMART and also reliability. I thought that Baker was going to testify to a zero tariff being created out of this case too for some of the reliability issues.

Q. Well, that's another question I have, because you just said gridSMART and you referenced the zero rider on page 4, but then you attribute it to Baker and Scheck, and the way I read Baker and Scheck was Baker was the distribution automation programs, he was recommending a zero rider, and then

Scheck was more the gridSMART, and so you just referenced gridSMART.

But I guess what you're talking about is any rider be set in this case at zero to cover either gridSMART or distribution automation or any other item that might come up.

A. I'm only suggesting that to the extent the Commission wants an ongoing program and continued cost recovery. I don't think you can do that in a distribution base rate case in the electric industry, unfortunately. I don't think we have the statute to do that. I think you need -- other than the statute we have here. I think you need to do it here.

Q. Do it here, you just mean establish the mechanism for recovery but you're not suggesting what would be included in that ultimate pot of dollars that would be recovered or whether the company, whatever they decided to request would be prudent in any way. You're not making those kind of judgments at this time.

A. That's absolutely correct.

Q. And then you said one more thing that I need clarification on. You said to Mr. Resnik that the line extension policies that they have in place today should continue until the next distribution rate case. And I guess did you mean continue till either an ESP order was issued addressing or continue until the Commission's rules became effective that explained what would happen with line extensions, or did you truly mean to whenever that distribution rate case might be?

A. I guess mentally the way I was thinking, I think our rules say there are standards that are established in the line extension, and I believe those rules say that the companies each need to file some kind of a case to comply with those standards. My vision was that that could be done in the next distribution rate case.

Q. So when you say their policies continue, the flat up-front payments only continue as long as -- until something else happens that the Commission may direct them to do with regard to the policies.

A. That's correct. Their policies are

actually a part of their tariffs. So I'm not sure that they can change those tariffs until they have Commission authorization, and I'm suggesting that that be done in the next distribution rate case to comply with the rules that suggest that they file some kind of a case before the Commission to make those changes.

Q. And again, that's assuming that they accept your recommendation to file a distribution rate case in 2009. What if they don't accept that recommendation?

A. Then I think to comply with the Commission's rules, they'll have to file some other kind of case to change their line extension policies.

EXAMINER BOJKO: Thank you. That's all I have. Thank you, Mr. Hess.

THE WITNESS: Thank you.

MR. LINDGREN: Your Honor, I would like to move the admission of staff Exhibits 1 and 1A.

EXAMINER BOJKO: Yes. On December 2nd we moved a portion of Mr. Hess's testimony, Staff Exhibit 1, so at this time is there any opposition to the admission of the remainder part Plaintiff Hess's testimony?

MR. RESNIK: No.

EXAMINER BOJKO: Hearing none, the entire testimony will be admitted.

(EXHIBITS ADMITTED INTO EVIDENCE.)

EXAMINER BOJKO: And I'm assuming you also would like to move the -- I think you did move the admission before my questions of JEH-1A.

MR. LINDGREN: Yes.

EXAMINER BOJKO: Is there any opposition to the admission of JEH Exhibit 1A?

MR. RESNIK: No.

EXAMINER BOJKO: It will be so admitted.

(EXHIBIT ADMITTED INTO EVIDENCE.)

EXAMINER BOJKO: Let's go off the record.

(Discussion off the record.)

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

First of all, I think Mr. Boehm would like to mark an exhibit.

MR. BOEHM: Yes, your Honor. I would like to have the direct testimony of Charles W. King marked, I think it's OEG Exhibit 4.

EXAMINER BOJKO: Yes. Is will be so marked.

MR. BOEHM: Okay.

(EXHIBIT MARKED FOR IDENTIFICATION.)

EXAMINER BOJKO: It will be so marked, and we'll handle the admission at a later time after the deposition is completed.

MR. BOEHM: Thank you, your Honor.

EXAMINER BOJKO: Mr. Resnik.

MR. RESNIK: Thank you, your Honor. I'd

like to have marked as Companies' Exhibit 14 the affidavit of proof of publication of the public notice for the public hearings that was directed by the Commission. I left the tear slips out. I'm not sure if everyone has taken an opportunity if they wanted to look at them. If you haven't, I can make a representation that at least one counsel took them home, took a look at them. I won't say who it was, but she returned them to me this morning.

MS. GRADY: You can say who it was. As my role as a Consumers' Counsel, I should be looking at that.

MR. RESNIK: Absolutely. So the affidavit's here. I don't know if anyone still wants to look at these proofs. I can leave them here, although I'm not going to leave them over the weekend break.

EXAMINER BOJKO: Okay. Did you -- I'm sorry, did you move the admission?

MR. RESNIK: Move for the admission of that Exhibit 14.

EXAMINER BOJKO: Any opposition to the admission of Companies' Exhibit 14?

Hearing none, it will be admitted.

(EXHIBIT ADMITTED INTO EVIDENCE.)

EXAMINER BOJKO: Rebuttal testimony must be filed by close of business on Monday, December 8th and transmitted to all parties, including the attorney examiners, electrically.

And we will resume the hearing to take cross-examination on that rebuttal testimony on Wednesday, December 10th, at 9 a.m.

Additionally, while we were off the record we discussed a briefing schedule. It has been determined that initial briefs in this proceeding will be due on December 30th and, again, that includes electronic service and transmission to the attorney-examiners. And reply briefs will be due on January 14th, again, electronically served and transmitted to the examiners.

Is there anything else before we conclude the hearing and adjourn until next Wednesday?

Hearing none, the hearing will be adjourned until Wednesday, the 10th, at 9 a.m.

MR. RESNIK: Thank you.

EXAMINER BOJKO: Thank you.

(The hearing adjourned at 12:56 p.m.)

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CERTIFICATE

I do hereby certify that the foregoing is a true and correct transcript of the proceedings taken by me in this matter on Friday, December 5, 2008, and carefully compared with my original stenographic notes.

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

(3310-MDJ)

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