

1 BEFORE THE PUBLIC UTILITIES COMMISSION OF OHIO

2 - - -

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

12 - - -

13 PROCEEDINGS

14 before Ms. Kimberly W. Bojko and Ms. Greta See,
15 Hearing Examiners, at the Public Utilities Commission
16 of Ohio, 180 East Broad Street, Room 11-C, Columbus,
17 Ohio, called at 9:00 a.m. on Wednesday, December 10,
18 2008.

19 - - -

20 VOLUME XIV

21 - - -

22

23 ARMSTRONG & OKEY, INC.

222 East Town Street, Second Floor

24 Columbus, Ohio 43215

(614) 224-9481 - (800) 223-9481

25 Fax - (614) 224-5724

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 APPEARANCES:

2 American Electric Power
By Mr. Marvin I. Resnik
3 Mr. Steven T. Nourse
One Riverside Plaza
4 Columbus, Ohio 43215-2373

5 Porter, Wright, Morris & Arthur, LLP
By Mr. Daniel R. Conway
6 41 South High Street
Columbus, Ohio 43215-6194

7
On behalf of Columbus Southern Power
8 and Ohio Power Company.

9 Janine L. Migden-Ostrander
Ohio Consumers' Counsel
10 By Ms. Maureen R. Grady
Mr. Terry L. Etter
11 Ms. Jacqueline Lake Roberts
Mr. Michael E. Idzkowski
12 Mr. Richard C. Reese
Assistant Consumers' Counsel
13 Ten West Broad Street, Suite 1800
Columbus, Ohio 43215-3485

14
On behalf of the Residential
15 Ratepayers of Columbus Southern Power
and Ohio Power Company.

16
Sherry Maxfield, First Assistant
17 Attorney General
Duane W. Luckey
18 Senior Deputy Attorney General
Public Utilities Section
19 By Mr. Werner L. Margard III
Mr. John H. Jones

20 Mr. Thomas G. Lindgren
 Assistant Attorneys General
21 180 East Broad Street, 9th Floor
 Columbus, Ohio 43215-3793
22
 On behalf of the staff of the Public
23 Utilities Commission of Ohio.

24

25

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 APPEARANCES (Continued):

2 Mr. Richard L. Sites
General Counsel, Ohio Hospital Association
3 155 East Broad Street, Floor 15
Columbus, Ohio 43215-3620

4 Bricker & Eckler, LLP
5 By Mr. Thomas J. O'Brien
100 South Third Street
6 Columbus, Ohio 43215-4291

7 On behalf of the Ohio Hospital
Association.

8 Mr. Joseph V. Maskovyak
9 Mr. Michael R. Smalz
Ohio State Legal Services Association
10 555 Buttles Avenue
Columbus, Ohio 43215

11 On behalf of the Appalachian People's
12 Action Coalition.

13 McNeese, Wallace & Nurick
By Mr. Samuel C. Randazzo
14 Ms. Lisa McAlister
Mr. Joseph M. Clark
15 Fifth Third Center, Suite 1700
21 East State Street
16 Columbus, Ohio 43215

17 On behalf of the Industrial Energy
Users of Ohio.

18 McDermott, Will & Emery
19 By Ms. Grace C. Wung
600 Thirteenth Street, NW

20 Washington, DC 20005-3096

21 On behalf of Wal-Mart Stores East, LP,
22 Macy's, Inc., Sam's East, Inc.

23

24

25

26

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 APPEARANCES (Continued):

2 Boehm, Kurtz & Lowry
By Mr. David Boehm
3 Mr. Michael Kurtz
36 East Seventh Street
4 Suite 1510
Cincinnati, Ohio 45202-4454

5
On behalf of the Ohio Energy Group.

6
Chester, Willcox & Saxbe, LLP
7 By Mr. John W. Bentine
Mr. Matthew S. White
8 Mr. Mark S. Yurick
65 East State Street
9 Columbus, Ohio 43215

10 On behalf of the Kroger Company.

11 Bell Royer, Co., LPA
Mr. Langdon D. Bell
12 Mr. Barth Royer
33 South Grant Avenue
13 Columbus, Ohio 43215-3927

14 On behalf of the Ohio Manufacturers
15 Association.

16 Bell Royer, Co., LPA
Mr. Barth E. Royer
17 33 South Grant Avenue
Columbus, Ohio 43215-3927

18
On behalf of the Ohio Environmental
19 Council and Dominion Retail.

20 Schottenstein, Zox & Dunn

By Mr. Andre Porter

21 Mr. Christopher Miller

Mr. Gregory Dunn

22 250 West Street

Columbus, Ohio 43215-2538

23

On behalf of the Association of

24 Independent Colleges and Universities of

Ohio.

25

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 APPEARANCES (Continued):

2 Vorys, Sater, Seymour and Pease, LLP
By Mr. M. Howard Petricoff
3 Mr. Michael J. Settineri
Ms. Betsy L. Elder
4 52 East Gay Street
Columbus, Ohio 43216-1008

5
Mr. Bobby Singh
6 300 West Wilson Bridge Road
Worthington, Ohio 43085

7
On behalf of Integrys Energy.

8
Vorys, Sater, Seymour and Pease, LLP
9 By Mr. M. Howard Petricoff
Mr. Michael J. Settineri
10 Ms. Betsy L. Elder
52 East Gay Street
11 Columbus, Ohio 43216-1008

12 Ms. Cynthia Fonner
500 West Washington Boulevard
13 Chicago, Illinois 60661

14 On behalf of the Constellation NewEnergy
and Constellation Commodity Energy Group.

15
Vorys, Sater, Seymour and Pease, LLP
16 By Mr. M. Howard Petricoff
Mr. Michael J. Settineri
17 Ms. Betsy L. Elder
52 East Gay Street
18 Columbus, Ohio 43216-1008

19 On behalf of EnerNoc, Inc. and
Consumer Powerline.

20

Vorys, Sater, Seymour and Pease, LLP

21

By Mr. M. Howard Petricoff

Mr. Michael J. Settineri

22

Ms. Betsy L. Elder

52 East Gay Street

23

Columbus, Ohio 43216-1008

24

On behalf of the Ohio Association of
School Business Officials.

25

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 APPEARANCES (Continued):

2 Mr. David C. Rinebolt
3 Ms. Colleen Mooney
4 231 East Lima Street
5 P.O. Box 1793
6 Findlay, Ohio 45839-1793

7 On behalf of Ohio Partners for
8 Affordable Energy.

9
10 - - -

11

12

13

14

15

16

17

18

19

20

21

22

23

20

21

22

23

24

25

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1	INDEX	
2	- - -	
3	WITNESSES	PAGE
4	Dr. Anil Makhija	
	Direct examination by Mr. Conway	11
5	Cross-examination by Mr. Kurtz	13
	Voir Dire by Ms. Roberts	20
6	Cross-examination by Mr. Randazzo	32
	Cross-examination by Ms. Roberts	41
7	Cross-examination by Mr. Maskovyak	43
	Redirect examination by Mr. Conway	54
8	Examination by Examiner Bojko	55
9	Philip J. Nelson	
	Direct examination by Mr. Nourse	58
10	Cross-examination by Ms. Grady	72
	Cross-examination by Mr. Randazzo	100
11	Cross-examination by Mr. Kurtz	110
	Cross-examination by Mr. Maskovyak	118
12	J. Craig Baker	
13	Direct examination by Mr. Resnik	125
	Cross-examination by Mr. Randazzo	130
14	Cross-Examination by Mr. Petricoff	155
	Cross-examination by Mr. Maskovyak	175
15	Cross-examination by Mr. White	210
	Cross-examination by Mr. Kurtz	226
16	Cross-examination by Ms. Roberts	236
	Cross-examination by Mr. Bell	256
17	Cross-examination by Mr. Rinebolt	264
18	- - -	
19		

20

21

22

23

24

25

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1	INDEX		
2	- - -		
3	COMPANIES' EXHIBITS	ID'D	REC'D
4	2E - Rebuttal Testimony of		
	J. Craig Baker	124	269
5			
	2F - LIBOR v. Treasury Rate Chart	125	269
6			
	5A - Rebuttal Testimony of		
7	Dr. Anil K. Makhija	12	57
8			
	7B - Rebuttal Testimony of		
	Philip J. Nelson	58	122
9			
10	OEG EXHIBITS	ID'D	REC'D
11	4 - Direct Testimony of		
	Charles W. King	V-XII	122
12			
	4A- Deposition Testimony of		
13	Charles W. King	122	122
14	- - -		
15			
16			
17			
18			
19			

20

21

22

23

24

25

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 Wednesday Morning Session,

2 December 10, 2008.

3 - - -

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

5 Good morning. This is a continuation of
6 08-917, 08-918-EL-SSO, being In the Matter of the AEP
7 Operating Companies Proposal for Electric Security
8 Plans.

9 My name's Kim Bojko. With me is Greta
10 See.

11 We'll take abbreviated appearances again
12 this morning.

13 MR. RESNIK: For the companies, Marvin
14 Resnik, Stephen Nourse, and Dan Conway.

15 MR. MASKOVYAK: For the Appalachian
16 People's Action Coalition, Joe Maskovyak and Mike
17 Smalz.

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

20 MR. MARGARD: Werner Margard, John Jones,

21 Tom Lindgren on behalf of the Commission staff.

22 MS. GRADY: On behalf of the residential

23 ratepayers of the companies, Janine L.

24 Migden-Ostrander, Consumers' Counsel, Maureen R.

25 Grady and Jacqueline L. Roberts.

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 MR. RANDAZZO: Joe Clark, Lisa McAlister,
2 and Sam Randazzo on behalf of the Industrial Energy
3 Users-Ohio.

4 MR. ROYER: If your Honors please, I'd
5 like to enter an additional appearance on behalf of
6 the Ohio Manufacturers Association, so please let the
7 record show of appearance of Barth Royer, Bell &
8 Royer Co., LPA.

9 MR. KURTZ: For the Ohio Energy Group,
10 Mike Kurtz and Dave Boehm.

11 MR. WHITE: For the Kroger Company, John
12 Bentine, Mark Yurick, and Matt White.

13 EXAMINER BOJKO: Thank you.

14 As we established at the conclusion of
15 last week of the case in chief, rebuttal testimony
16 was filed by three AEP witnesses on Monday the 8th,
17 and today we are putting those witnesses on the stand
18 and giving parties an opportunity to cross-examine
19 those witnesses.

20 Mr. Resnik, would you like to call -- oh,

21 Mr. Conway, would you like to call your first

22 witness?

23 MR. CONWAY: Thank you, your Honor.

24 The companies call Dr. Anil K. Makhija.

25 EXAMINER BOJKO: Mr. Makhija, you

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 remember that you are still under oath?

2 THE WITNESS: Yes, I do.

3 EXAMINER BOJKO: Thank you.

4 EXAMINER SEE: Mr. Conway.

5 MR. CONWAY: Thank you, your Honor.

6 - - -

7 DR. ANIL K. MAKHIJA

8 being previously sworn, as prescribed by law, was

9 examined and testified as follows:

10 DIRECT EXAMINATION

11 By Mr. Conway:

12 Q. Dr. Makhija, could you state your full

13 and correct name for the record, please?

14 A. My name is Anil Kumar Makhija.

15 Q. Dr. Makhija, you previously presented

16 direct testimony in this proceeding; is that correct?

17 A. Yes, I did.

18 Q. And you have prepared and it has been

19 submitted on your behalf rebuttal testimony in this

20 proceeding.

21 A. Yes, it has.

22 MR. CONWAY: Your Honor, at this time I'd

23 like to mark for identification purposes

24 Dr. Makhija's rebuttal testimony that was prefiled on

25 Monday, and I believe his original exhibit number was

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 5 for the companies, and if it's acceptable, I would

2 mark the rebuttal testimony as Exhibit 5A.

3 EXAMINER SEE: The exhibit is so marked.

4 MR. CONWAY: Thank you.

5 (EXHIBIT MARKED FOR IDENTIFICATION.)

6 Q. Dr. Makhija, you prepared this testimony

7 for submission in this proceeding?

8 A. Yes, I did.

9 Q. And do you have any corrections or

10 additions to the testimony that you would like to

11 make at this time?

12 A. Yes. At this time I would like to point

13 out on page 6, line 11, where it reads "Exhibit JRW-2

14 in Woolridge Direct," it's missing a closing

15 parentheses. So after the word "Direct" there should

16 be a closing parentheses.

17 Q. Thank you, Dr. Makhija. Do you have any

18 other changes or corrections to make at this time?

19 A. No.

20 Q. Dr. Makhija, if I were to ask you the
21 questions contained in your prefiled rebuttal
22 testimony which has been marked as Companies' Exhibit
23 5A, would your answers be the same as they appear in
24 that document?

25 A. Yes.

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 Q. And is that testimony true and accurate
2 to the best of your belief and knowledge?

3 A. I believe so.

4 MR. CONWAY: Your Honors, at this time I
5 would move for the admission of Companies' Exhibit
6 No. 5A, Dr. Makhija's rebuttal testimony, and
7 Dr. Makhija is available for cross-examination.

8 MS. ROBERTS: Your Honor, I would ask
9 that we move the exhibit of his -- the admission of
10 his testimony following cross-examination as it's
11 usually done.

12 MR. CONWAY: Excuse me, I didn't mean to
13 indicate that I was asking you to admit it at this
14 time. I just wanted to make sure I didn't forget to
15 move for its admission later.

16 EXAMINER SEE: Okay.

17 Mr. White?

18 MR. WHITE: I have no questions, your
19 Honor.

20 EXAMINER SEE: Mr. Kurtz?

21 MR. KURTZ: Thank you, your Honor.

22 - - -

23 CROSS-EXAMINATION

24 By Mr. Kurtz:

25 Q. Good morning, Doctor.

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 A. Good morning.

2 Q. The majority of your testimony, your
3 rebuttal testimony here, deals with critiquing the
4 other witnesses on how they chose the comparable
5 companies for their analysis; is that fair?

6 A. A fair amount of it does, but I also
7 provide justification in response for my own
8 methodology.

9 Q. Okay. And the comparable companies are
10 used for 2007 just as an example; in actuality, the
11 Commission will use a future year, correct?

12 A. That's right.

13 Q. And the comparable earnings is the first
14 step in establishing the threshold for the
15 significantly excessive earnings test?

16 A. If you mean by that the establishing of
17 the ROEs for the comparable firms, that's correct.

18 Q. Now, I'd like to -- there were four
19 witnesses on this topic, and I'd just like to

20 understand what the return on equities were that the
21 various witnesses came up with in 2007. On page 6,
22 was Dr. Woolridge's return on equity for the
23 comparable groups 11.37 percent as shown on line 12?
24 A. Yes. That's the average ROEs that he got
25 for his 64 comparable firms.

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 Q. And for Mr. King, the OEG witness, he was
2 at 12.2 percent?

3 A. I recall that that's correct, yeah.

4 Q. Did you recall what Mr. Gorman's
5 comparable return on equity was?

6 A. I believe since he didn't form a
7 comparable group, what he did was he took a 2 percent
8 adder to the 10.5 and came up with 12.5.

9 Q. That was the ultimate recommendation, but
10 the first starting point, he was at 10.5?

11 A. Yes, he started with that.

12 Q. And based upon your examination of the
13 comparable groups in 2007, what was your return on
14 equity starting point?

15 A. Yeah, for the illustrative group of 25
16 firms, it was 13.91, I believe.

17 Q. 13.9.

18 A. Yeah.

19 Q. So we have you at 13.9, Mr. Gorman at

20 10.5, Mr. Woolridge at 11.37, and Mr. King at 12.2.

21 A. According to the different methodologies,
22 they have arrived at very different numbers, yes.

23 Q. Well, I guess actually these numbers are
24 fairly close in the sense, wouldn't you agree, that
25 the range is the low of 10.5, the high of 13.9, 340

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 basis points or 3.4 percent difference between the
2 high end and the low end?

3 A. Well, it's a material difference I think,
4 but, nevertheless, that's what it is, yes.

5 Q. Okay. But the real -- the bigger
6 controversy is, isn't it true, is how you get from
7 the starting point to the threshold for significantly
8 excessive. You end up at, I recall, 26, 27 percent?

9 A. 17.33, yes.

10 Q. 27 point --

11 A. 3.

12 Q. .3, okay. And the other witnesses add
13 150 or 200 basis points to their starting point; is
14 that right?

15 A. Yes.

16 Q. Okay. So would you agree that the bigger
17 controversy or the bigger question or the more
18 important issue is how you get from the starting
19 point, you've basically doubled the starting point

20 from 13.9 to 27.3, whereas all they've done is

21 increment it up by 200 basis points or thereabouts?

22 A. The issue actually is that the mean and

23 the standard deviation to which you are referring are

24 not truly separable items because of the differences

25 in methodology. When we try to compare only one

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 aspect of it, it turns out to be a bit of an apples
2 and oranges comparison.

3 Q. But mathematically when they add 200
4 basis points to 11 percent, 12 percent, 10 percent,
5 it's about a 20 percent adder or less, and you
6 basically have a hundred percent adder on your
7 recommendation going from 13.9 percent to
8 27.3 percent.

9 MR. CONWAY: Objection. That misstates
10 the record. Your assertion about the 150, 200 basis
11 points is not an accurate recap of what the other
12 witnesses' positions are. You got Dr. Woolridge that
13 you're leaving out of it and you have Mr. Cahaan that
14 you're leaving out of it.

15 MR. KURTZ: I think I did. Dr. Woolridge
16 was, or Mr. Woolridge was 150 --

17 THE WITNESS: Only in one of his
18 methodologies.

19 MR. CONWAY: So it's inaccurate.

20 EXAMINER SEE: Just a minute, gentlemen.

21 MR. KURTZ: I don't understand the

22 objection. I thought the doctor agreed with the

23 foundation and the basic premise of the question.

24 MR. CONWAY: Your Honors, that is flatly

25 not accurate. Dr. Woolridge had two approaches that

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 he used, one of which included a 4-1/2 percent adder,
2 and then Mr. Cahaan had an adder which is not 200
3 basis points but is in the range of 200 to 400 basis
4 points. So the premise to the question is not
5 accurate, and I object to it.

6 EXAMINER SEE: And your objection is
7 noted. If you feel that it's -- you can take it up
8 on redirect of Dr. Makhija.

9 MR. KURTZ: Thank you, your Honor.

10 Q. (By Mr. Kurtz) In any event, I just want
11 to sort of wrap up here. Looking at just these
12 numbers, wouldn't you agree that the bigger
13 difference in your recommendation versus the other
14 witnesses is how you get from the starting point up
15 to the significantly excessive threshold, you used
16 the two standard deviations and they used a different
17 methodology and that's why we get -- your
18 recommendation sort of doubles the starting point and
19 theirs does not?

20 A. Well, the starting point, of course, is a
21 little more fundamentally different because their
22 methodologies are built to pick up largely utilities
23 and, therefore, it's hard wired in a way to produce
24 lower variances.

25 So, in fact, the difference in numbers is

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 not merely that of the numbers themselves, but a more
2 fundamental methodological difference, and which is
3 why I'm finding the comparison of their standard
4 deviations with my standard deviations not an
5 equivalent conversation.

6 Q. Just mathematically speaking, if we took
7 your starting point of 13.9 and took the
8 recommendation of at least some of the witnesses to
9 add 200 basis points, we would be at 15.9 percent,
10 just mathematically speaking.

11 A. Well, if you want to take that kind of
12 exercise, you might also want to bring us on an equal
13 footing, which would require that we have comparable
14 confidence levels, so right now if you're comparing
15 incomparable confidence levels, you would also want
16 comparable definitions of ROE, whereas in my
17 definition I'm looking at the bottom line for the
18 shareholder net of all items. So consequently those
19 variances are not as comparable as they appear merely

20 by looking at the numbers themselves.

21 Q. Mathematically you would agree, though,

22 that 13.9 percent plus 2 percent is 15.9 percent.

23 A. For that unique setting, which doesn't

24 carry over to the other way of developing the groups.

25 Q. Okay.

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 MR. KURTZ: Thank you, your Honor. Those
2 are all my questions.

3 EXAMINER SEE: Mr. Royer.

4 MR. ROYER: No questions, your Honor.

5 EXAMINER SEE: Mr. Randazzo?

6 MR. RANDAZZO: Just a couple. But I
7 understand OCC may have a motion to strike, and
8 before I do any questions, it may be better to get
9 that out of the way.

10 EXAMINER SEE: Ms. Roberts?

11 MS. ROBERTS: Yes, if I may. If I may
12 ask a couple foundational questions, your Honor, for
13 my motion.

14 - - -

15 VOIR DIRE

16 By Ms. Roberts:

17 Q. Dr. Makhija, if you would turn to page 4
18 of your testimony, the question beginning on line 9
19 and following over onto page 5, lines 1 and 2, is

20 there any information in this question that is

21 inconsistent with your direct testimony in this case?

22 A. I'm sorry, what page number and what line

23 again, please?

24 Q. Page 4.

25 A. Yes.

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 Q. The question beginning on line 9.

2 A. Yes.

3 Q. And the answer carries over onto page 5,
4 the first two lines.

5 MR. CONWAY: I'm sorry, I didn't catch --
6 the first two lines of page 5, is that --

7 MS. ROBERTS: Yes.

8 EXAMINER BOJKO: What was your question?

9 MS. ROBERTS: My question was, is there
10 any information in this that is inconsistent with
11 what he filed in his direct testimony.

12 A. I stand by the answer of the material you
13 pointed out.

14 Q. Thank you. And if you turn to page 11,
15 the question beginning on line 8, the answer carries
16 over onto page 12 and 13 and 14, and 15 and ends at
17 line 3 on page 15. Do you see that?

18 A. Page 11 starting line 8 --

19 Q. Yes.

20 A. -- and going on to page 15.

21 Q. Line 3.

22 A. Line 3.

23 Q. Do you want to take a second to look at

24 that?

25 A. Yeah.

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 MR. CONWAY: If I might have a
2 clarification, the end of the section that you're
3 directing his attention to is page 15. I apologize,
4 but what line on page 15?

5 MS. ROBERTS: 3.

6 A. I stand by what I have provided here.

7 Q. And it's consistent with your direct
8 testimony.

9 A. I believe so.

10 Q. All right. And if you look at page 15,
11 line 5, the section that starts "Book Common
12 Equity" --

13 A. Yes.

14 Q. -- through line 16, the sentence ending
15 on line 16, this is also information that was in your
16 direct testimony; is that correct?

17 MR. CONWAY: Excuse me. Could I, again,
18 I'm sorry, Ms. Roberts, where does it start?

19 MS. ROBERTS: Page 15, line 5, through

20 page 15, line 16, the sentence ending "equity divided
21 by total assets."

22 EXAMINER BOJKO: Now, what was your
23 question?

24 MS. ROBERTS: This is information that
25 was included in his direct testimony.

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 THE WITNESS: Could you repeat the lines
2 in the last set you just want me to look at?

3 Q. Line 16.

4 A. Okay.

5 Q. The sentence ending "equity divided by
6 total assets, period" from line 5 through the end of
7 that sentence.

8 A. Oh, I see. Let me just look.

9 I'm okay with this.

10 Q. And this is information that was in your
11 direct testimony.

12 A. I believe it's consistent with the
13 analysis that was provided in the exhibits of my
14 direct testimony.

15 Q. Thank you.

16 And on page 16, Dr. Makhija, at the top
17 of the page you discuss "Asset Turnover" and that
18 discussion ends -- the sentence ending on line 8 at
19 "risk." This was also addressed in your direct

20 testimony, was it not?

21 A. Could you please repeat the page numbers?

22 Q. Page 16.

23 A. Yes.

24 Q. Line 1, through line 8, the sentence on

25 line 8, ending on line 8 with the word "risk,

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 period."

2 MR. CONWAY: You're asking him whether
3 these lines are consistent with his direct testimony
4 or are different from it; is that right?

5 MS. ROBERTS: Consistent, yes.

6 MR. CONWAY: Including the last phrase in
7 there.

8 MS. ROBERTS: Ending on line 8 with the
9 word "risk, period."

10 MR. CONWAY: Okay.

11 A. I believe so.

12 Q. And on line 17 -- excuse me, on page 17,
13 line 21, you discuss the earned rate on common equity
14 and that discussion carries over to page 18, line 10.
15 Can you look at that? Page 17, line 21, through page
16 18, line 10.

17 A. I'm fine with that, too.

18 Q. And that was information that's
19 consistent with your direct testimony; is that

20 correct?

21 A. Yes.

22 MS. ROBERTS: Your Honor, the testimony

23 that I've just indicated and discussed with

24 Dr. Makhija is actually not rebuttal testimony but

25 additional direct testimony. It is not offered to

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 contest the evidence presented by opposing parties,
2 it is a restatement of his direct testimony. He is
3 repeating or expanding upon his positions in his
4 direct testimony, and under the case of In the Matter
5 of Ameritech-Ohio Economic Costs for Interconnection,
6 PUCO case number 96-922, the Commission has routinely
7 limited rebuttal testimony to testimony that a party
8 could not have presented in the direct part of their
9 case.

10 And the items that I've identified in
11 Dr. Makhija's testimony fail that test and on that
12 basis would move to strike those portions of his
13 testimony.

14 EXAMINER SEE: Mr. Conway, did you wish
15 to respond?

16 MR. CONWAY: Thank you, your Honor. Let
17 me see if I can just go through these and touch on
18 the individual sections that counsel identified for
19 the witness.

20 I think the first one was, as I recall,
21 page 4 where the question starts out by asking
22 Dr. Makhija, "What are the issues surrounding the
23 identification of the comparable group?" And the
24 issues he's identifying are the issues that are
25 raised by all the testimony that's been submitted on

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 this issue, on this topic, and he's simply setting up
2 his explanation of what his responses are to the
3 differences or the unique characteristics of the
4 competing proposals for how one would go about
5 constructing a comparable group. And so that is the
6 purpose of the answer to the question that starts on
7 page 4 at line 9 and continues on to page 5 at line
8 2.

9 And I would just point out that at the
10 end of that sentence he explains that he will review
11 the relevant merits and application of these measures
12 after he summarizes the methodologies that have been
13 proposed for the formation of the comparable group.
14 So all of it is introductory to the issues that have
15 emerged as a result of several witnesses that have
16 testified on this topic.

17 The next section that was identified,
18 which I must confess that I am not sure which page it
19 started on.

20 MS. ROBERTS: Page 11.

21 MR. CONWAY: Page 11.

22 Again, if the section was the question

23 starting at line 8 and continuing on to page 15, he

24 is -- for purposes of setting up his response to the

25 competing proposals, he does summarize his testimony,

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 but he also specifically addresses starting on page
2 12 the merits of using an unlevered beta for
3 measuring a comprehensive weight business risk which
4 has gotten criticism from Mr. Cahaan in his direct
5 testimony.

6 So I think that's responsive to explain
7 what the basis is that he has for believing that
8 unlevered beta risk, notwithstanding criticisms that
9 have been raised about it, is a useful and a
10 comprehensive tool for measuring business risk. And
11 that is the purpose of the testimony through the top
12 of page 15, line 3.

13 With regard to the book common equity
14 discussion that begins on page 15, line 5 and
15 continues on to the bottom of that page, he explains
16 where there is a debate among the witnesses which is
17 important to clarifying where there is debate, that's
18 the first part of that answer.

19 In the second part of the answer he

20 explains what the differences are in the witnesses'
21 that have, particularly Mr. Woolridge's testimony,
22 what the difference is between the two, and he
23 indicates what the problem is that he indicates
24 results from the difference. So in order to tell
25 what the difference is, you've got to reiterate what

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 the starting point is.

2 With regard to the asset turnover
3 discussion at the top of page 16, lines 1 through 9,
4 at least two of the witnesses relied heavily on asset
5 turnover as a measure of business risk. He's
6 pointing out here that he's not opposed to using that
7 as an additional measure to his unlevered beta
8 approach to comprehensively measuring business risk.

9 So I think that, in particular, I'd just
10 note that the introduction of that response by him
11 where he's actually saying that he's not opposed to
12 the use of this additional factor, he points out that
13 the additional use of capital intensity, that is the
14 asset turnover ratio which he did not use in his
15 original work, would produce an overreliance on the
16 single measure of business risk that he has proposed.

17 So it's clearly explaining what the basis
18 is for his response to the different proposals that
19 have been made, and the fact that he's indicating

20 he's not opposed to it doesn't make it any less a

21 matter for rebuttal.

22 Is there anything after that, Counsel?

23 MS. ROBERTS: After page --

24 MR. CONWAY: Page 16.

25 EXAMINER SEE: Page 17.

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 MS. ROBERTS: No, after page 18.

2 EXAMINER SEE: Page 17, line 21, to page
3 18, line 10.

4 MS. ROBERTS: Yes, your Honor.

5 MR. CONWAY: There was also a difference
6 among the witnesses with regard to the inclusion or
7 exclusion of one-time items or extraordinary items,
8 and Dr. Makhija is pointing this out and he's also
9 indicating what his view is in the difference that
10 has emerged from that discussion. So that's also a
11 proper subject for rebuttal testimony.

12 And I think that the first criticism that
13 we heard was that some of this is reiterative of his
14 direct testimony. I'd just point out for you in
15 order for the testimony to make sense about what it
16 is he's responding to, you've got to have some point
17 of origination for the discussion. You've got to
18 have some anchor for it, and that's what the purpose
19 of it is.

20 Finally, I would just note that Mr. Kurtz
21 has already started his cross-examination, has
22 completed his cross-examination of the witness, and
23 the proper time to have raised a motion would have
24 been at the outset rather than after we already
25 started our cross-examination.

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 So I would request that the motion be
2 denied and allow the cross-examination to continue.

3 MS. ROBERTS: May I respond?

4 EXAMINER SEE: Ms. Roberts, I have a
5 question for you. You referred to case No. 96-922.

6 MS. ROBERTS: I'm sorry? 96-922, yes.

7 EXAMINER SEE: Okay. What portion of
8 that case are you referring to?

9 MS. ROBERTS: Referring to the language
10 addressing the -- when the Commission limits rebuttal
11 testimony.

12 EXAMINER SEE: Do you have the page?

13 MS. ROBERTS: Page 5.

14 MR. CONWAY: It's page 12, line 20 it's
15 discussed. Is that what you're referring to?

16 EXAMINER SEE: I'm sorry, Ms. Roberts,
17 you said page 5?

18 MS. ROBERTS: Yes, the entry at 5.

19 EXAMINER SEE: The entry. What date?

20 MS. ROBERTS: January 29th, 2001. I

21 may have a copy of it.

22 EXAMINER SEE: Okay.

23 MR. CONWAY: Excuse me, your Honor. Now

24 I'm not on the same page as the rest of you. Which

25 reference were you asking about?

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 EXAMINER SEE: I'm talking about in
2 Ms. Roberts' request to strike, such motion she
3 referred to Commission case number 96-922-TP-UNC, and
4 I asked her what entry or order she was referring to.
5 I think she just said January 29th, 2001.

6 MS. ROBERTS: That's right, your Honor.

7 EXAMINER BOJKO: It is quite a
8 coincidence that the doctor also refers to that same
9 case. That's the confusion.

10 MR. CONWAY: May I -- excuse me.

11 EXAMINER SEE: Go ahead, Mr. Conway.

12 MR. CONWAY: Thank you. My understanding
13 was that she objected to Dr. Makhija's reference to
14 the Ameritech TELRIC case. No?

15 EXAMINER BOJKO: No.

16 MR. CONWAY: I'm sorry.

17 MS. ROBERTS: It's a colossal
18 coincidence.

19 EXAMINER SEE: And you said you have a

20 copy of that entry?

21 MS. ROBERTS: I do not have it with me

22 but I'd be happy to provide it.

23 EXAMINER SEE: No need.

24 Let's take five minutes.

25 (Recess taken.)

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 EXAMINER SEE: Let's go back on the
2 record.

3 In considering OCC's motions to strike
4 Dr. Makhija's testimony and reviewing case
5 No. 96-922, entry dated January 29th, 2001, we find
6 that the items -- the portions of Dr. Makhija's
7 testimony which they have requested be stricken, the
8 request should be denied.

9 While it may repeat pieces of
10 Dr. Makhija's direct testimony, it lays out a
11 foundation and then goes on to make comparisons with
12 the arguments made by other parties, and for that
13 reason the motion to strike is denied.

14 Mr. Randazzo.

15 MR. RANDAZZO: Thank you.

16 - - -

17 CROSS-EXAMINATION

18 By Mr. Randazzo:

19 Q. Without further ado, good morning,

20 Doctor.

21 A. Good morning.

22 Q. I just have a few questions for you, and

23 I want to make sure I understand your position. Can

24 you tell me how you define earnings?

25 A. In my direct testimony I had defined

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 earnings as the bottom line of what shareholders
2 experience, consequently it was net income in which
3 preferred had been removed and, however, one-time
4 nonrecurring items were taken into account. This
5 would be consistent with what the shareholders --
6 common shareholders ultimately experience and is
7 consistent with what you hear all the time when
8 people say what are the earnings per share.

9 Q. Okay. And so if I were to pursue that a
10 little bit further, the dollar math that you've just
11 described is the product of revenues less,
12 effectively, the cost of goods sold including the
13 interest expense associated with debt and preferred
14 dividends, right?

15 A. That's correct.

16 Q. So we essentially have a dollar amount
17 that's available for common shareholders adjusted to
18 remove extraordinary items, as you mentioned, that is
19 the residual after excluding the cost associated with

20 providing the service, right?

21 A. Yes.

22 Q. Okay. Now, do you get the sense from
23 your review of the legislation that the goal of the
24 legislation is to produce a revenue stream that
25 provides the utility with excessive earnings?

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 A. My understanding is that the purpose of
2 this legislation, and I'm not a lawyer --

3 Q. Sure.

4 A. -- is to prevent excessive earnings.

5 Q. Right. And the best way of doing that
6 would not be through a retrospective test, it would
7 be by looking at the relationship between revenues
8 and costs on the front end, right?

9 A. Unfortunately, on that part I don't agree
10 because the wording, as I see it, is explicitly
11 retrospective. It talks about earned returns. It
12 looks on an annual basis looking back, so this is, I
13 believe, remarkably different from the typical rate
14 hearing cost-of-capital prospective analysis.

15 Q. Well, I understand that perspective
16 relative to the application of the excessive earnings
17 test, but if we were trying to avoid fighting over
18 how to measure excessive earnings and what list of
19 comparables should be used, we should on the front

20 end of the analysis try to provide the utility with a

21 revenue stream that would not give the utility too

22 much or too little in the way of earnings, right?

23 MR. CONWAY: Objection. This witness is

24 not being presented to opine about what methods might

25 be used to avoid the application of the significantly

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 excessive earnings test. His testimony is directed
2 towards providing an approach for actually applying
3 the test. So I object to it's outside the scope of
4 his rebuttal testimony. It's outside the scope of
5 even his direct testimony, which is, of course, not
6 fair game here in this proceeding.

7 So on those two objections I would ask
8 that the question be not allowed.

9 EXAMINER SEE: Mr. Randazzo, do you want
10 to respond?

11 MR. RANDAZZO: Yes, your Honor. On page
12 19 of the witness's testimony he responds to
13 Mr. Cahaan's observations about statistical methods
14 failing to recognize the rate stabilizing and
15 earnings stabilizing impact that comes from an ESP
16 case. So I think this broader context is completely
17 appropriate and is actually a subject that is
18 initiated by the witness's testimony.

19 MR. CONWAY: That's absolutely a

20 mischaracterization of what the witness is testifying

21 to on 19. He's not talking about --

22 EXAMINER SEE: Thank you, Mr. Conway.

23 I'm going to -- your objection is

24 overruled.

25 Q. (By Mr. Randazzo) Do you recall the

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 question, Doctor?

2 A. Please repeat it.

3 MR. RANDAZZO: Could I have the question
4 read back, please?

5 (Record read.)

6 A. In my testimony what I have done is
7 applied the wording of the significantly excessive
8 earnings test as it stands, which is to look at
9 earnings that have actually been experienced. What
10 you are suggesting is a new test, and I'm not certain
11 whether the narrow confines of 4928.143(F) actually
12 permits me to do that.

13 While I may have some personal opinions
14 about the alternative desirable ways of controlling
15 excessive earnings, the prospective methodology that
16 you have just suggested appears not consistent with
17 the one presented in the existing legislation.

18 Q. Okay. Thanks for that answer.

19 What happens if the Commission finds that

20 there are excessive earnings, significantly excessive

21 earnings? What is the consequence of that?

22 A. Well, that issue, as you know, has not

23 been attempted in my direct testimony or in my

24 rebuttal; however, you might note that there is

25 wording in 4928.143(F) about it. It's simply beyond

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 the scope of the analysis, which is to develop a
2 methodology to determine excessive and not its
3 consequences.

4 Q. Okay. Very good. Then for purposes of
5 your testimony you haven't looked at the broader
6 context of what the legislation or the policy
7 objectives of the General Assembly might be relative
8 to electric security plans; you have just focused,
9 rather, mechanically on how the excess --
10 significantly excess earnings test might be computed.

11 MR. CONWAY: Objection.

12 Q. Correct?

13 EXAMINER SEE: Mr. Conway.

14 MR. CONWAY: It's not mechanic -- a
15 mechanical approach; it is a holistic, and I would
16 characterize it as a --

17 MR. RANDAZZO: Withdraw the "mechanical."
18 I'm sorry, I'm trying to get through this in some
19 reasonable time.

20 EXAMINER SEE: Thank you.

21 A. I have indeed focused on the
22 methodological aspect of the determination of
23 significantly excessive earnings.

24 Q. Okay. And if there are other things in
25 the legislation that the Commission needs to take

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 into account for purposes of developing a plan, an
2 overall plan, an electric security plan, you have not
3 taken those things into account for purposes of your
4 recommendations on how the significantly excess
5 earnings test should be computed, correct?

6 A. I have narrowly focused on the
7 development of an illustrative methodology for the
8 determination of significantly excessive earnings.

9 Q. Thank you for that.

10 On page 6 at the top of the page, line 1,
11 where you were in the course of criticizing some of
12 the approaches taken by some of the other witnesses
13 in the case, you say that on the -- carrying over
14 from page 5 to the top of page 6 you make reference
15 to a sample that is made up overwhelmingly of
16 regulated firms. What do you mean by "regulated
17 firms" there?

18 A. As you might note from Mr. Woolridge's
19 exhibits, in this reference the regulated firms go to

20 gas, water, et cetera.

21 Q. Do you regard Columbus & Southern and

22 Ohio Power to be regulated firms?

23 A. Which is perhaps the reason why we have

24 this discussion, because they are under the purview

25 of the Public Utility Commission.

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 Q. Right. The fact that we're here sort of
2 suggests that they're regulated firms, right?

3 A. Yes.

4 Q. On page 7 you make reference to
5 FirstEnergy's electric distribution utilities. Are
6 you there referring to the Ohio electric distribution
7 utilities of FirstEnergy?

8 A. Yeah. I might very quickly add the
9 purpose of this example is simply to illustrate that
10 there can be risk differences across utilities,
11 whereas the methodology that we are referring to in
12 this particular section by Mr. Woolridge takes no
13 specific aspects of the subject utility into account
14 in developing a comparable group.

15 Whether or not we agree on the specifics
16 of FirstEnergy is actually not material to me,
17 rather, that if such differences could exist, would
18 it not be important that our methodology hone in and
19 capture the business and financial risks of the

20 subject utility? The methodology being presented by
21 Mr. Woolridge simply ignores the risk characteristics
22 of the subject utility.

23 MR. RANDAZZO: I would move to strike
24 everything after "yes."

25 EXAMINER SEE: Read back the question and

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 the answer, please.

2 (Record read.)

3 EXAMINER SEE: Mr. Conway.

4 MR. CONWAY: Thank you, your Honor. I

5 think the witness provided a yes with an explanation

6 and gives context to the answer so I think it's

7 appropriate.

8 EXAMINER SEE: I'm going to grant

9 Mr. Randazzo's motion to strike everything after

10 "yes."

11 Q. (By Mr. Randazzo) On page 19,

12 Dr. Makhija, of your rebuttal testimony beginning at

13 line 16 you indicate that: "If the methodology for

14 matching business and financial risk is effective,

15 the stabilization impact of the ESP will show up in

16 the EDU's unlevered beta." My question to you is

17 when will it show up?

18 A. As you're aware, betas themselves are

19 periodically updated and since this -- since this

20 SEET, S-E-E-T or significantly excessive test, is
21 applied retrospectively, it will show up in the betas
22 during that year.

23 Q. Might it show up in the unlevered beta
24 after the term of the ESP?

25 A. I expect that the market shows a degree

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 of efficiency incorporating risks in the pricing of
2 stock which, in turn, leads to adjustments of the
3 betas, so it will begin to show up as people
4 recognize the risks.

5 Q. So would that situation exist now? Would
6 it show up in the unlevered beta now?

7 A. To the extent that there is uncertainty
8 about this isometrical test, the market is presumably
9 beginning to incorporate such risks.

10 Q. Okay.

11 MR. RANDAZZO: That's all I have.

12 Thank you very much, Doctor.

13 THE WITNESS: Thank you.

14 EXAMINER SEE: Ms. Roberts?

15 MS. ROBERTS: Thank you.

16 - - -

17 CROSS-EXAMINATION

18 By Ms. Roberts:

19 Q. Dr. Makhija, in questioning by Mr. Kurtz

20 you were discussing the mean and the standard
21 deviation and how they really weren't separable; is
22 that a fair characterization of --

23 A. Yes.

24 Q. -- part of that discussion?

25 Wouldn't you agree, Dr. Makhija, that the

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 higher the confidence level that you use in your
2 standard deviation, the greater the likelihood that
3 the companies will never earn significantly excess
4 earnings?

5 A. Yes. It will reduce the likelihood of
6 false positives.

7 Q. Does that mean it would reduce the
8 likelihood of the company earning significantly
9 excess earnings?

10 A. That's tautological. I think the moment
11 you tell me a level of confidence, then that defines
12 what is the significantly excessive.

13 Q. All right. And is the use by other
14 witnesses in this case of an 85 percent confidence
15 level less likely to produce -- less likely to
16 produce significantly excess earnings than if a
17 higher confidence level is used as you have used?

18 A. No. Just the other way around. If you
19 choose a lower confidence level, then the likelihood

20 of producing false positives goes up, and that is,
21 more cases of significantly excessive will be arrived
22 at.

23 Q. Will be -- I'm sorry?

24 A. We would arrive -- there is a greater
25 likelihood of arriving at earnings that are deemed

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 significantly excessive if you lower the confidence

2 level.

3 Q. And if you raise the confidence level,

4 there's less likelihood that you will identify

5 companies with significantly excess earnings.

6 A. That is correct.

7 Q. And in your application of the standard

8 deviation methodology, you've assumed a normal

9 distribution curve; is that correct?

10 A. So have all the other witnesses in this

11 case.

12 Q. You have as well, correct?

13 A. Yes.

14 MS. ROBERTS: I have no other questions.

15 EXAMINER SEE: Mr. Maskovyak?

16 MR. MASKOVYAK: Thank you, your Honor.

17 Just a few questions.

18 - - -

19 CROSS-EXAMINATION

20 By Mr. Maskovyak:

21 Q. Good morning, Dr. Makhija.

22 A. Good morning.

23 Q. I'd like you to turn to page 8 of your

24 testimony. Are you there?

25 A. Yes.

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 Q. Beginning at line 4 what we refer to as
2 the King procedure, and you talk about the SEE test
3 requiring the formation of one comparable group. Do
4 you see that?

5 A. Yes.

6 Q. I assume you're familiar with Senate Bill
7 221.

8 A. Yes, I've read it.

9 Q. And I assume that it is from Senate Bill
10 221 that you use as the basis for stating that it is
11 required to have only one group of comparable firms.

12 A. That's my interpretation of the bill
13 because it makes a statement which I will repeat. It
14 talks about comparison with "publicly traded
15 companies, including utilities."

16 Q. Can you tell us from where you're
17 reciting, Dr. Makhija?

18 A. This is my recall of the 4928.143(F)
19 section of SB 221.

20 Q. Are you reading from section (F) now?

21 A. Yes, I did.

22 Q. Okay. And so from section (F) can you
23 tell me where section (F) uses the term "requires"?

24 A. Since I'm not a lawyer, I will say that
25 this is my interpretation of what I understand from

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 it.

2 Q. Okay. So are you saying you cannot find
3 the term "require"?

4 A. I do not.

5 Q. Do you see where it says anything about
6 where one must use one comparable group?

7 A. No, I do not. However, I see the intent
8 to have a comparable group of companies.

9 Q. And from where do you divine that intent?
10 I thought I understood you to tell me that you were
11 not a lawyer, correct?

12 A. I'm not a lawyer.

13 Q. So where do you divine the intent?

14 A. On the advice of counsel.

15 Q. Okay. Does it even mention any statement
16 regarding one comparable group?

17 A. No, it does not. However, except for
18 Mr. Gorman, everyone else has interpreted it in that
19 fashion.

20 Q. I understand that. Thank you.

21 I'd like to turn to page 19 now,

22 beginning on line 8, the question and answer

23 regarding Mr. Cahaan's testimony. Do you see where I

24 am?

25 A. Yes.

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 Q. I'd like you to slide down to the bottom
2 of that page beginning at line 21 where you state
3 that: "Moreover, given the asymmetrical nature of
4 the SEET, certain Ohio utilities may face additional
5 risks not present for comparable firms."

6 I take it by this statement that you are
7 suggesting that your test could be used by other
8 utilities?

9 A. My methodology is illustrative, and,
10 consequently, it will be applicable in fact to
11 AEP-Ohio companies anywhere in the future, so it's a
12 transferable methodology.

13 Q. So transferable to other Ohio utilities
14 as well?

15 A. I believe so.

16 Q. Have you spoken with any other Ohio
17 utilities regarding whether they are willing to adopt
18 your test?

19 MR. CONWAY: Excuse me, could I have the

20 question reread, your Honor?

21 EXAMINER SEE: Okay.

22 (Record read.)

23 MR. CONWAY: Objection.

24 EXAMINER SEE: Grounds?

25 MR. CONWAY: There are three utilities

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 that have cases pending right now, and each of them
2 has an expert. Dr. Makhija is working for AEP.
3 Dr. Vilbert is working for FirstEnergy, and Mr. Rose
4 is working for Duke, and that's -- so I object to the
5 line of questioning because of the implication and to
6 the extent that there are other firms that
7 Dr. Makhija or any of the other witnesses might be
8 working for or consulting with, that's not relevant
9 to this case.

10 MR. MASKOVYAK: Your Honor, I'm not --

11 MR. CONWAY: It's objectionable.

12 MR. MASKOVYAK: Your Honor, I'm not
13 interested in what the other utilities are doing with
14 their experts. I'm only interested in what
15 Dr. Makhija has done, if anything, with other
16 utilities regarding his general application of the
17 test.

18 MR. CONWAY: Are you talking about other
19 utilities outside of Ohio?

20 EXAMINER SEE: Thank you, Mr. Conway.

21 MR. CONWAY: There's only one -- excuse

22 me.

23 EXAMINER SEE: Thank you, Mr. Conway.

24 And I'm going to allow Dr. Makhija to

25 answer the question to the extent he can.

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 Q. (By Mr. Maskovyak) Do you remember the
2 question, Dr. Makhija?

3 THE WITNESS: Could you please repeat it?
4 (Record read.)

5 MR. CONWAY: And, your Honor, I know
6 you've already ruled, but this line of questions is
7 well past rebuttal testimony. This is also -- if
8 these tacks were going to be taken, if they were ever
9 appropriate, would have been on direct, not on
10 rebuttal.

11 So I know you've ruled on the objection,
12 but I have a continuing objection on the scope of the
13 line of questions being outside his testimony.

14 EXAMINER SEE: Your objection is noted.

15 Answer the question, Dr. Makhija.

16 THE WITNESS: Could you repeat it once
17 again.

18 EXAMINER SEE: Let's have it read back.

19 (Record read.)

20 THE WITNESS: Is it permitted for me to

21 seek counsel?

22 EXAMINER SEE: Not at this point.

23 MR. CONWAY: And the question, as I

24 understand it, is whether he's had discussions with

25 another utility or --

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 EXAMINER SEE: We'll have it read back
2 again.

3 (Record read.)

4 THE WITNESS: As a finance expert, I am
5 approached by people across the state. But your line
6 of reasoning would lead me to implications at a level
7 that I'm not prepared to go to. Yes, I am consulted,
8 not only on this issue, on many issues in this state.

9 Q. (By Mr. Maskovyak) So from that do I take
10 it that your answer is yes, you have spoken to other
11 Ohio utilities regarding whether they are willing to
12 adopt your test?

13 A. Yes.

14 Q. Are they willing to adopt your test?

15 A. We have -- no such determination has been
16 made.

17 Q. Do you think that if the Commission
18 adopts your test here, it should then be applied to
19 all EDUs?

20 A. I am fairly confident about the nature of
21 my methodology because it focuses on the individual
22 specifics of the subject utility, so it could be
23 transferable to others as well.

24 Q. Thank you. I understand your confidence
25 in the methodology and I understand that it could be

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 applied. I'm asking you if it should then be applied
2 if the Commission adopts your test here.

3 A. I would hope so. I'm hoping to convince
4 the Commission of the merits of this methodology.

5 Q. Should each utility be allowed to have
6 its own formula for a SEE test?

7 A. The same methodology, which is not the
8 same -- which is not to say same formula.

9 Q. Okay. So in order to do this properly,
10 there should only be one test for all EDUs in Ohio?

11 A. One fairly designed test or rather one
12 designed methodology should work for them all.

13 Q. Would you go so far as to say that it
14 would not be fair to have more than one test?

15 A. In order for the Commission to make a
16 good decision, if it feels that it should see more
17 than one methodology, that certainly would be within
18 their rights.

19 Q. Do you have any idea how we can do that

20 here in this proceeding, to make a test of general
21 applicability when at issue here are only the AEP
22 companies OP and CSP?

23 MR. CONWAY: Objection. Same basis, your
24 Honor. These are questions that could have been
25 raised when he presented his direct testimony. It's

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 outside the scope of his rebuttal. There was no
2 criticism about this nature of variation among tests
3 that was addressed in his rebuttal testimony.

4 EXAMINER SEE: The objection is
5 overruled.

6 Answer the question to the extent you
7 can, Dr. Makhija.

8 THE WITNESS: Please repeat the question.

9 (Record read.)

10 A. Mr. Cahaan has, I believe, suggested some
11 kind of format for that; however, I have not given
12 enough thought to the kind of format that would bring
13 various parties to some common understanding on this.

14 Q. So you're not saying whether you agree or
15 disagree with Mr. Cahaan's format at this time.

16 A. That's right.

17 Q. So, again, I need you to answer my
18 question that I originally posed. How can we then in
19 this proceeding make a test that you say should be of

20 general applicability when this case applies only to

21 the AEP-Ohio companies CSP and OP?

22 MR. CONWAY: Your Honor, I object. It's

23 not only outside the scope of his rebuttal, but it

24 addresses a subject that he's not capable of

25 answering. We have many issues in this case that are

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 going to be AEP-Ohio specific, and to ask him to
2 explain how this or that issue could be applied
3 comparably, identically in all the other ESP cases, I
4 think is inappropriate. And I think this is just
5 continuing to walk down a path that keeps spreading
6 out and it is, again, well past not only his scope of
7 his testimony, but the purpose that even his initial
8 testimony was supposed to address, which is not
9 supposed to be in front of us here.

10 EXAMINER SEE: Given that Dr. Makhija
11 just represented that he had not considered
12 Mr. Cahaan's proposal as to the application of the
13 test across other Ohio utilities, I'm going to on --
14 on that basis I'm going to grant your motion to --
15 your objection.

16 MR. MASKOVYAK: Your Honor, if I may, I
17 wasn't asking him about Mr. Cahaan's proposal. I was
18 asking him about the application of his test here
19 across other utilities, but not by using Mr. Cahaan's

20 approach.

21 He has certainly opened the door by

22 virtue of his statement at the bottom of page 19.

23 Furthermore, if you look at the top of page 7, he is

24 apparently able to compare, as he does with a

25 specific example with FirstEnergy, when it suits

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 their purposes for comparing the tests, but is not
2 suitable now in terms of a general application.

3 MR. CONWAY: The purpose of the --

4 EXAMINER SEE: Just a second. Just a
5 second.

6 Read Mr. Maskovyak's last question posed
7 to the witness, please.

8 (Record read.)

9 MR. MASKOVYAK: Your Honor, as I believe
10 you -- I'm sorry. As I believe you just heard, I
11 removed Mr. Cahaan's approach entirely from my
12 question. It doesn't implicate Mr. Cahaan's approach
13 at all. I'm asking here and now in this case.

14 MR. CONWAY: Your Honor, if I might --

15 EXAMINER SEE: The objection is
16 sustained.

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

19 EXAMINER BOJKO: Doctor, I'd like to

20 know -- I'll wait.

21 EXAMINER SEE: Mr. Sites?

22 MR. SITES: No questions, your Honor.

23 EXAMINER SEE: Mr. Margard?

24 MR. MARGARD: No questions, your Honor.

25 Thank you.

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 EXAMINER SEE: Mr. Conway?

2 - - -

3 REDIRECT EXAMINATION

4 By Mr. Conway:

5 Q. Dr. Makhija, I just have one or two

6 questions.

7 At one point I think you stated that one

8 of the witnesses, I think it was in response to

9 Mr. Maskovyak's question about two groups or more

10 versus -- or two groups versus one group, what the

11 statutory test contemplates in your view. And I

12 believe at one point you mentioned that one of the

13 intervenor witnesses had constructed two separate

14 groups, and I believe you referenced Mr. Gorman, but

15 I would ask you to review your recollection of

16 various witnesses and their proposals and ask you

17 whether or not you meant to say Mr. King.

18 A. You're right, I misspoke. It is Mr. King

19 that develops two groups, and he stands in exception

20 to everyone else, and when he does form the two
21 groups, he then tries to marry them, in fact, to get
22 one common implication. So that even in his intent
23 the ultimate purpose is to somehow find that one
24 common impact.

25 MR. CONWAY: That's all I have, your

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 Honor.

2 EXAMINER SEE: Do you have questions,

3 Ms. Bojko?

4 - - -

5 EXAMINATION

6 By Examiner Bojko:

7 Q. Dr. Makhija, the question where I think

8 Mr. Maskovyak was going, and I'm not sure I heard the

9 answer that I thought he was asking the question, I

10 understand you said you haven't had time to think of

11 Mr. Cahaan's format for establishing some kind of

12 general methodology, but do you agree with the

13 concept that one methodology should be established

14 for the whole state when looking at this kind of test

15 that will be applied to all utilities in the future?

16 A. Well, obviously I feel that the

17 methodology I'm offering should be that -- has the

18 merit to be the desirable methodology, but I can

19 understand why the Commission may want to see more

20 than one methodology as it assesses --

21 Q. I'm not asking whether they need to

22 consider more than yours. I understand that you

23 think yours is the right one, but I want to know if

24 you think there should only be one ultimately. They

25 can consider thousands, but do you agree they should

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 only pick one and apply it on a statewide basis?
2 Let's assume that it is yours. I mean, do you think
3 yours or the one should be applied on a statewide
4 basis?

5 A. Since I feel my methodology is actually
6 applicable to all the different firms, I can well
7 support the idea of that single methodology.

8 Q. Okay. Say yours wasn't chosen. Would
9 you still support a single methodology used and
10 applied across the state for all utilities in Ohio?

11 A. If it has the merits of being an
12 appropriate methodology.

13 Q. Do you think it would be
14 counterproductive or do you think it would be
15 difficult to have separate methodologies applied to
16 different utilities?

17 A. It's a very good question because when I
18 think about the way the section 4928.143 is set up,
19 it would be difficult to recognize how meeting those

20 same requirements could then lead you to such variant
21 methodologies across different firms. Because the --
22 you know, I'm thinking about the nature of the test,
23 and it requires you to match business risks, it
24 requires you to match financial risks both, so
25 presumably there is some good appropriate way to do

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 that, and it does not say that the business risks and
2 financial risks are to be measured in different ways
3 for different companies.

4 EXAMINER BOJKO: Okay, thank you.

5 EXAMINER PRICE: Thank, Dr. Makhija.

6 THE WITNESS: Thank you.

7 EXAMINER SEE: Are there any objections
8 to the admission of Dr. Makhija's rebuttal
9 testimony, Companies' Exhibit 5A?

10 Hearing none, Companies' Exhibit 5A is
11 admitted into the record.

12 (EXHIBIT ADMITTED INTO EVIDENCE.)

13 EXAMINER SEE: Would the companies like
14 to call their next witness?

15 MR. NOURSE: Thank you, your Honor. The
16 companies call Philip Nelson.

17 EXAMINER SEE: Good morning, Mr. Nelson.
18 I'll remind you that you continue to be under oath.

19 THE WITNESS: Yes, I understand that.

20 EXAMINER SEE: Okay.

21 Mr. Nourse.

22 MR. NOURSE: Your Honor, we previously

23 marked, at least for the reporter, Exhibit 7A, the

24 prefiled rebuttal testimony of Philip J. Nelson.

25 EXAMINER SEE: Companies' Exhibit 7?

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 MR. NOURSE: Companies' Exhibit 7A.

2 EXAMINER SEE: We have A. 7B.

3 MR. NOURSE: We'll have to remark it.

4 Thank you.

5 EXAMINER SEE: Mr. Nelson's rebuttal
6 testimony will be marked Companies' Exhibit 7B.

7 MR. NOURSE: Thank you, your Honor.

8 (EXHIBIT MARKED FOR IDENTIFICATION.)

9 - - -

10 PHILIP J. NELSON

11 being previously sworn, as prescribed by law, was
12 examined and testified as follows:

13 DIRECT EXAMINATION

14 By Mr. Nourse:

15 Q. Mr. Nelson, do you have the exhibit
16 that's just been marked Companies' Exhibit 7B in
17 front of you?

18 A. Yes, I do.

19 Q. Is that your prefled rebuttal testimony

20 prepared by you or under your direction?

21 A. It is.

22 Q. Do you have any corrections, additions,

23 or changes you'd like to make this morning?

24 A. Yes, I have one correction. It's on page

25 4. It's line 18, and it says, the phrase "2008 FAC

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 costs where used" and it should be "were used."

2 Q. Do you have any additional corrections or
3 changes?

4 A. No, I do not.

5 Q. With that change, if I were to ask you
6 the questions contained in your prefiled rebuttal
7 testimony this morning under oath, would your answers
8 be the same?

9 A. They would.

10 MR. NOURSE: Thank you, your Honor.

11 I'd like to move for admission of
12 Companies' Exhibit 7B subject to cross-examination.

13 EXAMINER SEE: And I believe Ms. Grady
14 wants to go first.

15 MS. GRADY: Well, your Honor, I have a
16 motion to strike, but I could go first as well. My
17 motion to strike, I've got three different motions,
18 your Honors. I can go through them one by one if
19 that's your preference --

20 EXAMINER SEE: Yes.

21 MS. GRADY: -- and state the grounds and

22 move on after I state the grounds.

23 The first motion to strike begins on page

24 4 starting with line 20, question posed beginning

25 "Setting aside the criticisms." The motion to strike

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 goes to the next page through -- carrying over to
2 page 5, lines 1 through 8.

3 The grounds for this is that the scope of
4 rebuttal should be limited to evidence offered by the
5 opposing party in the testimony, cross-examination,
6 or redirect -- it's not the equivalent of introducing
7 evidence in a party's case-in-chief -- expanding upon
8 positions earlier taken in direct testimony that
9 could or should have been presented as part of AEP's
10 direct case is inappropriate.

11 Earlier Ms. Roberts cited to the TELRIC
12 case. I again would cite to that where in that case
13 the attorney-examiner recognized that the Commission
14 has routinely limited rebuttal to testimony that a
15 company could not have presented as part of its
16 direct case.

17 This testimony that the motion to strike
18 addresses, addresses the purported reasonableness of
19 the companies' baseline FAC calculation by presenting

20 fuel costs on a historic basis for the period of 2001
21 through 2007. It is meant to confirm -- and that is
22 the company's words used on page 5, line 6 -- that
23 the company did not understate the FAC rate component
24 because as the data shows, that the FAC component
25 used in the current SSO is higher than the historic

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 fuel cost rate.

2 Initially Mr. Nelson presented detailed
3 testimony on the FAC at page 8 through 15, Company
4 Exhibit 7. This information presented now today goes
5 to the reasonableness of the FAC baseline. It could
6 have been presented as part of the company's direct
7 case. It should not be -- it was not and it should
8 not be presented now as rebuttal.

9 Additionally, your Honor, no opposing
10 party has claimed that the use of the baseline
11 presented by the company is inappropriate because it
12 varies from historic fuel cost levels. No one has
13 said that.

14 EXAMINER SEE: I'm sorry, repeat that
15 last sentence, Ms. Grady.

16 MS. GRADY: No opposing party has claimed
17 that the use of the baseline presented by the company
18 is inappropriate because it varies from historical
19 fuel cost levels. That is what this testimony is

20 attempting to rebut. No one claimed that.

21 Staff and OCC chose different approaches

22 to setting the baseline using the most recent actual

23 fuel costs with limited or no adjustment instead of

24 using the company's approach, which is a 1999 proxy

25 for fuel costs with numerous adjustments

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 Additionally, your Honor, as was the earlier ruling
2 today and is distinguishable, this is not foundation
3 laying testimony, so on that basis OCC moves to
4 strike.

5 MR. NOURSE: Your Honor, would you like
6 me to respond to each one, or are you going to wait
7 to the end?

8 EXAMINER SEE: If you want to respond to
9 that one now, you may.

10 MR. NOURSE: Thank you, your Honor.

11 Mr. Nelson's testimony in the Q and A
12 that's referenced here on page 4 and 5, this is
13 certainly responding, it's in the context of
14 addressing the criticisms and presenting additional
15 information. You know, Mr. Nelson's initial
16 testimony presented the rate method of unbundling the
17 FAC rate and did not support use of looking at costs.

18 The other parties have since filed
19 testimony looking at costs. This testimony is -- in

20 this Q and A is saying even in that context as a
21 sanity check or a reasonableness check, the data
22 shows that the result of the company's method is
23 reasonable. So it's certainly within the scope of
24 rebuttal to respond to criticisms and present
25 additional information that reinforces the company's

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 position.

2 With respect to the statement about the
3 use of the word "confirms" on line 6 of page 5,
4 again, the whole purpose of this exercise is to say
5 that -- is to reinforce the company's position that
6 the result is reasonable, even in light of this cost
7 data that I don't believe would be contested
8 information.

9 I'm sorry, one more thing, your Honor.
10 In OCC Witness Smith's testimony on page 12, she
11 states that if fuel costs actually increase more from
12 '99 to '08 than the total of these escalations, then
13 the companies' calculated 2008 fuel rate will have
14 understated 2008 fuel costs. Again, that's the
15 statement reference on lines 6 and 7 of Mr. Nelson's
16 testimony on page 5.

17 EXAMINER BOJKO: I'm sorry, what was the
18 reference to Miss Smith's?

19 MR. NOURSE: Page 12, lines 18 through

20 20.

21 EXAMINER SEE: Your next motion to

22 strike, Ms. Grady.

23 MS. GRADY: Thank you, your Honor.

24 Beginning on page 6 starting with line

25 10, with the sentence that states "By implying that

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 these investments do not benefit customers," running
2 through the end of that paragraph which ends on line
3 18 with "environmental investments."

4 Again, your Honor, the grounds is that
5 the scope of the rebuttal should be limited to
6 evidence that is offered by the opposing party,
7 that's offered in testimony, cross-examination, or
8 redirect, expanding upon positions taken in earlier
9 testimony that could or should have been presented as
10 part of AEP's direct case is inappropriate.

11 This testimony, your Honor, purports to
12 address OCC Witness Smith who advocates that the
13 Commission should disallow carrying charges on
14 environmental capital expenditures made between 2001
15 through 2008. While the earlier portion of this
16 question posed on page 5 does appropriately rebut
17 specific statements in Ms. Smith's testimony, this
18 testimony does not rebut any specific testimony,
19 cross-examination, or redirect related to Ms. Smith.

20 Nowhere, your Honor, does she state that these

21 investments do not benefit customers.

22 The company can only claim that Ms. Smith

23 implies this because there is no testimony, cross, or

24 redirect in which she states this is a reason for

25 disallowing the carrying charges. This could have

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 been presented as part of AEP's direct case.

2 Your Honor, I believe this really is an
3 afterthought by the company to bolster its
4 case-in-chief by claiming that customers benefit by
5 such investment since the operating cost of the units
6 are below market power costs and the Ohio high-sulfur
7 coal can be purchased and used with these investments
8 going to pay for scrubbers.

9 It's interesting testimony but it could
10 have been presented in AEP's direct case and AEP
11 chose not to do so, it's inappropriate, your Honor.

12 MR. NOURSE: Your Honor, if I might.

13 EXAMINER SEE: Yes.

14 MR. NOURSE: I think it's evident, but
15 Mr. Nelson in that paragraph on page 6 beginning on
16 line 8, the entire paragraph is responsive to the
17 quote at the top of the page in lines 1 and 2 from
18 page 32 of Miss Smith's testimony that states:
19 "Moreover, stockholders will reap the benefits over

20 the lives of these investments." That was her
21 testimony as a criticism of including carrying
22 charges.

23 Suggesting that shareholders or
24 stockholders will reap all the benefits of these
25 investments is certainly not something we would have

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 anticipated and addressed in our initial testimony
2 until Ms. Smith entered that testimony several months
3 later. This response is directly related to her
4 statement that the shareholders have all the benefits
5 of the investments, and that's precisely what the
6 response goes to, your Honor.

7 EXAMINER SEE: Your third motion to
8 strike, Ms. Grady.

9 MS. GRADY: Thank you, your Honor.

10 Beginning on page 7, starting at line 7,
11 with the sentence "In all cases that I have been
12 involved in," running through the end of line 15
13 which ends with "will maintain a similar capital
14 structure during the ESP."

15 Your Honor, grounds are that this
16 testimony just expands upon positions earlier taken
17 in direct that could or should have been presented as
18 part of AEP's direct case. It's inappropriate. The
19 Commission has routinely limited rebuttal to

20 testimony that should have -- could not have been
21 presented as part of the direct case. This could
22 have been presented in a direct case.

23 The testimony is directed to providing
24 additional support for using a full weighted cost of
25 capital as the carrying cost for environmental

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 investment, provides information that suggests that
2 the full weighted cost of capital has been used
3 historically by the Commission since SB 3. It also
4 explains how the capital structure used excludes
5 short-term debt in the Gavin lease and talks about
6 GAAP accounting. All this testimony could have been
7 presented as part of AEP's direct case and wasn't.

8 Your Honor, additionally, the testimony
9 is cumulative. If you look at the last sentence of
10 the paragraph, that information is already in the
11 record. I would cite Mr. Nelson's testimony, page
12 16, line 16 is cumulative. It's not foundational.

13 And, your Honor, further I would state
14 that the testimony about providing authority for
15 using the weighted average cost of capital, I would
16 suggest, your Honor -- not even suggest. I would
17 state that if you look at the transcript where
18 Mr. Nelson was cross-examined, I asked specifically
19 Mr. Nelson, which I as well asked on deposition if

20 there was any authority other than the fact that the
21 company wanted money to use the weighted average cost
22 of capital.

23 And his response at that time, and I can
24 find the cite, I somehow have lost the cite, but I
25 can find that, is no, there was no other authority.

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 So this is contradicting the statements
2 contained in the cross-examination that I earlier
3 conducted of this witness. It obscures the record,
4 it's confusing, it should not be allowed in.

5 MR. NOURSE: Could we get the reference
6 from the transcript?

7 MS. GRADY: Yes.

8 MR. NOURSE: It would have been Volume V,
9 I believe, when you cross-examined.

10 MS. GRADY: It's Volume V, page 70, and I
11 can read the sentence. I did find it now. Volume V
12 I was cross-examining Mr. Nelson and the question
13 posed on line 7: "And you are seeking a carrying
14 charge, Mr. Nelson, that includes the cost of equity
15 under the principle that the company needs a full
16 return on its investment and not under any particular
17 authority other than that the company needs to
18 recover its costs; is that correct?"

19 "Answer: Yes, that's correct. I'd say

20 the company and the investor in the company needs

21 that return."

22 The same question I asked him on

23 deposition.

24 MR. NOURSE: Yeah, your Honor, you know,

25 I don't think -- let me start at the end and go

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 backwards. I don't think in a detailed question like
2 that with making multiple points, you know, that it's
3 fair to presume the witness understood she was asking
4 about legal authority. That wouldn't have been a
5 proper question to begin with. So I don't think
6 that's really the proper context of that answer or
7 that that certainly would be something that he didn't
8 recall at the time or that couldn't be brought out in
9 the rebuttal testimony.

10 With respect to the motion to strike
11 starting on line 7, there again, this discussion is
12 directly responsive to the criticisms about the use
13 of the WACC that's proposed by the company in their
14 direct testimony. These particular criticisms could
15 not have been anticipated in filing testimony back in
16 July when the intervenor testimony wasn't filed until
17 three months later.

18 Mr. Nelson is just stating he was
19 involved with those cases. He did have personal

20 knowledge, and he's stating that that WACC, as
21 proposed, not anticipating these objections, was used
22 in the prior cases that he's referencing there.

23 You know, as far as the -- and he gives
24 the additional reasons.

25 As far as the idea that the statement on

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 line 13 through 15 is cumulative, again, it's -- even
2 if it was stated in the record previously, it's part
3 of a complete answer. It's reinforcing his original
4 position in response and in the context of addressing
5 criticisms of the other parties.

6 One moment.

7 And, your Honor, just to add, we're
8 looking at the transcript, again in Volume V, page
9 70, and the following Q and A right after the portion
10 Ms. Grady quoted asks again about what particular --
11 "any particular authority other than the company
12 needs to recover." Again, Mr. Nelson's response was:
13 "Well, particular authority? I would say that we're
14 recovering under Senate Bill 221."

15 So, again, it just shows the quasi-legal
16 nature of that prior discussion, whereas here he's
17 stating his personal experience and knowledge based
18 on involvement in those cases.

19 MS. GRADY: Your Honor, if I might just

20 address that final point.

21 EXAMINER SEE: Yes.

22 MS. GRADY: That's a different question,

23 your Honor. That goes to what other expenses, not

24 the weighted average cost of capital. That's is a

25 question specifically on what other expenses are you

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 seeking to recover in your return.

2 MR. NOURSE: But, your Honor, if I might
3 point out that also references PJN-10 in that
4 exchange, and that's the same exhibit Mr. Nelson is
5 referring to here again in that statement explaining
6 the WACC as used.

7 EXAMINER SEE: Mr. Randazzo.

8 MR. RANDAZZO: Your Honor, I don't wish
9 to complicate this further but I'm afraid --

10 EXAMINER SEE: Yes you do.

11 MR. RANDAZZO: -- I'm going to. I guess
12 one of the things I've been struggling with is which
13 witness has responsibility for which subject area,
14 and we also have Mr. Baker touching on carrying costs
15 so we've got layers of rebuttal, it seems to me, and
16 I would appreciate some guidance from the company on
17 which witness actually has responsibility for this
18 subject.

19 MR. RESNIK: They both address it. And I

20 don't think there's anything inconsistent in that.

21 MR. RANDAZZO: No; but there are rules

22 against cumulative testimony. And with that answer I

23 would join the motion to strike.

24 EXAMINER SEE: Okay.

25 Ms. Grady, did you have any other

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 motions?

2 MS. GRADY: No, your Honor, that is it.

3 EXAMINER SEE: We're going to take five
4 minutes.

5 EXAMINER BOJKO: Actually, we're going to
6 take ten minutes.

7 (Recess taken.)

8 EXAMINER SEE: Let's go back on the
9 record.

10 After considering OCC's three motions to
11 strike portions of Mr. Nelson's testimony and
12 reviewing the direct testimony of Miss Smith, the
13 Bench has decided to deny all three motions.

14 With that, Ms. Grady.

15 MS. GRADY: Thank you, your Honor.

16 - - -

17 CROSS-EXAMINATION

18 By Ms. Grady:

19 Q. Mr. Nelson, let's go to page 2 of your

20 testimony, line 24. You indicate there that it is
21 "necessary to implement an active fuel mechanism
22 where none exists currently." Do you see that?
23 A. Yes.
24 Q. How are the fuel costs recovered
25 specifically by the company?

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 A. There is no specific recovery for fuel
2 costs currently.

3 Q. Now, you are seeking to implement a fuel
4 clause under SB 221; is that correct?

5 A. That's correct.

6 Q. And is that pursuant to 4928.143(B)(2)?

7 A. Yes.

8 Q. Now, the language of that provision says
9 that the ESP plan may provide for, or include
10 automatic recovery of costs of fuel and costs of
11 energy and capacity; is that correct?

12 A. That's correct.

13 Q. Let's go to page 3, lines 4 through 5.
14 You indicate there that your methodology "resulted in
15 a 22.5 percent increase in the original unbundled FAC
16 rate for OPCO and a 17.8 percent increase to CSP."
17 Do you see that reference?

18 A. Yes, I do.

19 Q. Are those numbers -- do those numbers

20 represent the percent increases of FAC rates from

21 2001 to 2008; is that what that represents?

22 THE WITNESS: Could you repeat the

23 question?

24 (Record read.)

25 A. Yes, they would be the level of

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 escalation that I applied using the 3 and 7
2 methodology in the PAR and divided by the number
3 before those escalations.

4 Q. Now, Mr. Nelson, in your direct testimony
5 on page 10, line 3, you provide a different compound
6 rate, at least for CSP, did you not?

7 A. Yes. On line 5 I've included the PAR
8 piece of it. It would be more than just the
9 3 percent escalation for the three years, it also
10 includes the PAR adjustment. So if you add the PAR
11 adjustment to the 3 percent escalation, divide that
12 by your base, you get the 17.8 percent increase.

13 Q. So is the 17.8 percent the more
14 appropriate figure to use rather than the 9.3
15 indicated in your earlier testimony?

16 A. I think they're talking about two
17 different things, but I've used for consistent --
18 with what I've used, there's no inconsistency with
19 this testimony and the direct testimony.

20 Q. No, on page 3, lines 10 through 15, you
21 state that: "2008 is shaping up to be one of the
22 most volatile years in the Companies' fuel costs for
23 many decades." Do you see that?

24 A. Yes, I do.

25 Q. And you say further there that using

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 total fuel costs within such a volatile period would
2 be inappropriate. Mr. Nelson, what's your
3 expectation of the 2008 total fuel costs of the
4 companies compared to, let's say, the fuel costs of
5 2007?

6 A. I would expect them to be higher than
7 2007. If you look at the monthly fuel rates, they've
8 varied considerably month to month. Fuel cost
9 changes monthly, so they've been up and down. Of
10 course, we're not complete with 2008 yet.

11 Q. When you say higher than 2007, are you
12 talking about significantly higher? Can you quantify
13 how much higher you expect the 2008 total fuel costs
14 to be in relation to the fuel cost of 2007?

15 A. No, I can't quantify it sitting here.

16 Q. Can you tell me what your expectation of
17 the fuel costs of 2009 are compared to the fuel costs
18 of 2008?

19 A. Yes. 2009 would be above the fuel costs

20 of 2008, is my expectation.

21 Q. And that's reflected in your filing, your
22 ESP filing, correct?

23 A. Yes. And I think I've addressed that in
24 my direct testimony.

25 Q. Now, when you reference there that the

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 companies' fuel costs are volatile, by "total fuel
2 costs" are you talking about the costs to the
3 company?

4 THE WITNESS: Could you repeat the
5 question, please?

6 Q. Let me rephrase it.

7 A. Okay.

8 Q. On page 3, line 10, you say that, you use
9 the phrase "the Companies' fuel costs." Are you
10 referring there to the actual costs to the company of
11 fuel? Is that what that reference is intended?

12 A. Yes.

13 Q. And by volatility of fuel costs are you
14 speaking of the volatility related to the spot market
15 price of coal?

16 A. Not specifically there. I'm thinking
17 more or speaking to our own costs that we're
18 experiencing in 2008.

19 Q. And what costs would those be,

20 Mr. Nelson?

21 A. Those would primarily be costs driven by
22 contracts, coal contracts that we have, and, of
23 course, there's issues around the coal contracts in
24 2008, as OCC Witness Medine has set out in her
25 testimony.

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 Q. Now, the coal contracts are long-term
2 contracts, is that correct, that you're speaking of?

3 A. They're long term, though I think over
4 time the definition of "long term" is not as long
5 term as it used to be.

6 Q. Under those contracts the company has
7 locked in fuel prices for periods of time; isn't that
8 correct?

9 A. Yes. We have deliveries to be made under
10 those contracts, and most of the deliveries for 2009
11 are already committed.

12 Q. And even for 2008, you have locked in
13 prices for your coal contracts, your long-term coal
14 contracts.

15 A. Yes. Other than there are issues with
16 suppliers that are addressed again in OCC Witness
17 Medine's testimony.

18 Q. The company purchased very little coal in
19 the spot market, right, for 2008? Let's talk about

20 2008.

21 A. I think "very little" is a fair

22 characterization for 2008.

23 Q. So wouldn't you agree with me,

24 Mr. Nelson, that many of the companies' fuel costs

25 and the fuel costs that you're referencing on line 10

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 are not immediately determined by the market price of
2 coal but are set by various longer term contracts
3 where the price is locked in?

4 THE WITNESS: Could you repeat that?

5 (Record read.)

6 A. Yes, they wouldn't be heavily influenced
7 by spot purchases.

8 Q. Now, Mr. Baker testifies, does he not,
9 that a fall in the wholesale power prices from August
10 to October was not unusual?

11 A. I can't speak to what he testified to.

12 Q. Are you aware that he testified at page
13 10, line 17, that a fall in the wholesale power
14 prices from August to October was not an unusual
15 occurrence?

16 A. Page 10 in what testimony?

17 Q. Line 17, Mr. Baker's rebuttal testimony,
18 I believe.

19 A. Yes, if he said that, he said it, I'll

20 agree.

21 Q. And, in fact, Mr. Nelson, Mr. Baker also
22 testifies that recent volatility is not unusual, does
23 he not? And I'm referencing again the testimony on
24 page 10.

25 MR. NOURSE: I'm sorry, did you say --

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 could I have the question read back?

2 (Record read.)

3 MR. NOURSE: When you say "recent
4 volatility is not unusual," could you rephrase that
5 question?

6 MS. GRADY: Well, your Honor, yes, I
7 could. I'm using "recent" because that's what
8 Mr. Baker uses in his testimony.

9 Q. Are you aware that Mr. Baker testifies
10 that the volatility that's been experienced in the
11 period of August through October 2008 is not unusual
12 or not uncommon?

13 MR. NOURSE: I'm sorry, your Honor, could
14 I just have a clarification. You're referring to his
15 testimony about power prices and asking Mr. Nelson
16 about coal prices?

17 MS. GRADY: Yes.

18 MR. NOURSE: Thank you.

19 A. Well, power prices are influenced by a

20 lot of different factors than coal prices would be.
21 For one, in PJM gas prices tend to set the market
22 price. We have very little gas on our system, so
23 power prices may be more volatile because I think
24 generally gas prices are more volatile than coal
25 prices.

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 Q. Now, on page 4, lines 4 through 6 of your
2 testimony, you indicate that OCC's approach will
3 produce substantially different results which
4 indicates the deficiency of OCC's approach. Do you
5 see that?

6 A. No. I wasn't quick enough getting back
7 to my testimony.

8 Q. I'm sorry. I'm talking too fast, I
9 guess. On page 4, lines 4 through 6.

10 A. Okay. Yes, I see that sentence.

11 Q. Have you done an analysis of what OCC's
12 approach actually produces?

13 A. No. I'm not able to because I think, you
14 know, in some instances I think the original
15 testimony, as I recall, said something about 2008,
16 and that 2008 look isn't done yet, of course. That's
17 one problem with that.

18 I think when Miss Smith was on the stand,
19 she may have thrown out a couple other ideas, periods

20 ending maybe September or October. Don't know
21 whether she meant just nine months ended September,
22 12 months ended September, so that goes to my point
23 that if you start to pick costs rather than the
24 proper method of identifying the rate component, it's
25 very subjective. You might be able to pick, you

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 know, different periods that might meet a particular
2 need, and so I'm not clear exactly what Miss Smith's
3 ultimate proposal was.

4 Q. Well, if you pick costs for 2008, actual
5 costs, is that still subjective?

6 THE WITNESS: Can I have that question
7 read back?

8 (Record read.)

9 A. Well, I think the fact that you pick that
10 method is subjective. For example, staff has used
11 2007 escalated, so again, different parties may
12 gravitate to a particular cost period, so yes, I
13 would think that that is subjective.

14 Q. And the different parties would have
15 subjective approaches, including the company, isn't
16 that correct, in setting the baseline FAC?

17 A. Well, the company would have its own
18 point of view. Of course, I feel our point of view
19 is the correct point of view, and since we've looked

20 at the rate aspect of it, which is, I think, more of

21 an auditable process to identify the current fuel

22 rate of the current SSO, total SSO.

23 Q. Would you agree with me that you would be

24 able to audit actual 2008 data? Wouldn't that be

25 auditable as well?

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 A. The actual costs are auditable --

2 Q. Yes.

3 A. -- but the fact whether they're included
4 in the current rate is not auditable.

5 Q. And that would be under your approach
6 that the bottoms-up approach is preferable to
7 anything that -- any top-down, or top-down approach
8 as perhaps OCC and the staff's methodology could be
9 defined.

10 A. Yes, I feel that that's a superior
11 method.

12 Q. Now, when you conclude that OCC's
13 approach would produce substantially different
14 results, on what basis are you concluding that, then,
15 if you've not done an analysis of the 2008 data?

16 A. Well, I do follow what monthly fuel costs
17 are. I haven't done a particular period because,
18 obviously, as I said, 2008 isn't done yet. There's
19 some other options. I haven't looked at all of the

20 potential periods in 2008 because someone could
21 argue, well, just use the last month as a proxy for
22 what's in rates.

23 So there's various periods and so forth.

24 But I do know that any SEE cost which is a large
25 component of the total FAC, I do follow that, and

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 I've seen that that's gone up during this year.

2 Q. Now, is it your understanding that OCC's
3 arguing that a proxy for 2008 would be several months
4 in 2008?

5 A. Again, I'm not quite sure what she had
6 recommended when she was on the stand.

7 Q. Is the test of the reasonableness of
8 determining the FAC whether or not the results are
9 close to the results produced under your method and
10 if they're close, then that approach is reasonable,
11 and if they're not close, then the approach is not
12 reasonable?

13 A. Not necessarily. Obviously, what I think
14 is I've done the correct approach. I've kind of
15 confirmed that -- the historic numbers against the
16 approach I've used, and I think it's for information
17 purposes and to assess that historic costs during
18 almost all this period, well, 2001 through 2007, have
19 in fact been below what I identified as the FAC

20 component of the current SSO.

21 It also does show that if you're using

22 costs, it does tend to vary year to year, so it is

23 important, and I guess that's where I get to

24 subjective, you could pick different periods and

25 choose to use different periods and you get a

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 different result, rather than my method where if you
2 look at the bottoms-up approach, or I should say
3 bottom-up -- not bottoms-up --

4 Q. I wouldn't know what you were referring
5 to there.

6 A. -- you get a consistent answer.

7 Q. Now, on page 4, lines 13 through 14, you
8 indicate that "no such earnings test is permitted for
9 a three-year ESP plan." Do you see that reference?

10 A. Yes.

11 Q. And is that -- is the basis of that
12 statement your analysis of SB 221, or is that based
13 on advice of counsel?

14 A. I listened to my counsel, and I believe
15 they're represented correctly so I didn't form that
16 position independently.

17 Q. Okay. Thank you.

18 Now on line 17 through 19 on page 4 you
19 say that: "Using 2008 FAC costs . . . might result

20 in unacceptable returns." Is the basis of that
21 statement something independent from Mr. Baker's
22 testimony or is that -- let me strike that.
23 Is that something independent from
24 Mr. Baker's testimony, or are you primarily relying
25 on Mr. Baker's testimony?

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 A. I'm primarily relying on Mr. Baker's
2 testimony.

3 Q. And you say that he addresses this
4 concern in his rebuttal testimony; is that right?

5 A. I believe he was going to.

6 Q. Now, going on to the testimony on page 5,
7 the 2001 through 2007 FAC costs, you indicate that
8 for CSP only one year, and that was 2006, exceeded
9 the FAC rate identified in the current SSO. Do you
10 see that?

11 A. Yes.

12 Q. And would you agree with me that if we
13 looked at the workpapers that back these figures up,
14 that the most striking and significant piece of the
15 FAC for CSP at that time was the NEC of 1.777?

16 A. I can't answer that. I don't have the
17 workpapers in front of me. I can't answer that
18 question without looking at the data.

19 Q. Let's talk about the FAC for 2009 for a

20 moment. If we true up the FAC for 2009, we'll use
21 the actual fuel costs for 2009, correct? And that
22 might be quite different from -- let me strike that.
23 I'm going to try to make it a little bit
24 more simple. If we true up the FAC for 2009, we
25 would actually use the actual fuel cost of 2009,

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 correct?

2 A. When you calculate an over/underrecovery
3 in 2009, you would compare the actual fuel rates
4 billed for 2009 versus the cost in 2009.

5 Q. And would you agree with me that the
6 actual fuel cost for 2009 might be quite different
7 than the projected fuel costs of 2009 that you have
8 presented in your testimony on PJN-2 and PJN-5?

9 A. Should I be going back to my direct
10 testimony now?

11 Q. Yes.

12 A. I don't address 2009 in my rebuttal,
13 but --

14 Q. Yes.

15 MR. NOURSE: Your Honor, if I could
16 interject, I was seeing if this was going to lead
17 back to his rebuttal testimony. It seems to be an
18 independent line of questioning at this point
19 unrelated to the rebuttal testimony.

20 EXAMINER SEE: Let me have the question

21 read back, please.

22 (Record read.)

23 EXAMINER SEE: Did you want to respond,

24 Ms. Grady?

25 MS. GRADY: Yes, your Honor. There's a

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 couple more questions, your Honor, that's going to
2 the importance of establishing a baseline, and there
3 is importance to establishing a baseline, and then
4 importance going from the baseline into adjustments
5 to the baseline, so that's where these questions are
6 headed.

7 EXAMINER SEE: Okay. The objection --

8 MR. NOURSE: I'm sorry, I just don't see
9 the connection to rebuttal. That's certainly an area
10 that could have been explored in his direct testimony
11 and cross-examination, your Honor.

12 EXAMINER SEE: And I'm going to allow the
13 question.

14 MS. GRADY: Thank you.

15 EXAMINER SEE: Do you need the question
16 read back?

17 THE WITNESS: Yes, please.

18 (Record read.)

19 A. Of course, there's the word "quite"

20 different. I absolutely think they'll be different
21 than our forecast. The forecast is never totally
22 accurate, so, yes, there will be a difference between
23 the actual fuel costs and the projected fuel costs
24 for 2009.

25 Q. And would you agree that the FAC increase

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 calculated that's based on the 2009 FAC costs -- let

2 me strike that.

3 Would you agree that the FAC increase

4 that's requested in the ESP is calculated based on

5 the 2009 FAC costs compared to the current 2008 FAC

6 rate that you testified to?

7 THE WITNESS: Would you please read that

8 one back to me?

9 (Record read.)

10 A. Could you please rephrase that question?

11 I don't understand it.

12 Q. Would you agree with me, Mr. Nelson, that

13 the FAC increase that you are recommending in the ESP

14 is calculated based on the 2009 FAC cost and on the

15 current 2008 FAC rate?

16 MR. NOURSE: Your Honor, I would just

17 object to the extent I don't think the companies have

18 requested a FAC increase. They're requesting to

19 establish a FAC mechanism as part of the ESP.

20 EXAMINER SEE: Rephrase your question,

21 Ms. Grady.

22 Q. Would you agree with me, Mr. Nelson, that

23 we need to have an accurate baseline on which to

24 implement a FAC?

25 A. Well, the baseline, if we're talking

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 about what is the tracker component of the current
2 SSO needs to be established, I think more for the
3 non-FAC piece of the rate than the FAC piece of the
4 rate, the FAC piece of the rate will be established
5 by the estimate of 2009 FAC costs, and then, of
6 course, we'll have a trueup to actual costs incurred
7 in 2009.

8 Q. Now, according to the information that
9 you provide on page 5 of your testimony, the FAC rate
10 which includes the fuel cost increases little from
11 2007 to 2008 in the case of both CSP and OPCO,
12 correct?

13 MR. NOURSE: I'm sorry, your Honor, I
14 think she might have said FAC rate for 2007, and I
15 believe the chart referred to is talking about FAC
16 costs.

17 THE WITNESS: And I think you also
18 mentioned 2008, and I don't see 2008 on there.

19 Q. Well, don't you have a FAC rate listed on

20 line -- on an unnumbered line as 2.562?

21 A. Yeah. Of course, that is the FAC rate.

22 I thought you said FAC cost to -- maybe we should

23 repeat the question.

24 Q. Mr. Nelson, according to the information

25 that you provide on page 5 of your rebuttal

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 testimony, and I'm looking at the 2001 through 2007
2 FAC costs which include fuel costs, there is very
3 little increase from 2007 to 2008 in the case of CSP
4 and OPCO as shown by comparing the 2007 FAC cost to
5 the company FAC rate on the unnumbered line shown
6 below your charge.

7 A. Well, there's two different companies
8 represented there, of course.

9 Q. Correct.

10 A. I think one may be closer between the
11 '07 costs and the FAC rate I've identified as the
12 current component of the SSO, but I don't know what
13 you mean by "very little."

14 For instance, we look at the Ohio Power
15 Company, staff applied a 7 percent increase to the
16 2007 cost rate to arrive at their number which is
17 shown that produces 1.757 cents per kilowatt-hour, so
18 even a 7 percent increase is below the rate I've
19 identified for Ohio Power Company, which is 1.780.

20 So it depends on your definition of "very
21 little." A 7 percent increase in fuel costs under
22 normal times might be considered not very little, but
23 in the circumstances we have today, it could be
24 characterized that way.

25 MS. GRADY: Your Honor, I move to strike

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 beginning with "the staff applied a 7 percent rate."
2 It was nonresponsive. I specifically asked him with
3 respect to the company FAC rate compared to the FAC
4 costs, whether or not there was little increase. The
5 staff proposal was not part of my question.

6 MR. NOURSE: Your Honor, if I might
7 respond.

8 EXAMINER SEE: Yes.

9 MR. NOURSE: He's explained that they're
10 comparing a cost to an unbundled rate, and in
11 comparing those I think it's fair to explain the
12 difference between an apple and an orange in making
13 that comparison. So I think it was just a complete
14 answer of his understanding.

15 EXAMINER SEE: Read the beginning of the
16 answer, please, Maria.

17 (Record read.)

18 EXAMINER SEE: The motion is sustained.

19 EXAMINER BOJKO: Except I believe the

20 sentence began with "for example," or "for instance."

21 MS. GRADY: Yes, that can remain, but the

22 other part of the sentence was where I was going.

23 Q. (By Ms. Grady) Mr. Nelson, let's go to

24 page 5 of your testimony, which is where we are.

25 There you begin addressing Witness Smith's testimony

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 on carrying charges on environmental investments. Do
2 you see that?

3 A. Yes.

4 Q. You indicate that she cites two bases for
5 the disallowances. Do you see that reference?

6 A. I do.

7 Q. Would that language that you've included
8 there, would that be lifted from page 29 of Smith's
9 testimony, if you know?

10 A. I believe it was. I can't tell you
11 specifically it was page 29, but I recall lifting it
12 from her testimony.

13 Q. And is it your recollection that she
14 testified at 29 that to grant the company's increase
15 for these specific investments implies that -- and
16 she goes on to make the points that you referenced.

17 A. I don't have Miss Smith's testimony in
18 front of me.

19 Q. Would you accept, subject to check, that

20 that's what her testimony reveals?

21 A. Yes.

22 Q. Now, on page 6, line 4, you referred to

23 Smith's criteria not being set out in SB 221. Do you

24 see that?

25 A. Yes, I do.

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 Q. To your knowledge are there any criteria
2 set out in SB 221 for allowing carrying charges on
3 past investment from 2001 through 2008?

4 A. There are provisions in Senate Bill 221
5 that provide for carrying costs. There are also
6 provisions in Senate Bill 221 that address
7 environmental. I think you characterized this as
8 past costs. The carrying cost itself is the carrying
9 cost we're going to incur in 2009.

10 Q. Well, let me be more specific then,
11 Mr. Nelson. Are there any criteria set out in SB 221
12 that allow carrying charges on a going-forward basis
13 for past investment that is investment prior to
14 SB 221?

15 A. No, I don't think there's anything
16 specific that I recall.

17 Q. Now, you indicated that there were
18 provisions that provide for carrying costs. Can you
19 explain to me what provisions those are?

20 A. Well, one was the phase-in plan I think
21 specifically mentioned carrying costs. That's the
22 one that comes immediately to mind without flipping
23 through the bill.

24 Q. And is it your interpretation that when
25 the SB 221 refers to carrying costs associated with a

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 phase-in plan, that those would be specifically meant
2 to cover environmental -- or, carrying charges on
3 past environmental investment?

4 A. No. That's just an instance where
5 carrying charges appear in the bill.

6 Q. Now, you also indicated I believe in your
7 answer that there was another provision in 221 that
8 referred to environmental investment, and can you
9 explain what provision you're speaking of in SB 221
10 that pertains to environmental investment?

11 A. The specific one is on page -- I'm sorry,
12 it's under section -- the MRO section of the bill.

13 Q. Can you give me --

14 A. It says it's --

15 EXAMINER SEE: If you have a page number.

16 Q. Or a section cite would be helpful,
17 Mr. Nelson. Thank you. I'm not as familiar with the
18 bill.

19 A. I have a page number. It's page 30, and

20 it's item 4 on that page.

21 Q. Okay. So we are in section

22 4928.142(D)(4); is that right?

23 A. Yes.

24 Q. And the language says: "Costs prudently

25 incurred to comply with environmental laws and

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 regulations, with consideration of the derating of
2 any facility associated with those costs." Is that
3 correct?

4 A. Yes, that's the way it reads.

5 Q. And you said this is the section
6 applicable to an MRO; is that right?

7 A. I think that is a provision under the
8 MRO. I believe this all started with my comment that
9 environmental is mentioned several places in the
10 bill, and I just was giving you an example where it
11 is mentioned specifically. We did not, obviously,
12 file the ESP under this provision.

13 Q. Now, on page 6, lines 8 through 10, you
14 state that the shareholder will not reap any benefits
15 associated with environmental investment if they are
16 not paid for these past environmental investments.
17 Do you see that?

18 A. No, I don't see that. I didn't say
19 anything about past environmental investments.

20 Q. Well, isn't the investment related to
21 past environmental expenses? Didn't you invest in
22 facilities from 2001 through 2008?

23 A. Yes. But this relates to rebutting
24 Miss Smith's assertion that: "Moreover, stockholders
25 will reap the benefits over the lives of these

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 investments." And if no one pays for these
2 investments, I don't know how shareholders would reap
3 the benefits.

4 Q. You say shareholders will not reap any
5 benefits associated with that investment. And are
6 you talking about the investment from 2001 through
7 2008? Looking at page 6, line 8 through 10.

8 A. Yes. If these investments are not
9 included in rates and no one pays for them, we
10 wouldn't reap any benefits, fairly straightforward
11 response to the criticism of Witness Smith.

12 Q. And the investments you're referring to
13 are those shown on PJN-9 of your direct testimony,
14 correct?

15 A. That's correct.

16 Q. Now, if the companies shut down a coal
17 unit rather than making environmental expenditures or
18 other investments, would the shareholders receive any
19 return on the value of the plant from Ohio

20 ratepayers?

21 A. I'd need a little background under what

22 regulatory scenario or what plan. It's kind of

23 open-ended.

24 Q. And I'm not sure that I follow you. What

25 are you seeking?

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 A. I was just saying the question is a
2 little broad for me to answer. If you could be more
3 specific, I might be able to answer.

4 Q. Do shareholders receive any return on the
5 value of plant once a unit is shut down?

6 A. I wouldn't think so.

7 Q. Under traditional ratemaking?

8 A. Yes, they could.

9 Q. Mr. Nelson, would you agree with me that
10 the hourly market prices in the MISO market are
11 usually higher than the marginal costs of the coal
12 units?

13 A. I'm not even familiar with the MISO
14 market. We don't operate in MISO.

15 Q. PJM. Let's substitute PJM for that. I'm
16 sorry.

17 A. Okay.

18 Q. Are you aware or would you agree with me
19 that the hourly market prices in the PJM market are

20 usually higher than the marginal costs of coal units?

21 A. You'd have to look at it unit by unit.

22 There are off-peak periods where the marginal costs

23 might be lower than some of our most expensive units

24 so I don't think you can make that broad a statement.

25 Q. Let's assume for a moment that the hourly

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 market prices in the PJM market are higher than the
2 marginal costs associated with your coal units. If
3 the company sells power into the PJM market during
4 those hours when the prices are higher than the
5 marginal costs of the coal unit, won't the companies
6 make money on these sales?

7 THE WITNESS: Could you repeat that,
8 please?

9 (Record read.)

10 A. I would think so, that if our costs are
11 below the marginal sales level, then we would have a
12 net gain.

13 Q. And if these are off-system sales and --
14 under the company's proposal not to reflect
15 off-system sales in the FAC, won't the shareholders
16 benefit from these sales?

17 A. I'm sorry, I can't answer that question.

18 Q. Why can't you answer that question?

19 A. I don't understand it. Could you repeat

20 it?

21 Q. Under the company's proposal they are not
22 reflecting margins from off-system sales. They're
23 not offsetting any of the ESP costs with margins from
24 off-system sales; isn't that correct?

25 A. Yes. But that might be a question better

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 directed to Witness Baker.

2 Q. And so under that situation, aren't the
3 shareholders benefiting from such off-system sales?

4 A. Shareholders do benefit from off-system
5 sales.

6 Q. So wouldn't that be a benefit that
7 they're reaping from the investment in the plant?
8 Going back to your testimony where you say
9 shareholders will not reap any benefits, that's not
10 correct.

11 A. Well, I disagree because I say if a
12 company is not paid for such investments. I think
13 you're putting out the prospect of some portion of
14 that being paid by sales in the off-system market. I
15 was making a general statement that if it's not paid
16 for, then they can't benefit, so I was focusing more
17 on the retail side of it rather than the wholesale.

18 But if, in fact, we do sell it into the
19 off-system sales market then, yes, shareholders would

20 benefit.

21 MS. GRADY: That's all the questions I

22 have, your Honor. Thank you.

23 Thank you, Mr. Nelson.

24 EXAMINER SEE: Mr. Randazzo?

25 MR. RANDAZZO: Yes.

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 - - -

2 CROSS-EXAMINATION

3 By Mr. Randazzo:

4 Q. Mr. Nelson, would you turn to page 6 of
5 your testimony. In the middle of that page you talk
6 about the "Environmental investments are necessary to
7 keep the companies' low-cost coal-fired generating
8 units running." Do you see that?

9 A. Yes.

10 Q. And then you say: "The customers will
11 benefit because the operating costs of these units
12 remain well below the cost of securing the power on
13 the market," right?

14 A. Yes.

15 Q. Well, are you saying there that the
16 customers will receive -- will pay prices for the
17 electric services provided that is based upon the
18 cost of these low-cost generating units?

19 A. With respect to the FAC, yes.

20 Q. With regard to the other portion of the
21 rate, the non-FAC, are you suggesting there that
22 customers are going to receive the benefit of these
23 low-cost generating units through their prices?

24 A. In the sense that the ESP prices are
25 below the market price, yes.

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 Q. Well, you say there that the customers
2 will benefit because the operating costs, not the
3 prices, of the units remain well below the cost of
4 securing the power on the market. You're not talking
5 about prices there, are you?

6 A. I'm talking, as I said before, I'm
7 specifically addressing the FAC, and I mention that
8 in the next line.

9 Q. Well, would it be appropriate if the
10 customers are going to pay for environmental -- let's
11 back up.

12 Environmental investments are investments
13 that are made to generating plants, right?

14 A. That's correct. Well, yeah,
15 environmental investments are broad, but I think in
16 this context we're talking about investments to the
17 generating facilities.

18 Q. Okay. And you say there that the
19 investments are necessary to keep the companies'

20 low-cost coal-fired generating units running, right?

21 A. Yes.

22 Q. For how long? It's more than three

23 years, right?

24 A. If we -- well, hopefully, yes, but it

25 would depend on the unit and what the retrofit was,

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 what the investment was, so there's a lot of
2 variables there. But if we're talking about FGDs, if
3 we're putting an FGD on a unit, we're expecting that
4 to operate for some period of time and not just three
5 years.

6 Q. Right. And the proposal that is in the
7 companies' ESP contemplates that a portion of the
8 generation supply that customers receive as part of
9 the standard service offer is actually going to be
10 purchased from the market, right?

11 A. We have a proposal to make some purchases
12 from the market as addressed in Company Witness
13 Baker's testimony.

14 Q. So for at least that portion of the
15 generation supply, the customers will not be
16 receiving the benefits of the low-cost generating
17 units to which these environmental modifications are
18 made, right?

19 A. I believe it's just too broad a statement

20 for me to give you a precise answer to.

21 Q. So you don't know under the company's ESP

22 proposal whether or not the customers will benefit

23 from the low-cost coal-fired generating units?

24 A. I'm pretty certain they'll benefit from

25 the low-cost generating units because we do plan to

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 have those serving the customer during this ESP
2 period and have those lower costs flow through the
3 FAC provision.

4 Q. But you're also proposing to purchase a
5 portion of the generation supply from the market,
6 right?

7 A. We're proposing some purchases from the
8 market in the plan, yes.

9 Q. And so for the portion that is purchased
10 from the market, customers would not be paying prices
11 based upon these low-cost coal-fired generating
12 units, right?

13 A. Well, they'd be paying the market price.
14 It would be blended in with the other, the low-cost
15 generation, yes.

16 Q. So for at least the portion that is
17 market priced, there's no correlation between the
18 low-cost coal-fired generating units to which these
19 environmental investments attach and the prices that

20 customers will be paying, right?

21 A. Well, these are purchases and not

22 sourced-down-the-road generation, so I can't

23 disagree.

24 Q. Okay. Will any of the generating units

25 to which these environmental investments are attached

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 be used to make off-system sales?

2 A. Yes.

3 Q. Will any of the units to which these

4 environmental investments attach be used to sell

5 capacity into the PJM market, if you know?

6 A. That would be a better question for

7 Mr. Baker. He's more familiar with PJM.

8 Q. Will any of these units provide an

9 opportunity for the companies to sell ancillary

10 services into the PJM market, if you know?

11 A. Again, I'd defer to Mr. Baker.

12 Q. What is the cost of the low-cost

13 coal-fired generating units?

14 A. Could you reread the question, please?

15 (Record read.)

16 Q. And let me be more specific. On an

17 average per kilowatt-hour annualized basis, what is

18 the cost of running the generating units that are in

19 the fleet of generating assets that are owned and

20 operated by Columbus & Southern and Ohio Power?

21 A. I don't know specifically. Each

22 generating unit would have a separate set of costs,

23 and these environmental investments are on certain

24 generating units, so I can't give you a number.

25 Q. Okay. But for purposes of your testimony

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 here, what you are suggesting at lines 13 and 14 is
2 that it would be appropriate for customers to pay for
3 costs related to certain environmental investments to
4 the extent that they are receiving the benefits
5 associated with the low-cost coal-fired generating
6 units to which these environmental investments are
7 attached; is that correct?

8 A. First of all, I'm responding to OCC
9 Witness Smith's suggestion that -- or implied
10 suggestion that the stockholder is reaping all the
11 benefits of the low-cost generation, and I stand by
12 the fact that the customer will benefit from
13 including this low-cost generation in the FAC cost.

14 Q. I understand that, but that had nothing
15 to do with my question.

16 THE WITNESS: Could you repeat the
17 question?

18 Q. Let me restate it again.

19 A. Okay.

20 Q. Let's try it again. What you are
21 suggesting here in your testimony at lines 13 and 14
22 is that customers should be responsible for picking
23 up costs related to these environmental investments
24 because they will receive the benefits associated
25 with the low-cost generating assets to which these

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 environmental investments attach, right?

2 A. They are receiving benefits from these
3 low-cost generating units.

4 Q. No; I'm trying to get to your
5 justification for the point that you're making in the
6 testimony. As I understand your testimony, you're
7 suggesting that it's appropriate for customers to pay
8 for these environmental investments because customers
9 will get the benefit of the low-cost generating --
10 low-cost coal-fired generating units to which the
11 environmental investments attach. Is that the point
12 that you're making at lines 13 and 14?

13 A. I say: "The customers will benefit
14 because the operating costs of these units remain
15 well below the cost of securing power on the market."
16 If we were to charge market power, customers' rates
17 would go up. Since we're using these generating
18 units to supply at least a majority of the power, the
19 customer does benefit by that fact.

20 Q. All right. Close enough.

21 On pages 6 and 7 you discuss carrying

22 cost issues. Have you been involved in applications

23 to issue securities that have been submitted to the

24 Commission on behalf of Ohio Power, Columbus &

25 Southern, or their affiliate?

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 A. No, I haven't personally been involved in
2 those.

3 Q. Are you aware that there are specific
4 types of financing arrangements that are peculiar to
5 investments in environmental compliance equipment?

6 A. Yes. I'm generally familiar with that,
7 yes.

8 Q. And that these types of financing
9 arrangements would include particular types of debt
10 that may have certain tax advantages, correct?

11 A. Yes.

12 Q. And would it be your expectation that the
13 debt -- cost of debt associated with these particular
14 types of financing arrangements would be typically
15 less than the cost of common equity?

16 A. Less than the cost of common equity, yes.

17 Q. Just on a very mechanical basis so that I
18 can understand the significance of certain things,
19 the greater the common equity ratio is in the overall

20 capitalization ratio, generally the higher the
21 carrying charge rate will be; is that correct?
22 A. Generally. I could see instances today
23 where that might be reversed since it's very hard to
24 issue debt today. Some debt issuance has been 13,
25 14 percent, for example. I've only used 10-1/2

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 percent for equity, but typically I think that's a
2 fair statement.

3 MR. RANDAZZO: May I approach the
4 witness, your Honor?

5 EXAMINER SEE: Yes.

6 Q. Mr. Nelson, I'm going to hand you an
7 application that was filed by Ohio Valley Electric
8 Corporation on December the 5th of this year in
9 08-1286-EL-AIS. Will you accept, subject to check,
10 that that's an application?

11 MR. NOURSE: Your Honor, could I view
12 that document as well?

13 EXAMINER SEE: Yes.

14 A. It appears to be an application, yes.

15 Q. Yeah. And you said you weren't familiar
16 with applications to issue securities filed by the
17 companies or their affiliates, correct?

18 A. Not personally familiar with them, no.

19 MR. RANDAZZO: Your Honor, I would ask

20 that administrative notice be taken of the
21 application filed in this proceeding. It's
22 08-1286-EL-AIS.

23 MR. NOURSE: Could I inquire as to what
24 the purpose of taking notice of it is?

25 MR. RANDAZZO: Yeah. It's an application

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 that was filed on December the 5th to issue
2 \$900 million in notes with the assistance of the Ohio
3 Air Quality Development Board.

4 EXAMINER SEE: I'm sorry, what was the
5 last part of that, Mr. Randazzo?

6 MR. RANDAZZO: With the assistance of the
7 Ohio Air Quality Development Authority.

8 MR. NOURSE: Your Honor, I would just
9 note for the record, I'm not sure what this would be
10 used for. Although it's an AEP-affiliated company,
11 I'm not sure what it would be used for. I guess
12 we'll just reserve the right to cite any other
13 pertinent filings or orders in response to whatever
14 it is that IEU might use this document for.

15 MR. RANDAZZO: Your Honor, I don't mind
16 being clear about my intended use if it's useful. I
17 was offering the request to take administrative
18 notice of this in response to the witness's position
19 that it might be difficult to issue debt at the

20 moment. We have an application to issue \$900 million
21 worth of debt related to environmental compliance
22 strategies so that's the purpose of it, and I
23 certainly don't have any problem with counsel
24 referring to other applications or orders of this
25 Commission that may be related.

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 EXAMINER SEE: Okay. And with that we'll

2 take administrative notice of case 08-1286-EL-AIS.

3 MR. RANDAZZO: That's all I have. Thanks

4 very much.

5 Thanks, Mr. Nourse.

6 EXAMINER SEE: Mr. Royer.

7 MR. ROYER: No questions.

8 EXAMINER SEE: Mr. Kurtz.

9 MR. KURTZ: Thank you, your Honor.

10 - - -

11 CROSS-EXAMINATION

12 By Mr. Kurtz:

13 Q. Good afternoon, Mr. Nelson. Would you

14 turn to page 5 of your rebuttal testimony, please?

15 A. Okay.

16 Q. Are you there?

17 A. Yes.

18 Q. Okay. I just want to -- it's not

19 numbered, but you have company FAC rate in the middle

20 of the page, let's just look at Columbus & Southern,

21 2.562 cents per kilowatt-hour.

22 A. Yes, I see that number.

23 Q. That is what you're proposing to use as

24 your FAC base amount?

25 A. That's what I'm identifying as the FAC

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 component of the current SSO rate.

2 Q. Okay. And then under your --

3 mechanically under your proposal as we move into the

4 future, to the extent the actual FAC costs were above

5 or below the baseline, there would be a charge or a

6 credit on the FAC?

7 A. No. I don't think that's exactly our

8 proposal. I think what we're doing is starting with

9 the current SSO, and this was in Mr. Roush's

10 testimony. He does the mechanics of backing out from

11 the total SSO rate the FAC, current FAC, component of

12 that and develops a non-FAC component of the rate,

13 and then we have a tariff to put on to charge the

14 2009 fuel costs that we're proposing.

15 Of course, we're proposing a phase-in so

16 we're not proposing the full amount. In my

17 schedules, Mr. Roush has applied the 15 percent cap

18 and designed a rate to recover the fuel costs

19 according to the phase-in plan.

20 Q. So mechanically this is not -- this is
21 standard fuel adjustment where we have a baseline
22 amount, we have -- then we track actual, to the
23 extent there's a difference, there's a charge or a
24 credit?

25 A. I think it's standard. What I'm pointing

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 out is I'm not sure there's any FAC. I think that
2 the tariff is the full FAC charge. It's not that
3 there's some in base and there's an increment above
4 what's buried in base. It's just a little bit of a
5 technicality. That's my understanding of Mr. Roush's
6 tariffs.

7 Q. Okay. Let me ask you about the
8 environmental carrying cost 2001 through 2008. You
9 rebut OCC Witness Smith. You understand that OEG
10 Witness Mr. Kollen also opposed the carrying charges?

11 A. I don't recall it specifically, but I'll
12 accept that.

13 Q. The incremental 2001 through 2008
14 environmental investments, there were a lot of things
15 that happened in the period 2001 through 2008 in
16 addition to investing incrementally in environmental
17 capital plants, weren't there? For example --

18 A. Well, yeah, a lot of things happened.
19 I'm not sure exactly what you mean, with respect to

20 investment or --

21 Q. Didn't the existing generation investment

22 depreciate during this time period?

23 A. There would be some depreciation

24 associated with that. There would also be additional

25 capital expenditures on generation facilities beyond

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 the environmental.

2 Q. Okay. And even with the environmental
3 plant that was already in service during 2001 to
4 2008, that depreciated as well; did it not? For
5 example, the 1995 Gavin scrubber would have
6 depreciated during this period of time?

7 A. It could have depreciated. There could
8 have been upgrades and additional capital investments
9 to that particular scrubber, so I don't know. I'd
10 have to follow the history of all the plant
11 additions.

12 Q. In any event, you have not proposed
13 netting out the 2001 to 2008 incremental capital
14 increases with decreases in capital costs during the
15 same period.

16 A. I don't know that there would be any
17 decreases in capital costs in the same period, for
18 one.

19 Q. Did you look at that question?

20 A. No, I did not.

21 Q. When you put capital on a power plant, a
22 scrubber for SO₂ or an SCR for NO_x, aren't there also
23 cost savings that the utility experiences? For
24 example, purchasing less SO₂ or NO_x allowances, being
25 able to burn a higher sulfur lower cost coal with

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 respect to the FGD or the scrubber, aren't there cost
2 savings that would be experienced as well?

3 A. Yes. There could be cost savings and, in
4 fact, that's what my FAC would reflect. It would
5 show the cost savings associated, for example, with
6 allowances; however, you would also have consumables
7 or chemicals to operate the environmental equipment.
8 You also would have parasitic load associated with
9 certain environmental so we would have less kWh to
10 sell.

11 Q. And if we were going to do a complete
12 analysis for all of the pros and cons, revenues and
13 expenses, cost savings during 2001 through 2008,
14 those are the type of things we would look at rather
15 than just simply looking at the incremental cost
16 increases?

17 A. Well, I'm not sure why you would be
18 looking at an analysis of cost during 2001 through
19 2008. What I'm doing is applying the balance at the

20 end of the period and calculating carrying charges

21 associated with 2009.

22 Q. Did I -- okay. Did I understand in

23 response to questions from OCC counsel that you could

24 identify no specific provision of Senate Bill 221

25 authorizing a carrying cost on investments that were

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 made before the law's enactment?

2 A. I'm not sure exactly what I said there.

3 But to be more specific, I didn't see a specific

4 provision in the bill that said you get carrying

5 costs on environmental. I mentioned that, you know,

6 environmental appears quite a few times in the bill

7 and we think it was the intention of the legislators

8 to allow recovery of that. The particular provision

9 that we're filing under, I'll give you a reference,

10 it's section 4928.143(B)(2).

11 Q. Well, I won't debate the statute with

12 you. Let me ask you about carrying costs real quick.

13 The weighted average carrying cost you're proposing,

14 you have not included the Internal Revenue Code

15 Section 199 tax deduction in your calculation of the

16 weighted average cost of capital; is that correct?

17 A. That's correct. The reason is that it's

18 not an adjustment to the tax rate. It's a deduction.

19 And typically when you do a gross-up calculation for

20 terms of -- for doing revenue requirement, you
21 include the statutory tax rate; you don't include
22 deductions.

23 Q. Didn't the Commission rule against AEP on
24 this very issue in the RSP case?

25 A. Yes. This issue did come up in the --

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 one of the 4 percent cases, as I recall, and we did
2 lose that issue. We respectfully asked the
3 Commission to reconsider it.

4 One thing that I don't know that was
5 known at the time was FERC has ruled that this
6 deduction is not appropriate for the gross-up
7 calculation of formula rates, for example, so that
8 lends support to the arguments we made. This is a
9 deduction, not a change in statutory tax rate.

10 So -- and I think, you know, there's
11 other issues. For example, we haven't been able to
12 take the full deduction. I think there was some
13 speculation by OEG's witness that they might expect
14 to be able to take the full deduction, but you offset
15 the deductibility of that with operating company
16 losses, and we did have some over -- I think Kentucky
17 wasn't able to take it one year. PSO wasn't able to
18 take it another year. We expect Appalachian Power
19 not to be able to take the 199 deduction this year.

20 What that means is that offsets -- it's
21 offset against the deductions that the Ohio companies
22 can take. So the Ohio companies, if a particular
23 other member of the group doesn't get to take the
24 full deduction, their amount of reduction -- or the
25 amount of the deduction they can take is reduced. So

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 there's a lot of facts that we believe that will
2 convince the Commission that it isn't appropriate to
3 use the 199 deduction in the gross-up calculation.

4 Q. When you gross up the equity returns
5 10-1/2 percent that you use in your weighted average
6 cost of capital, you assume that the utilities
7 essentially pay taxes on a stand-alone basis and you
8 assume the maximum federal corporate income tax rate
9 and a maximum state corporate income tax rate, do you
10 not?

11 A. I don't think I had to make that
12 assumption. I've never seen other -- before 199 came
13 up, revenue conversion and gross-up was always pretty
14 darn straightforward. I don't think we had many
15 arguments. It was always the statutory tax rate.

16 Q. Right, but --

17 A. And I would say today that I would argue
18 that it's still straightforward, that is, the
19 statutory tax rate.

20 Q. You did not use the actual tax rate --
21 first of all, Ohio Power doesn't file a federal
22 income tax return, does it, as it's a consolidated
23 return for AEP?

24 A. It's a consolidated return, as I
25 understand it.

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 Q. Right, for AEP Corp. And the AEP
2 corporate federal income tax rate is not the maximum
3 rate, I take it, because you can't use these
4 deductions. Is that what you're saying?

5 A. Could you repeat that question, please?

6 Q. AEP as a corporation does not actually
7 pay the maximum federal income tax rate because of
8 offsets, losses in other parts of your business,
9 which would be the reason why you couldn't take the
10 full section 199 deduction.

11 A. Each year there are various deductions
12 taken for tax purposes. Again, as far as my
13 experience in terms of revenue conversion and
14 gross-up factors, you use the statutory rate because
15 deductions tend to get consumed and they're not
16 available to reduce incremental revenue.

17 MR. KURTZ: Thank you, Mr. Nelson.

18 EXAMINER SEE: Mr. White?

19 MR. WHITE: No questions, your Honor.

- 20 EXAMINER SEE: Mr. Petricoff?
- 21 MR. PETRICOFF: No questions, your Honor.
- 22 EXAMINER SEE: Mr. O'Brien?
- 23 MR. O'BRIEN: No questions, your Honor.
- 24 EXAMINER SEE: Mr. Maskovyak.
- 25 MR. MASKOVYAK: Just one, your Honor.

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 - - -

2 CROSS-EXAMINATION

3 By Mr. Maskovyak:

4 Q. Mr. Nelson, I want to turn to page 5 on
5 the chart that's on page 5, so to get my
6 understanding -- questions from Ms. Grady where you
7 were talking about the company FAC rate that doesn't
8 have a line number but just above line 8, and she was
9 asking you to compare that to the numbers above. I
10 believe you gave a long explanation, which was
11 objected to, and your counsel defended you giving you
12 latitude to answer the question because you were --
13 by comparing rates to costs you were being asked to
14 compare apples to oranges. Is that what we're doing
15 here by this chart, comparing apples to oranges?

16 A. In the sense that I've used a rate method
17 rather than a cost method that may be considered
18 apples to oranges, but in terms of definition of the
19 FAC, I think it would be apple to apple.

20 Q. Can you explain the last part of your

21 answer?

22 A. The components of the FAC are similar,

23 that is, if I'm identifying a cost, I'm using the

24 same FAC components as when I unbundled the rate, and

25 all the components are the same, the accounts.

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 Q. I'm sorry, you're trailing off. I can't
2 hear you.

3 A. I'm sorry. All the components are the
4 same, the accounts, et cetera, that are used in the
5 FAC definition.

6 MR. MASKOVYAK: I have no further
7 questions.

8 EXAMINER SEE: Mr. Margard?

9 MR. MARGARD: No questions. Thank you,
10 your Honor.

11 EXAMINER SEE: Mr. Nourse, any redirect?

12 MR. NOURSE: Could I have just one
13 moment, your Honor?

14 EXAMINER SEE: Sure.

15 MR. NOURSE: Your Honor, we have no
16 redirect questions, thank you.

17 EXAMINER SEE: Okay.

18 EXAMINER BOJKO: Mr. Nelson, look on page
19 3 of your testimony. On line 1 you say the company

20 started with the FAC rate component in the 2001 SSO
21 rate. I want to be clear that that 2001 SSO rate was
22 based on -- my understanding of your direct testimony
23 is it was based on your 1999 EFC. Now I don't know
24 whether to use the word "rate" or "cost" after
25 today's discussion.

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 THE WITNESS: Hopefully, we'll clear that
2 up a bit. As I recall about the bill, when we had
3 the market development period, it specifically said
4 what rate you were supposed to use when you unbundle
5 rates starting in 2001, and it was the October 5th,
6 1999, EFC rate. In fact, we had another EFC
7 proceeding after that that was only in there for an
8 interim period, and then when 2001 came along, we
9 reverted to the October 5th, 1999, rate.

10 But here I'm talking about the start of
11 the market development period. That's why I used
12 2001, but it would be based on that.

13 EXAMINER BOJKO: Okay.

14 THE WITNESS: That EFC.

15 EXAMINER BOJKO: Thank you.

16 EXAMINER SEE: Thank you, Mr. Nelson.

17 It's now approximately 12:40.

18 MR. NOURSE: I'm sorry, your Honor, are
19 we still on the record?

20 EXAMINER SEE: Yes.

21 MR. NOURSE: I did move earlier for

22 Exhibit 7B. I would renew my motion.

23 EXAMINER SEE: Are there any objections

24 to the admission of Exhibit 7B?

25 Hearing none, Companies' Exhibit 7B is

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 entered into the record.

2 (EXHIBIT ADMITTED INTO EVIDENCE.)

3 MR. KURTZ: Your Honor, may I also just

4 for the record move into evidence the direct

5 testimony of OEG Witness Charles King as well as his

6 trial deposition transcript, which I understand has

7 not been filed with the docketing division, but I

8 will have the deposition filed.

9 EXAMINER SEE: Okay. We will accept OEG

10 Exhibit 4 into the record.

11 MR. CONWAY: As well as the transcript?

12 EXAMINER SEE: Including the entire

13 deposition transcript taken on Friday, December

14 5th.

15 (EXHIBIT ADMITTED INTO EVIDENCE.)

16 EXAMINER SEE: On further consideration

17 we'll make the deposition taken December 5th 4A.

18 (EXHIBIT MARKED FOR IDENTIFICATION.)

19 EXAMINER SEE: And then OEG Exhibit 4

20 will be Mr. King's direct testimony.

21 MR. KURTZ: Thank you, your Honor.

22 EXAMINER SEE: It's now approximately

23 12:42. We'll reconvene till 1:45 to allow for the

24 Commission meeting.

25 Do you want to make it 2? It will be 1:45

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 or close to that depending on how long the Commission
2 meeting runs.

3 MR. RESNIK: No sooner than.

4 EXAMINER SEE: Correct, no sooner than.

5 So we're adjourned.

6 (At 12:42 p.m. a lunch recess was taken
7 until 1:45 p.m.)

8 - - -

9

10

11

12

13

14

15

16

17

18

19

20

21

22

23

24

25

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 Wednesday Afternoon Session,

2 December 10, 2008.

3 - - -

4 EXAMINER BOJKO: Mr. Resnik, would you
5 like to call your next witness?

6 MR. RESNIK: Thank you, your Honor. We
7 call Mr. Baker.

8 EXAMINER BOJKO: Mr. Baker, if you'll
9 recall, you are still under oath.

10 THE WITNESS: Okay.

11 EXAMINER BOJKO: Please be seated.

12 MR. RESNIK: Your Honor, first I'd ask
13 that we have marked, and I think the reporter already
14 has, but Mr. Baker's additional rebuttal testimony as
15 Companies' Exhibit 2E.

16 EXAMINER BOJKO: E?

17 MR. RESNIK: E.

18 EXAMINER BOJKO: It will be so marked.

19 MR. RESNIK: Thank you.

20 (EXHIBIT MARKED FOR IDENTIFICATION.)

21 MR. RESNIK: And at page 17 of that

22 prefiled testimony there was a chart that Ms. Roberts

23 called to our attention did not show up very well in

24 black and white, and we sent out copies of it in

25 color, and what I would suggest, this is the chart,

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 and we would like to mark that as 2F so that there
2 will be a readable copy of that in the record.

3 EXAMINER BOJKO: It will be so marked as
4 Companies' Exhibit 2F.

5 (EXHIBIT MARKED FOR IDENTIFICATION.)

6 MR. RESNIK: Thank you very much.

7 - - -

8 J. CRAIG BAKER

9 being previously sworn, as prescribed by law, was
10 examined and testified as follows:

11 DIRECT EXAMINATION

12 By Mr. Resnik:

13 Q. Please state your name.

14 A. My name is J. Craig Baker.

15 Q. Mr. Baker, do you have before you a copy
16 of what has been marked as Companies' Exhibit 2E?

17 A. Yes, I do.

18 Q. Could you identify that document, that
19 exhibit for us, please?

20 A. That is additional rebuttal testimony in
21 this case.

22 Q. And do you have before you a copy of
23 what's been marked as Companies' Exhibit 2F?

24 A. Yes, I do.

25 Q. And could you identify that exhibit,

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 please?

2 A. Yes. This is a chart that shows the
3 relative positioning of the three-year LIBOR with
4 three-year Treasury rate for the period of July of
5 '07 through July of '08.

6 Q. And is that the same chart that appears
7 on page 17 of your rebuttal testimony?

8 A. Yes, it is.

9 Q. Only it's in color and readable.

10 A. That's correct.

11 Q. Thank you. Going back to Companies'
12 Exhibit 2E, your rebuttal testimony, do you have any
13 corrections that need to be made?

14 A. I do. I have a few that missed the
15 last-minute edit checking so what I'd like to do is
16 run through them. First is on page 2, line 17. I'd
17 like to replace the word "legislature" with "General
18 Assembly."

19 The next is on page 6, line 4, there's an

20 extra word, and I would like to scratch the word "to"

21 between "the" and "selling" on line 4, page 6.

22 Page 7, line 8, fourth word in should be

23 "this" instead of "his."

24 MR. RANDAZZO: Could I have that one

25 back, Mr. Baker, please?

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 THE WITNESS: Certainly, Mr. Randazzo.

2 Page 7, line 8, fourth word in, which is "his,"

3 should be "this."

4 MR. RANDAZZO: Okay. Thank you.

5 A. Page 20, line 12, the last two words

6 should be hyphenated, "cost-based."

7 And the last one is on page 21, line 7,

8 there was a missing word between "70" and annually,

9 and the missing word is "million."

10 Q. Mr. Baker, any other changes that need to

11 be made?

12 A. No, that's it.

13 Q. Okay. And if I were to ask you the

14 questions that appear in what's been marked as

15 Companies' Exhibit 2E, and let's incorporate into

16 that the color chart that's marked as Companies'

17 Exhibit 2F, would your answers be the same as are

18 contained in your rebuttal testimony?

19 A. Yes, they would.

20 MR. RESNIK: Thank you, your Honor. I

21 have no further questions for Mr. Baker, and he's

22 available for cross-examination.

23 EXAMINER BOJKO: Thank you.

24 Do we have any volunteers to begin?

25 MR. WHITE: Your Honor, before we start

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 cross, I'd like to make a motion to strike.

2 EXAMINER BOJKO: Okay. Please proceed,
3 Mr. White.

4 MR. WHITE: The question on page 2, "Are
5 these examples consistent with the legislative
6 discussion leading up to the passage of Senate Bill
7 221 and the language of the bill," I'd like to strike
8 that question and answer. It's hearsay and without
9 substantiating -- without anything else
10 substantiating what the discussions were, it
11 shouldn't be on the record.

12 EXAMINER BOJKO: Do you have a response,
13 Mr. Resnik?

14 MR. RESNIK: Yes. Mr. Baker has the
15 specific qualification to testify about what was
16 going on at the legislature given the fact that, as
17 he said, he was the lead representative for the
18 AEP-Ohio companies in that entire process. And so he
19 is, as many people have given their view of what the

20 legislature means or doesn't mean -- legislation

21 means or doesn't mean, I think this gives color, if

22 you will, from Mr. Baker's perspective about whether

23 or not cost-of-service concepts are somehow

24 implicitly in the bill.

25 MR. WHITE: Your Honor, if I may. Giving

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 interpretation to what a statute means is different
2 than actually testifying to discussions that
3 occurred.

4 MR. RESNIK: Your Honor, it's not
5 hearsay. He heard this. This was his personal
6 knowledge that he is reflecting here.

7 EXAMINER BOJKO: Okay. Do you have any
8 other ones?

9 MR. WHITE: No, that's the only motion to
10 strike I have.

11 EXAMINER BOJKO: Are there any other
12 motions to strike?

13 MR. RANDAZZO: I could probably come up
14 with something, your Honor.

15 EXAMINER BOJKO: Let's go off the record.

16 (Discussion off the record.)

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

19 Given that this was Mr. Baker's personal

20 experience and his participation in the matter and
21 given -- or, to be consistent with all of our other
22 discussions that we've had on Senate Bill 221
23 throughout this hearing process, we're going to deny
24 the motion to strike and we'll allow it and allow
25 parties to question or cross-examine Mr. Baker on his

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 experience during the SB 221 process.

2 Okay. Now do we have any volunteers?

3 MR. RANDAZZO: I'll go.

4 EXAMINER BOJKO: Okay. Thank you,
5 Mr. Randazzo.

6 - - -

7 CROSS-EXAMINATION

8 By Mr. Randazzo:

9 Q. Mr. Baker, let's pick up where the motion
10 to strike left off, and do you regard your experience
11 during the legislative process as something that
12 qualifies you as an expert on legislation?

13 A. I would not consider myself an expert, in
14 general, on legislation; however, I learned a lot and
15 experienced a lot and probably know more about this
16 process than, if I had my way, I'd know, want to
17 know.

18 Q. Fair statement.

19 Now, I'd like to ask you something that

20 is in the portion of your testimony that's on the
21 bottom of page 2 and carrying over to the top of page
22 3, and let me begin, you make reference there to a
23 "Just and Reasonable Standard." And then you say the
24 standard was connected to the evaluation of costs
25 incurred by the companies in setting rates.

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 Did the Commission during the legislative
2 process propose to establish a just and reasonable
3 standard?

4 THE WITNESS: I'm sorry, could I have the
5 question read back?

6 EXAMINER BOJKO: You may.

7 (Record read.)

8 A. I do not remember the Commission taking
9 that position.

10 Q. Well, you are aware, are you not,
11 Mr. Baker, that the just and reasonable standard is
12 one that's included in the Federal Power Act, right?

13 A. Yes.

14 Q. And presently under the Federal Power Act
15 AEP is selling electricity in the wholesale market
16 based upon a market-based pricing mechanism, correct?

17 A. Yes, they are. But I would point you --
18 I'd link -- in my view the testimony was intended to
19 link the two, cost of service and just and

20 reasonable. Where I do agree with you the, FERC has
21 found market-based rates to be just and reasonable.
22 Q. Okay. But, at least academically,
23 there's no necessary connection between the just and
24 reasonable standard and a particular methodology for
25 establishing prices, is there?

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 A. There doesn't have to be.

2 Q. And in your experience dealing with laws
3 that are associated with regulation of public
4 utilities, the use of the just and reasonable
5 standard does not imply a particular ratemaking
6 methodology, does it?

7 A. I don't think it has to, Mr. Randazzo,
8 but in states which have been traditional regulation
9 of generation at state level, those two, cost of
10 service and just and reasonable, have generally been
11 linked.

12 Q. Okay. Now, what is your understanding of
13 the objective behind the just and reasonable
14 standard? And let me ask the question more
15 specifically.

16 Is it your understanding of the standard
17 itself to be one which requires a balancing of
18 interests between the utility and customers for
19 purposes of establishing rates?

20 A. Yes, I would agree with that.

21 Q. All right. Is the company's

22 responsibility to be the provider of last resort a

23 competitive or noncompetitive function?

24 A. I was asked this question in my second

25 round of testimony, and I believe I said that it is a

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 responsibility of the distribution company and I
2 didn't know how it could be passed off to a
3 competitive supplier.

4 Q. Okay. I'm asking you if you are aware in
5 my next question. Are you aware of any requirements
6 in Senate Bill 3 as modified by Senate Bill 221 that
7 deals with how pricing for noncompetitive services is
8 to occur and, more specifically, what ratemaking
9 methodology is to be used by the Commission for
10 noncompetitive services?

11 A. I haven't reviewed that in preparation so
12 I wouldn't venture an answer at this point.

13 Q. If the General Assembly has specified a
14 ratemaking methodology for noncompetitive services,
15 that, of course, would control, correct? I'll
16 withdraw the question.

17 A. I'm sorry?

18 Q. I'll withdraw the question.

19 Are ancillary services competitive or

20 noncompetitive services?

21 A. I would believe that -- the way I would

22 answer that, Mr. Randazzo, is I think you're asking

23 me for definitions under the bill, and as I did with

24 POLR, what I'd like to say is that I believe that if

25 a customer shops, they could get -- they could

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 provide ancillary services from their supplier.

2 Q. Are you aware of anything in Senate Bill
3 3 as modified by Senate Bill 221, and I'm asking if
4 you are aware, that deals with the question of
5 whether ancillary services are a competitive or
6 noncompetitive services?

7 A. Again, I have not gone back and
8 researched that for purposes of this testimony.

9 Q. As part of this application, the electric
10 security plan application, have the companies asked
11 the Commission to declare ancillary services to be
12 competitive or asked the Commission to declare that
13 the provider of last resort function be declared --
14 be a competitive service?

15 A. I don't know.

16 Q. Now, on page 3 as well there's a question
17 I want to ask you about words used in the question,
18 assuming that you had something to do with the
19 question as well as the answer. In the question it

20 refers to true regulation. Can you tell me what you

21 mean by "true regulation" there?

22 MR. RESNIK: Can I have the question read

23 back, please?

24 EXAMINER BOJKO: It says "true

25 reregulation."

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 MR. RANDAZZO: Oh, true reregulation,
2 excuse me. That's what I meant to ask. Thank you.
3 I'm sorry, your Honor.

4 Thank you, Mr. Resnik.

5 A. What I mean by that in this context is
6 states which have had a plan for deregulation, passed
7 deregulation legislation and have gone back to
8 regulation of generation, as I believe I lay out in
9 this answer which deals with the standard that you
10 virtually eliminate customer choice, that you set
11 rates on a cost of service and things of that ilk.

12 Q. Okay. And you say on the next page
13 that -- in the sentence that begins on line 1, that
14 "Ohio did none of these things," and from that
15 you're, I think, trying to make the point, are you
16 not, that we no longer have true reregulation in Ohio
17 or we don't have true reregulation in Ohio. Is that
18 the point you're trying to make?

19 A. I would say that we do not have true

20 reregulation as I defined it in this answer.

21 Q. Okay. Now, one of the things that is
22 identified on page 3, line 21 in discussing the
23 Virginia legislation is your indication that they
24 have virtually eliminated customer choice. Is it
25 your understanding of Senate Bill 221 that it

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 provides an opportunity for the companies to suggest
2 limitations on shopping as part of an electricity
3 security plan? Is that your understanding?

4 A. My recollection is there is that kind of
5 provision, but I don't think it's consistent -- if we
6 were to do that, wouldn't be consistent with other
7 parts of the bill so I don't know how you rationalize
8 those two things.

9 Q. Okay. Now, on the bottom of page 4 and
10 top of page 5 you're there discussing your views on
11 circumstances that might cause the Commission to
12 modify an ESP and what would happen in the event the
13 Commission did, as I read it. When you were on the
14 stand previously, I discussed with you briefly a
15 document that was marked and admitted as IEU Exhibit
16 No. 5. It's the presentation from the EEI
17 conference, the nicely colored document that I would
18 be happy to furnish you a copy.

19 A. I remember a discussion about that

20 document, yes.

21 Q. Okay. And --

22 MR. RANDAZZO: May I approach the

23 witness?

24 EXAMINER BOJKO: You may.

25 Q. Mr. Baker, I'd like to ask you to turn to

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 page 9 of that document. And am I correct that that
2 page is a page that focuses on the earnings guidance
3 provided by AEP at the Edison Electric Institute
4 Conference?

5 THE WITNESS: Could I ask that that
6 question be reread because I'm not sure I understood
7 the lead-in to them. So if I could have it reread,
8 I'd know how to answer the full question.

9 Q. The lead-in was we talked about this
10 before.

11 A. No, I think there was a sentence or two
12 before that.

13 (Record read.)

14 A. I'm sorry, is that the total -- okay.
15 Then I read more into what you were asking me.

16 Q. I think so.

17 A. Yes, this is a document that was provided
18 at the fall EEI conference that deals with our
19 guidance as far as 2008 and 2009 earnings.

20 Q. Okay. At the bottom of that page 5

21 there's a statement that says: "The 2009 guidance

22 provides a range for reasonable Ohio outcome." Do

23 you see that?

24 A. Yes, I do.

25 Q. As you understand it, the outcome that is

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 being referenced there would be the outcome of this
2 proceeding, right?

3 A. Yes. We are talking about this filing of
4 an ESP, but that is a broad term that deals with one
5 of the many issues that goes into the creating of the
6 guidance.

7 Q. Okay. What was the reasonable Ohio
8 outcome that was embedded in the earnings guidance?

9 A. I don't have that answer.

10 Q. Well, let me ask it this way, if there
11 was a reasonable Ohio outcome and it was identified
12 to the Commission and it happened to be different
13 than the proposal as filed by the companies, it would
14 be okay with AEP if the Commission approved that
15 reasonable outcome, right?

16 A. That one I will need to have reread.

17 Q. Let me reask it.

18 A. Thank you.

19 Q. Is the only outcome that is reasonable to

20 AEP for purposes of an electric security plan the
21 outcome that's been proposed in the application?
22 A. The Commission under the legislation, as
23 I understand it, has the right to modify our plan.
24 When and if they do, I would certainly hope they
25 would approve it, but if and when they modify it, we

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 would have to evaluate what the outcome was and
2 decide whether that was acceptable to the company.

3 Q. And based upon page 5 of IEU Exhibit No.
4 6, there's been some effort on the part of AEP to
5 identify a reasonable Ohio outcome for purposes of
6 providing earnings guidance to the investment
7 community, right?

8 MR. RESNIK: Can we have that back? I'm
9 not sure you had the reference right.

10 EXAMINER BOJKO: I think Mr. Randazzo
11 said this chart was in both documents. We've been in
12 IEU Exhibit 5 on page 9.

13 MR. RANDAZZO: Yes, I'm sorry. And it's
14 the same chart on page 5 of IEU Exhibit No. 6. Sorry
15 for the confusion.

16 A. Mr. Randazzo, in developing guidance, as
17 I understand the way our financial group does this,
18 they look at potential series of outcomes across the
19 range of our total business and get a high and a low

20 outcome. So I don't know the individual pieces that
21 go into this, and there wasn't a single-point
22 estimate that said this is reasonable or this is not
23 reasonable. The company hasn't made that
24 determination.

25 Q. Okay. Fair enough.

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 If we could turn to page 5, bottom of the
2 page where you focus on the Purchase Power Proposal.

3 A. This is in my testimony, not the exhibit?

4 Q. Yes, it is, I'm sorry. Yeah, good
5 question.

6 Turning to page 5 of your rebuttal
7 testimony where you begin the discussion of the
8 Purchase Power Proposal, the title Purchase Power
9 Proposal is the same as the slice-of-system proposal?

10 A. Yes, it is.

11 Q. Now, if the Commission were to approve
12 this aspect of the application, and regardless of the
13 percentage that is selected for the portion that is
14 sourced from the market, which source of supply, the
15 market purchases or existing generating assets owned
16 by the companies would flow first through the meter?

17 A. The way I would describe that,
18 Mr. Randazzo, is that these purchases would be
19 dedicated to the Ohio Power and Columbus & Southern

20 companies and, therefore, would be part of the FAC

21 charge.

22 Q. Okay. What I'm really asking here is

23 let's assume that -- as I understand it, you're going

24 to be purchasing based upon a forecast of

25 requirements, correct?

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 A. Correct.

2 Q. Okay. And let's assume that in 2009 you
3 forecast normal weather and sales associated with
4 normal weather and you purchase, for purposes of this
5 discussion, 5 percent of your total SSO requirements
6 from the marketplace based upon that forecast.

7 A. All right.

8 Q. Are you with me?

9 A. I'm with you.

10 Q. As weather actually turns out, it
11 deviates from normal and that deviation results in
12 actual sales that are less than the forecast. Does
13 the cost of the 10 percent purchase get reflected in
14 the FAC with the residual cost being determined by
15 the generating assets owned by the companies, or is
16 there some blend of those actual purchases with the
17 existing generation to determine how much flows
18 through the FAC?

19 A. We haven't developed the RFP for this,

20 Mr. Randazzo, but let me try to answer your question

21 in how I think it would be done.

22 We would be going out for the slice of

23 system based on -- to give people an idea of what

24 their expected supply requirement would be, but if

25 there were weather or loss of load, then that would

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 reduce the amount of power we would purchase under
2 the 5 percent.

3 Q. Okay. So you would end up with the
4 percentage being dictated by the ratio between actual
5 sales and actual purchases, correct?

6 A. What I'm saying is that you would be
7 forecasting and telling the suppliers to supply
8 5 percent of the load and you would change it over
9 time as conditions change. That's where I think we
10 would go, but as I say, we haven't finalized that.

11 Q. Well, if you did anything other than
12 that, then the actual percentage of purchases at
13 market prices would be something higher or above the
14 10 percent number that I used in my hypothetical,
15 right?

16 A. Well, if we did it based on a pure
17 forecast, it could be higher or lower.

18 Q. Right. But, as you say, you haven't
19 developed exactly how that's going to work yet?

20 A. No. But as we've thought of slice of
21 system, the way I described it is generally the way
22 we've done it.

23 Q. Okay. Now, on page 6 and also on page 7
24 you discuss the expectation that the companies had
25 relative to the Monongahela Power and Ormet

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 transactions. As a general proposition do you think
2 that the expectations in these areas should manifest
3 themselves in the results produced by regulatory
4 actions?

5 THE WITNESS: I'm going to need that
6 question read back.

7 (Record read.)

8 A. I'm not sure I understand the question,
9 but let me try to answer it as best I can. As we
10 looked at it, our expectation was that we would be
11 going to market and we recognize that the Commission
12 only needed to deal with the period up till we went
13 to market.

14 It was our expectation that if we had
15 something other than market, we could come to this
16 Commission, as we did -- as we have done in this
17 case, and ask for treatment, and it would have been
18 our expectation that we would have gotten the same
19 kind of treatment we've asked for here.

20 Q. Well, let's talk about -- you picked a
21 certain time frame here on expectations. When Senate
22 Bill 3 was enacted, was it the expectation that
23 market prices would be lower than cost-based
24 ratemaking prices that existed at the time?

25 A. I would say that probably different

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 people had different opinions on that.

2 Q. Well, AEP --

3 A. I'm sorry.

4 Q. Let's talk about AEP. Didn't you --

5 didn't the companies request stranded cost recovery

6 as part of the transition to --

7 A. Yeah. I may have misunderstood your

8 question so let me try to clarify it.

9 Q. Sure.

10 A. I thought what you were saying was an

11 expectation of what it would be in 2006 when we went

12 to market.

13 Q. Right.

14 A. And I believe that we did feel that our

15 forecast said there would be stranded costs for AEP.

16 I know there were people who said to the contrary and

17 said the prices in the case of AEP companies, it

18 would have been -- the price would have been higher.

19 That led to the debate about whether or not AEP had

20 stranded costs.

21 Q. Right. And the Commission awarded

22 stranded cost recovery for AEP, correct?

23 A. No, I don't believe they did.

24 Q. Okay. If the Commission did order

25 stranded cost recovery in the form of transition cost

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 payments made by customers, would you agree that the
2 expectation at the time was that market prices would
3 be less than legacy prices?

4 MR. RESNIK: Are you done?

5 MR. RANDAZZO: Yeah.

6 MR. RESNIK: I'm sorry. I would object.

7 The regulatory transition charges were not stranded
8 costs associated with changing value of the
9 generation plants relative to the market price that
10 was anticipated. So I think the question is assuming
11 that the regulatory transition charges were stranded
12 costs in the sense that the prior question was asking
13 about it.

14 EXAMINER BOJKO: I think Mr. Baker can
15 answer the question if he understands the question
16 and he is more than capable of clarifying his
17 response if he needs to.

18 THE WITNESS: Could I have the question
19 read back, please?

20 (Record read.)

21 A. My recollection, it could be flawed,

22 Mr. Randazzo, was the Commission approved a

23 settlement, and the settlement was a -- with a number

24 of parties, and we waived our rights to the stranded

25 cost in order to get regulatory assets.

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 Q. So your understanding is that the
2 provisions dealing with the recovery of regulatory
3 assets was something other than recovery that was
4 associated with transition costs or stranded costs?

5 A. It had nothing to do, in my mind, with
6 the difference between market and the cost of our
7 assets. It had to do with there were regulatory
8 assets that we had on the books for stuff that
9 happened prior to 1999 that we didn't want to write
10 off.

11 Q. All right. Let's go back to
12 expectations. Was it the expectation at the time of
13 Senate Bill 3 that market prices would be less than
14 the prices that had been previously produced by
15 traditional regulation?

16 THE WITNESS: Can I have that read back,
17 please?

18 (Record read.)

19 A. I believe I answered that question. I'm

20 not sure I'm catching the nuance, if there is one,
21 but I believe there were some people who thought that
22 market prices -- and I'm talking purely in the case
23 of AEP-Ohio. Some thought the prices would be --
24 market prices would be higher and some thought it
25 would be lower.

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 Q. Okay. If customers of AEP believed
2 that -- somehow, believed that market prices would be
3 lower, do you think it would be appropriate to
4 respect that expectation by producing a regulatory
5 outcome that satisfied that expectation?

6 A. I think regulatory outcomes are
7 determined by what the General Assembly tells the
8 Commission to do and they have to interpret it.

9 Q. All right. Let's move on to another
10 subject. On page 7 you talk here again about what
11 I'll call the slice-of-system proposal, and here
12 you're saying that the proposal "will help the
13 Companies encourage further economic development in
14 their service territories." I'm referring to page 7,
15 line 16 and 17. Do you see that?

16 A. Yes, I do.

17 Q. As a general proposition the
18 slice-of-system proposal results in a standard
19 service offer price that is higher than it would

20 otherwise be without the slice-of-system component,

21 right?

22 A. I would say that's the expectation today,

23 not knowing where the cost of generation --

24 Q. Sure.

25 A. -- will be over this whole period, I

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 can't guarantee that, but for purposes of this

2 filing, yes, I'd agree with that.

3 Q. Okay. So how is it that the

4 slice-of-system proposal which produces somewhat

5 higher prices in the aggregate helps economic

6 development?

7 A. Again, let's clarify. You said would

8 result in higher prices.

9 Q. Right.

10 A. And I put a caveat in the last answer --

11 Q. Well, if I may, Mr. Baker. Mr. Nelson

12 who testified previously indicated that one of the

13 reasons why we ought to consider providing carrying

14 charges on environmental costs is that it will

15 continue to make the lower-cost coal-fired generation

16 available to customers at a price that's

17 significantly below market.

18 But that aside, I understood your caveat

19 before, and I'm happy for you to make it again, but

20 the context of my question was understanding the

21 caveat that you made previously.

22 A. Certainly. What I meant by that term was

23 that we would have started to lock in supplies and we

24 would have a good idea of what the cost would be.

25 Now, we wouldn't have it all locked in because we

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 talk about doing this in tranches over periods, and
2 there would -- I believe that the rate will still be
3 very economically attractive, and we will know we
4 would have supplies in order to meet that rather than
5 having to go out in the market in realtime when it
6 happens and be debating as to whether it's
7 economically advantageous to pursue economic
8 development relative to the then cost of power in the
9 market.

10 Q. Well, I thought on page 6 that you made
11 it clear finally that the slice-of-system proposal
12 has nothing to do with the companies' need for
13 generation supply to serve Ormet or Monongahela Power
14 customers. That's on page 6, line 10 and 11. Right?

15 A. Those are what the words say, but what we
16 are saying is we are not putting the proposal forward
17 based on a need for power, it's about the issue
18 around Mon Power and Ormet and our expectations going
19 forward.

20 Q. Well, I understand the expectation part.
21 We talked about that. I'm just trying to connect the
22 dots here in terms of how a proposal that in general
23 has the tendency to increase prices relative to an
24 ESP without the slice-of-system proposal would
25 encourage economic development.

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 A. Because we would have more supply
2 available to us at known prices that we could then
3 help the State go after economic development with
4 prices that I believe will still be attractive
5 relative to the competition around us.

6 Q. Well, you would also know the cost of
7 your own generation, right, the company's generation?

8 A. We would have a good estimate.

9 Q. Would it -- strike that.

10 Now, turning to the off-system sales
11 discussion on page 8 and 9 of your testimony, are you
12 aware of how off-system sales were treated for
13 purposes of developing Columbus & Southern and, more
14 specifically, Ohio Power's rates and charges
15 historically under traditional regulation?

16 A. If we're talking about the period of
17 let's just use an example the rate cases that were
18 done in the '90s which set the rates that are the
19 base of our current rates, those off-system sales

20 were treated as credits to rate base.

21 Q. And so the -- translating that, if we

22 can, Mr. Baker, would it be fair to say that in those

23 rate cases rather than making adjustments to rate

24 base to exclude a portion of the asset value that

25 might be associated with making off-system sales, the

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 full amount of generating asset plant cost was used
2 for purposes of developing retail rates under
3 traditional regulation?

4 A. I'm not sure I can -- I won't buy the
5 proposition that starts out with "as opposed to doing
6 this, therefore, that." I will agree that they were
7 treated as a credit to rate base.

8 Q. If those off-system sales costs were
9 treated as a credit to rate base, then is it your
10 understanding that the full amount of the generating
11 plants associated with providing off-system sales was
12 included in rate base?

13 MR. RESNIK: I'm sorry, can I have that
14 question read back, please?

15 EXAMINER BOJKO: Yes.

16 (Record read.)

17 A. The full amount of the -- or the fixed
18 costs associated with the full capacity for those two
19 companies was included in rate base because those

20 plants were built to serve the internal load of those

21 two companies.

22 Q. Right. And historically, particularly in

23 the case of Ohio Power, it was quite common in those

24 traditional rate cases for stakeholders to make

25 claims that Ohio Power had excess capacity because of

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 the large reserve margin, was it not?

2 A. I would not be surprised. I notice it
3 appears -- has appeared that way in various states.

4 Q. And would you accept that, subject to
5 check, in the case of Ohio Power?

6 A. I would accept it, subject to check, that
7 some intervenors took that position.

8 Q. And would you accept, subject to check,
9 that the Commission rejected excess capacity
10 arguments because of the ability to make off-system
11 sales to reduce and -- thereby reduce the cost
12 ultimately that was borne by customers?

13 A. I will accept that, subject to check.

14 Q. Okay. And, based upon that history,
15 would you also accept then that the generation rates,
16 and particularly the non-FAC rates, include costs
17 associated with generating assets, some of which for
18 some portion of time have been used to support
19 off-system sales?

20 A. To support off-system sales, we make
21 off-system sales with surplus energy that we have on
22 the system, and it comes about because it's not
23 needed at that time to serve the native load, even
24 though they were built to serve native load.

25 Q. And now the answer to my question.

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 A. That was the answer to your question.

2 Q. Well, let me ask it this way. If those
3 plants were built to serve native load customers, why
4 is it that it's appropriate to take those assets to
5 market?

6 A. Because it's better than letting surplus
7 energy sit idle.

8 Q. All right. And if native load customers
9 are paying for those generating assets, do you think
10 it's appropriate they receive some portion of the
11 benefit that's derived from utilizing those assets
12 when they would otherwise be idle?

13 A. I don't think the customers are paying
14 for those generation assets. They're paying for
15 service that they received as rates were set,
16 Mr. Randazzo, back in the mid-'90s. We've had many
17 changes. We've gotten away from cost of service and
18 we just continue to make off-system sales, and we
19 said what we think the right treatment is.

20 Q. Okay. Mr. Baker, at page 20 -- and this
21 is the last area of my questions. Page 20 you begin
22 a discussion in your rebuttal testimony of sale or
23 transfer of certain generating assets. I thought
24 from your prior testimony that there was no current
25 plan to transfer or sell any of these generating

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 assets. Is there a current plan to sell or transfer
2 any of these generating assets?

3 A. No.

4 Q. So do you think it's unreasonable to
5 withhold authority that may be required from this
6 Commission on the transfer or sale of generating
7 assets until such time as the companies actually have
8 a plan to sell or transfer the generating assets?

9 A. I think it's appropriate for that
10 authority to be given as part of our ESP, which is
11 part of our total plan.

12 Q. Well, didn't you previously receive
13 authority from the Commission to transfer generating
14 assets?

15 MR. RESNIK: I'll object, your Honor.
16 It's been asked and answered from Mr. Baker's prior
17 stint on the stand.

18 MR. RANDAZZO: That's fine.

19 Q. Mr. Baker, I'd like you to assume that

20 AEP previously asked and received -- asked for and
21 received authority to transfer generating assets and
22 elected to not transfer generating assets. With that
23 history, why is it that it is so important for you to
24 receive authority to transfer these generating assets
25 at a time when you have no plan to transfer the

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 generating assets?

2 A. Let's talk about the time, Mr. Randazzo.

3 The plants we're talking about were not part of that
4 previous request for EWG status that was put in front
5 of this Commission. These plants -- these plants are
6 ones that were bought after Senate Bill 3 passed in
7 anticipation of going to the market, and the
8 shareholders of the company took the risk on these
9 plants and, therefore, I think it's appropriate for
10 us to have the authority to, if we choose, to
11 transfer or sell these assets at our discretion.

12 Q. Okay. That's as straightforward as
13 anybody could put it, Mr. Baker.

14 MR. RANDAZZO: Thank you very much.
15 That's all I have.

16 EXAMINER BOJKO: Mr. Petricoff?

17 MR. PETRICOFF: Thank you, your Honor.

18 - - -

19 CROSS-EXAMINATION

20 By Mr. Petricoff:

21 Q. Good afternoon, Mr. Baker.

22 A. Good afternoon, Mr. Petricoff.

23 Q. This is the third and probably final time

24 that we'll engage in this dialogue, at least

25 hopefully, in this case.

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 A. Well, I'll miss it.

2 Q. As will I.

3 If you would, turn to page 4 of your
4 testimony, and I want to refer you to the sentence
5 that starts on line 6, and I'll read it to you, it
6 says: "Section 4928.143(B)(2), Revised Code, makes
7 it clear that a company may provide any provision in
8 an ESP for approval by the Commission as long as the
9 ESP in the aggregate is more favorable to customers
10 when compared with the expected results from an MRO
11 option."

12 I want to explore that statement with
13 you. What if the ESP application had a provision in
14 it that violated a state statute but the ESP in the
15 aggregate was more favorable than the expected
16 outcome of the MRO, would the Commission have to
17 accept the ESP or could it require the offending
18 provision to be amended?

19 A. I assume that the Commission cannot do

20 something that breaks the law.

21 Q. What if the ESP had a provision that

22 violated a Commission rule but the ESP in the

23 aggregate was more favorable than the expected

24 outcome of an MRO, would the Commission have to

25 accept the ESP or could the Commission require the

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 offending provision be amended?

2 A. I don't know the answer to that because,
3 unlike the law, I assume the Commission could change
4 the rule.

5 Q. So you're uncertain on that one?

6 A. My answer is my answer.

7 Q. Well, my question is that you're
8 uncertain whether the Commission would have the
9 authority to amend an ESP because it violated a
10 Commission rule?

11 THE WITNESS: Can the question be read
12 back?

13 (Record read.)

14 A. I'd say I was uncertain.

15 Q. One last question in this series. What
16 if the ESP had a provision that violated an
17 established regulatory principle but the ESP in the
18 aggregate was more favorable than the expected
19 outcome of the MRO, would the Commission have to

20 accept the ESP or could it require the offending

21 provision to be amended?

22 A. I don't know what you mean by "regulatory

23 principle."

24 Q. Okay. Let's assume that a regulatory

25 principle would be the outcome that the Commission

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 has taken when faced with similar issues in similar
2 cases over a long period of time.

3 MR. RESNIK: And, your Honor, I'm going
4 to object. There by definition cannot have been
5 similar cases to an ESP under Senate Bill 221. I
6 think that's what's taken us all so long to get
7 through this. So when we talk about established
8 regulatory principles, those principles were
9 established in a different regulatory environment so
10 I would object to the question.

11 EXAMINER BOJKO: I guess I didn't think
12 Mr. Petricoff's question had to be necessarily in the
13 here and now.

14 I think you're just speaking generally if
15 there was a regulatory principle in place; is that
16 right?

17 MR. PETRICOFF: That's correct.

18 Q. And maybe I'll give you an example of a
19 regulatory principle and then see if that can assist

20 you. For example, over the years the Commission has
21 decided that there -- that customers in like position
22 should be treated in like manner by the utility.
23 That's an example of an established utility
24 principle.

25 A. I think the Commission's going to

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 redefine regulatory principle based on Senate Bill
2 221. I don't know how they're going to do that, but
3 this is a bill that is unlike anything I've ever seen
4 before, and it's going to create tremendous
5 challenges so I'm not sure there is a historic
6 regulatory principle that won't have to be tested.

7 Q. So it's your opinion that past decisions
8 and past practices of the Commission will have to be
9 reexamined in toto when approaching this case?

10 A. I think that the Commission will have to
11 consider what Senate Bill 221 tells them to do when
12 they have questions come before them.

13 Q. Let's move on here. On line 8 you recite
14 that -- and this is we're measuring now between the
15 ESP and the MRO -- that in the aggregate it is more
16 favorable, and I want you to focus on the word
17 "favorable."

18 In your opinion when the Commission
19 evaluates whether an ESP is more favorable in the

20 aggregate than the expected outcome of an MRO, is it

21 strictly an economic or cost per kWh test?

22 A. No.

23 Q. So it's possible then, that the ESP could

24 be lower per kWh but because it has an offending

25 provision in it, the Commission could deem it to be

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 less favorable than the MRO?

2 A. Offending? Offending is kind of an
3 interesting word. Do you mean something that is not
4 permitted under law, going back to your earlier
5 question?

6 Q. No. By "offending" I was thinking that
7 it had a -- well, let me try it again, then.

8 Assuming that the ESP was lower by a
9 penny a kilowatt-hour than the MRO but it had a
10 provision in it which was not illegal but in the
11 consideration of the Commission pernicious or
12 offensive but not illegal, could the Commission,
13 based on that, decide that it was not favorable, the
14 ESP was not as favorable to the MRO, even though it
15 was cheaper?

16 A. The Commission has the authority to
17 reject our plan or to reject an ESP. I think the
18 criteria should be looking at whether the ESP as it's
19 defined here in the aggregate is more favorable.

20 They're going to have to make that determination, and
21 they are going to tell us whether they accept,
22 modify, or reject our plan and we will react to that
23 activity. I don't tend to tell the Commission what
24 they can and cannot do.

25 Q. Let's move from reject and approach the

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 same issue and ask what about amend. Can the
2 Commission amend the ESP without rejecting it because
3 it considers an aspect of the ESP to be not as
4 favorable as the MRO?

5 A. I think I just answered that I don't tell
6 the Commission what they can and cannot do. They
7 will do what they do, and we will have to determine
8 whether the plan is still acceptable to us.

9 Q. Fair enough.

10 Let's turn to page 13 of your testimony.

11 If you would. I'd like you to turn to line 18, and
12 here's the sentence I want to have a dialogue with
13 you about. Your testimony says: "No. First, I have
14 been advised by counsel that customers who return to
15 the Companies' SSO upon the default of their
16 competitive supplier are statutorily entitled to
17 service at the SSO rate."

18 I want you to focus in on the word
19 "default." What did you mean there when you said

20 "default"?

21 A. Well, it was the advice of my counsel, so
22 I assumed that what we were talking about was for
23 whatever reason the competitive supplier failed to
24 continue to supply a customer under a contract.

25 Q. Okay. And if a customer -- well, let me

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 ask you this, does a CRES, a competitive retail
2 electric supplier now if they are going to qualify to
3 do business in AEP or on the AEP systems, do they
4 have to supply a bond or provide other financial
5 security?

6 A. I would expect they would.

7 Q. And the company generally can rely upon
8 that security in the case that the CRES does not meet
9 its obligations to supply power?

10 A. Again, I would assume so, but I'm not
11 sure that it necessarily would cover whatever the
12 impacts were.

13 Q. Well, now I'm just focusing in on the
14 word "default." You would agree with me that in a
15 situation like that where the CRES didn't supply and
16 the company supplied and then, you know, confiscated
17 the bond or took other actions, that that would be a
18 default that would fit in the language that -- your
19 testimony here on lines 18 to 20.

20 A. I didn't get into -- in thinking this
21 through, Mr. Petricoff, I wasn't thinking about what
22 the -- what bonds were out there or what the company
23 could do with those bonds. It was purely that if
24 there was a default, as I understand it, that the
25 customers could come back at the SSO rate.

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 Q. Let me give you another situation. Let's
2 say that there wasn't a default but the CRES supplier
3 stopped supplying because the contract came to an
4 end. It was a year contract. We're now in the
5 366th day, assuming this wasn't a leap year, and
6 the CRES stops supplying. In that situation does the
7 customer have a right to come back to the SSO rate?

8 A. I believe they do.

9 Q. Let's say that the customer now is --
10 actually, before we do that, your advice from counsel
11 seemed to be specific as to upon default. Your
12 understanding then, is that it's broader than on
13 default. It's just anytime the customer wants power
14 they can return to the SSO rate?

15 A. With the exception of the governmental
16 aggregation that I talk about later, it is my
17 understanding that if a customer comes back for
18 whatever reason, that they can come back at the SSO
19 rate.

20 Q. Well, let's talk about the government
21 aggregation now. If you have a government
22 aggregation and the government aggregator has given
23 the notice under section 4928.20(J) that it does not
24 care to pay the POLRs or have its members pay the
25 POLRs and that they will return at market. In that

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 case if there's a default, do the customers come back

2 at market rates rather than the SSO rate?

3 THE WITNESS: Could I have that read

4 back, please?

5 (Record read.)

6 A. We had a lot of dialogue about this in my

7 second round of testimony, and the Bench was asking a

8 number of questions about the standby and the POLR,

9 and I indicated that I wasn't sure how the Commission

10 would deal with POLR and standby, whether they were

11 one and the same or not. And then we got into a

12 dialogue about what standby service was, and there

13 were current tariffs that had standby service. So at

14 that point I indicated I really didn't know exactly

15 how the Commission would treat the governmental

16 aggregation in relation to our request for POLR but

17 they would do what they did, and we would look at it.

18 I also in my direct testimony talked

19 about the potential that although, as you described

20 it as I think what the law provides, that there may
21 be a situation where if, in fact, the market rates
22 were so high and that's the reason the governmental
23 aggregator got out of business -- went out of
24 business, there is a chance that we would not be
25 allowed to charge market-based rates. That's

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 captured in my direct testimony.

2 Q. Well, I want to see if we can funnel down
3 to something. What is your understanding today as to
4 the ability of a governmental aggregation to waive
5 the POLR charges as you have -- you being AEP -- have
6 applied for them in this case and come back if the
7 customers come back at market?

8 A. We indicated that we thought the POLR
9 charge was nonbypassable regardless of aggregation,
10 and it was brought to my attention that the POLR
11 might be a standby and, therefore, we might be
12 precluded from doing it, and I said in that case
13 that's what the Commission will tell us, but our
14 proposal was that POLR is there regardless.

15 Q. Okay. And you've not received similar
16 advice from counsel as you have on line 18 and 19 as
17 to what happens with the governmental aggregation as
18 you discuss on page 14 in lines 1 to 3.

19 A. Nothing more than what's in my direct

20 testimony.

21 Q. In that case I'd like to -- I want to ask
22 you a series of questions about the fuel adjustment
23 clause now.

24 A. Can you point me to a section in my
25 testimony that we're talking about?

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 Q. Yes, I can. Actually, these questions
2 are going to center around your testimony on page 14,
3 lines 7 to 9, where you indicate that your
4 understanding that this current Commission cannot
5 bind some future commissions that would have to
6 decide whether the companies could flow through their
7 fuel adjustment clause, the market prices of serving
8 the loads returning to customers. I want to explore
9 that concept with you.

10 Let's start with an easy example. If the
11 fuel adjustment clause requested by AEP is approved
12 by the Commission in 2009 and in 2010 500 new
13 customers move into the AEP territory, could the
14 Commission in 2010 deny recovery by AEP of the fuel
15 and purchased power costs associated with that
16 incremental load of 500 new customers because the
17 fuel adjustment clause was authorized by a past
18 Commission?

19 THE WITNESS: Could I have the question

20 read back, please?

21 (Record read.)

22 A. The issue we're trying to address here is

23 the idea that you just go out and buy at market to

24 serve the load, not whether or not you can use your

25 own generation or the purchase. The implication of

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 what everyone was -- what I read other people's
2 testimony to say was you don't have a risk because
3 just go out and buy at market and you got it covered.

4 When we were in -- when I was sitting in
5 listening to Miss Medine testify, she took this
6 position and then followed it up with, but if your
7 own generation is cheaper, then you wouldn't go out
8 to the market and buy it, you would use your own
9 generation.

10 So we've got a bit of dichotomy between
11 where what people are saying on one hand and then
12 what they say a couple minutes later about economic
13 dispatch and how you do resources.

14 If you're asking do they have a prudence,
15 can they look at prudence, of course they'll look at
16 prudence as far as the purchase decision or the
17 dispatch decision. Yes, they'll look at this --

18 MR. PETRICOFF: Your Honor, I move to
19 strike. It's nonresponsive. The question asked

20 about Commission authority.

21 MR. RESNIK: Your Honor, could I have the

22 question and answer read back, please?

23 EXAMINER BOJKO: Yes.

24 (Record read.)

25 MR. RESNIK: I think --

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 EXAMINER BOJKO: Actually, well, he
2 didn't answer it. I mean, the question wasn't
3 prudence that Mr. Petricoff was asking, so the answer
4 will be stricken.

5 And, Mr. Baker, maybe you could try to
6 answer the question. I was looking for some response
7 in that long answer somewhere and I just couldn't
8 find it.

9 THE WITNESS: Okay. I was trying, but if
10 I didn't do it, I'll try again.

11 EXAMINER BOJKO: Does the Commission have
12 authority under his hypothetical to modify the
13 previous decision?

14 THE WITNESS: I don't believe that
15 they -- if the question was around if a fuel
16 adjustment clause is put in place, could they deny
17 passing through -- costs through a fuel adjustment
18 clause, I think the answer is no. That, I think, is
19 set up as far as this bill.

20 What we're talking about here is a
21 specific action the company takes. This is the
22 action of going out and purchasing power to serve
23 returning customers and flow it through the FAC. I
24 think a future Commission could decide that they
25 didn't like that activity if there were cheaper

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 generation available in the fleet, and that's the

2 risk that I think we have.

3 Q. (By Mr. Petricoff) But it is your

4 testimony and your belief that the Commission in 2010

5 could not go back and redo the fuel adjustment clause

6 in terms of passing through fuel and power prices

7 that took place in 2009 if it was done in accordance

8 with a fuel adjustment clause that was approved.

9 MR. RESNIK: Your Honor, I'm going to

10 object because Mr. Petricoff is switching from the

11 narrow point that Mr. Baker just identified in his

12 answer that we're talking about a means of dealing

13 with the POLR issue and buying market power to do

14 that, which is being suggested by some parties, and

15 then we should pass it through the fuel clause which,

16 of course, is not our proposal. And he's -- his

17 question is talking on a much broader scale, well, if

18 the Commission approves a fuel clause, can they deny

19 costs.

20 EXAMINER BOJKO: I think that was the
21 point of Mr. Petricoff's question. I was trying to
22 figure out exactly what Mr. Baker said because his
23 response was twofold, and I think he was seeking that
24 clarification, so let's let Mr. Baker clarify if he
25 can.

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 THE WITNESS: Can I have it read back,
2 please?

3 (Record read.)

4 A. I tried to answer that as to the first
5 part so I'll try to do it again and hopefully be a
6 little more clear. I think if the Commission
7 approved a fuel adjustment clause as provided for in
8 this bill, that they could not say we couldn't have a
9 fuel adjustment clause going forward. Decisions on
10 how that fuel adjustment clause is done I think could
11 be changed in the future.

12 Q. But I want to narrow in just one more
13 level, one more gradation level down, and that is on
14 lines 7 and 8 of your testimony you say that the
15 Commission cannot bind some future Commission, but
16 isn't it true from your past answer that the
17 Commission in 2009 can, in fact, bind future
18 commissions as to what can go through the fuel
19 adjustment clause, at least retroactively, to any

20 future action of the Commission?

21 I'll withdraw the question. I've got to

22 fix it up a bit.

23 Let's go back and look at this language

24 that says the Commission cannot bind some future

25 Commission. I'm asking you now that if this

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 Commission issued a fuel adjustment clause and said
2 for the period of time that's covered by this fuel
3 adjustment clause, all purchased power and fuel costs
4 will be passed through, wouldn't you agree that that
5 would, in fact, bind future commissions until the
6 time that those -- that the future commissions change
7 that order prospectively?

8 A. Okay. Let's -- if you would allow me,
9 I'd like to just use what I was talking about in this
10 section, not to just have the broad generic, and I
11 hope that that answers your question. I'm really
12 trying to --

13 Q. I want a specific answer to my
14 theoretical question. Going to come down to the POLR
15 in a minute. That's my next question.

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

18 EXAMINER BOJKO: Yes.

19 (Record read.)

20 MR. RESNIK: Well, your Honor, I guess
21 I'm going to object because I'm not sure where this
22 is going. I think that's exactly consistent with
23 Mr. Baker's testimony that this Commission cannot
24 bind a future Commission, the future as it's
25 conditioned, until the Commission in some future

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 point changes what this Commission is doing --

2 EXAMINER BOJKO: I think we're focusing
3 on semantics, and I think that maybe Mr. Baker gets
4 the difference from what he said previously.

5 Do you understand the question?

6 THE WITNESS: Let me try. First of all,
7 I don't think the Commission would ever put out an
8 order that says all purchased power and all fuel
9 would be allowed to be flown through a fuel clause.
10 So I have trouble with the question because of the
11 premise it sets on.

12 And then if you start to say, okay, we're
13 not going to flow through all purchases and all fuel
14 regardless of what the company does, I think you'd
15 have to get down to the specifics, which is what I
16 was trying to do with my answer.

17 EXAMINER BOJKO: I think, Mr. Baker, the
18 confusion is that you were saying that you believe
19 that if a mechanism to recover such fuel costs was

20 approved by the Commission, that that would be
21 binding, but the exact costs that flow through that
22 mechanism may or may not be approved by future
23 Commissions, is that --

24 THE WITNESS: That's what I was trying to
25 say.

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 EXAMINER BOJKO: Is that a good summary?

2 THE WITNESS: Thank you.

3 Q. (By Mr. Petricoff) Mr. Baker, if the
4 Commission could authorize a fuel adjustment clause
5 that couldn't be amended, save for prospectively that
6 would cover new customers moving into the area, I
7 think 500 -- we'll stick with the analogy of 500 new
8 customers. Could the Commission likewise have the
9 authority to pass a fuel adjustment clause that says
10 500 returning customers from CRES suppliers, any
11 excess costs -- or, the costs of serving those
12 customers would be flowed through the fuel adjustment
13 clause? Would they have the authority to do that?

14 A. I believe they have the authority to do
15 it. The question is not around flowing through the
16 cost of serving customers; it's flowing through the
17 cost of purchased power specifically at market for
18 those returning customers. That's a different
19 hypothesis.

20 Q. Well, let's funnel down to the final
21 question, then. If the Commission -- do you believe
22 that the Commission has the authority to approve a
23 fuel adjustment clause that said any customers
24 returning because of a default from a CRES provider
25 will be provided standard service at the standard

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 service rates and the cost of the purchased power
2 fuel for serving those customers will be flowed
3 through the fuel adjustment clause?

4 MR. RESNIK: And just to clarify, is he
5 asking him to disregard the advice of counsel that he
6 received?

7 MR. PETRICOFF: That's a much more
8 complex question that is irrelevant.

9 MR. RESNIK: Well, I'd like to think not.

10 EXAMINER BOJKO: That's overruled.
11 Let Mr. Baker answer that question if he
12 can because now we're trying to get even narrower
13 from where we were discussing a few minutes ago.

14 MR. PETRICOFF: This is the final
15 question in the series.

16 THE WITNESS: Can I have the question
17 reread?

18 EXAMINER BOJKO: Just so I'm clear,
19 Mr. Petricoff, this isn't what's binding, you're

20 saying do they have the authority.

21 MR. PETRICOFF: Do they have the

22 authority to do it. I'm still focusing on this

23 question about that this -- what this Commission can

24 bind, you know, for a future period of time.

25 (Record read.)

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 A. I believe that the Commission could
2 authorize the company to go out and purchase power
3 for returning customers regardless of what their
4 portfolio was and flow that through the fuel clause,
5 I don't necessarily think that that -- or, I do think
6 that that could be changed by a future Commission.

7 MR. PETRICOFF: Your Honor, I have no
8 further questions. Thank you.

9 Thank you, Mr. Baker.

10 EXAMINER BOJKO: Mr. Maskovyak?

11 MR. MASKOVYAK: Thank you, your Honor.

12 - - -

13 CROSS-EXAMINATION

14 By Mr. Maskovyak:

15 Q. Good afternoon, Mr. Baker.

16 A. Good afternoon.

17 Q. I would like you to turn to page 3 and
18 look at lines 3 through 5, basically the last
19 sentence of that part of the testimony beginning with

20 "There is no mention of the word prudently." Or

21 there's only one mention.

22 EXAMINER BOJKO: I'm sorry, I cannot hear

23 a word that you're saying, Mr. Maskovyak.

24 MR. MASKOVYAK: I'm sorry, I'll speak up.

25 Q. You say there is no mention of the cost

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 of service and only one mention of the word

2 "prudently." Do you see where I am?

3 A. Yes, I do.

4 EXAMINER BOJKO: Which page? I'm sorry.

5 MR. MASKOVYAK: Page 3.

6 A. Yes, I do. I see it.

7 Q. So by virtue of the fact that you state

8 that the word "prudently" is only used once, does

9 this mean that any cost or expense for which the

10 companies seek reimbursement where it is not subject

11 to 143(B)(2)(a) means it does not need to be prudent?

12 THE WITNESS: Could I have the question

13 read back, please?

14 (Record read.)

15 A. What I believe is that the Commission as

16 part of what has been proposed by Senate Bill 3

17 should approve the plan, or reject the plan, or

18 modify the plan, and once you've done that, those are

19 the rates that are in place for -- going forward for

20 supply to customers. I don't think it falls under a
21 prudence discussion at that point because it's
22 approval of the plan.

23 Q. So does that mean the companies would be
24 otherwise free to seek costs that may well prove to
25 be imprudent?

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 A. It's part -- again, I go back to the
2 plan, and we put something in front -- it's compared
3 to the MRO. If the General Assembly had wanted
4 prudent to be the conditions of the plan, approving
5 the plan, I think they would have put that language
6 in.

7 Q. Can I take it from your answer that your
8 answer is yes?

9 MR. RESNIK: Your Honor, I'll object. He
10 gave his answer.

11 MR. MASKOVYAK: I'm not sure though
12 whether it falls as a yes or no, your Honor.
13 Truthfully, I don't know.

14 EXAMINER BOJKO: Mr. Baker, can you
15 answer it any further?

16 THE WITNESS: No, I can't.

17 Q. (By Mr. Maskovyak) If a cost was found to
18 be imprudent or thought to be imprudent that was not
19 part of 143(B)(2)(a), is it the company's position

20 that this would not be a bar to recovery?

21 THE WITNESS: Could I have that read

22 back?

23 (Record read.)

24 A. I haven't thought through all of that

25 because I've thought -- I've tried to think of this

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 in the context of what we have put in front of the
2 Commission as far as our plan is concerned, and the
3 section you pointed to is the section that forms the
4 general basis of our FAC which is clearly that's
5 subject to the word "prudent." It's there.

6 The others are requests. I think the
7 Commission has to look -- it's not asking for
8 continued trueup of costs or anything. There are
9 dollars we're asking for either in values that are
10 defined in the plan, values that are automatic
11 increases, purchased power. I think the Commission
12 needs to look at that as part of the plan, not
13 whether any single decision is prudent in their
14 judgment.

15 Q. Thank you.

16 Staying with page 3 with the question and
17 answer beginning on line 6 regarding the reasonably
18 priced goals, are you with me?

19 A. Yes.

20 Q. In your answer would it be fair to say
21 that you essentially define "reasonably priced" to
22 mean that any amount that makes the ESP in the
23 aggregate less than the MRO meets the definition of
24 reasonably priced?

25 A. Yes, I think it would be.

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 Q. Is the question of how much profit the
2 company may make irrelevant to the question of
3 reasonably priced?

4 A. Yes. Of course, subject to the
5 significant excessive earnings test.

6 Q. Okay. Thank you. Let's turn to page 4.
7 I'm going to look at the question and answer
8 beginning on line 17 where you talk about the
9 circumstances that would warrant the Commission
10 modifying an ESP. Do you see where I am?

11 A. Yes.

12 Q. In your answer you discuss three
13 possibilities, which you label as A, B, and C.

14 A. Yes.

15 Q. Is it my understanding that these are the
16 only ways you believe by which the Commission may
17 modify the ESP?

18 A. These were three that I thought of when I
19 was writing the testimony. I didn't go any further

20 than that.

21 Q. So is it possible there could be more

22 ways or other ways than the three you enumerate?

23 A. I don't know.

24 Q. If the Commission did modify the ESP in

25 the ways that you suggest, would it still be

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 considered a modification by the companies such that
2 you could decide to withdraw the application?

3 A. The question asks about modifying the
4 ESP. That to me is by definition, therefore,
5 modifying the ESP, which we then have the right to
6 determine whether we want to accept it.

7 Q. Okay. Thank you.

8 I'd like now to turn to the Purchase
9 Power Proposal section on page 5 with the question
10 and answer beginning on line 11. I'd like you to
11 look at the part of your answer beginning on line 15
12 starting with the word: "Although the Companies
13 propose to administer its slice-of-system purchases
14 within the FAC mechanism the proposal was not made
15 under that section and the Commission is not limited
16 to that section in approving it." And I assume by
17 "that section" you're referring back to the previous
18 sentence in reference to 4928.143(B)(2)(a).

19 A. Yes.

20 Q. I know you were not in the room when
21 Mr. Nelson was here testifying, but I believe in
22 response to questions from OCC that Mr. Nelson
23 testified that the company was, in fact, seeking
24 recovery pursuant to 143(B)(2)(a).

25 MR. RESNIK: I'll object, your Honor. I

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 think that Mr. Nelson's testimony just referred to

2 (B)(2), he did not use the letter (a).

3 EXAMINER BOJKO: Let's ask the witness if
4 he knows.

5 Can you respond to this question?

6 THE WITNESS: Certainly. That is, I
7 think that's defined by my answer on line 18 carrying
8 through line 22 that I consider it a two-step
9 process, that the approval of AEP going forward and
10 purchasing the 5, 10, and 15 from the market is just
11 part of the overall plan. The flowing the results of
12 that purchase then through the fuel clause are
13 consistent with the 4928.143(B)(2)(a).

14 Q. All right. We may not need Mr. Nelson.
15 Do you have a copy of the company's application?

16 A. Yes, I do.

17 Q. Can I get you to turn to page 4 and look
18 at Roman numeral II.A, the Fuel Adjustment Clause?
19 Perhaps you can clarify for me.

20 A. Yes, I see it.

21 Q. The first sentence starts: "As permitted
22 by 4928.143(B)(2)(a), Ohio Revised Code, the
23 Companies propose implementing an adjustment
24 mechanism" and so forth. And if you continue on in
25 that section and slide over to page 5, in the second

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 bullet point it talks about the purchased power costs
2 that are part of this mechanism, as I understand it.

3 A. All I can do is point you back to my
4 testimony because it talks about two proposals. That
5 is the area where we recover the cost. That's not
6 the approval of whether we can make the 5, 10, and
7 15 percent purchase as part of the plan.

8 Q. So the bullet point at the top of page 5
9 is not connected to the beginning of that particular
10 part that says that this is pursuant to 143(B)(2)(a).

11 A. Recovery of. It's two steps in this
12 process. I don't know how I can be more clear about
13 that.

14 Q. All right. Can you then tell me what
15 section you are relying on?

16 A. I'm terrible with these numbers in this
17 legislation, but it's the whole ESP section.

18 Q. I'm not sure what you're referring to,
19 sorry. When you say "the whole ESP section" --

20 A. That's fine. I'll go through the

21 legislation.

22 EXAMINER BOJKO: Section 143, is that

23 what you're talking about?

24 THE WITNESS: Let me look it up.

25 Q. Is there a statutory section to which you

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 are specifically citing for the proposition that it's
2 not (B)(2)(a) but something else?

3 A. I'm looking. It's 4928.143(B)(2).

4 Q. But none of the underlying subsections
5 apply.

6 A. There are words that say the plan may
7 provide for or include without limitation any of the
8 following.

9 Q. I understand. And your proposal, can it
10 be found in any of the following subsections?

11 A. It was really intended to fall under the
12 "without limitation" provision.

13 Q. Is the recovery for which you are seeking
14 on this fuel cost a cost that could be sought under
15 (B)(2)(a)?

16 MR. RESNIK: Your Honor, could I have the
17 question read back, please?

18 EXAMINER BOJKO: Yes.

19 (Record read.)

20 MR. RESNIK: Well, I guess I'm going to
21 object because I think now we're switching from the
22 purchased power to fuel. Sort of leaves me in the
23 dust, but . . .

24 MR. MASKOVYAK: I'm happy to go with
25 purchased power.

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 A. I look at (a) to be the recovery
2 mechanism for the costs the company incurs in these
3 specific areas in supplying the SSO. If we were to
4 say it's covered under that section, then everyone
5 who is saying you have to make these -- purchased
6 powers has to be a least-cost plan could use that as
7 a reason to deny the 5, 10, 15 purchase because they
8 may not believe it's the least-cost plan, and we've
9 taken the position that it is under the "without
10 limitation" that we're asking for the approval, and
11 we show that in the aggregate it's better than the
12 MRO.

13 Q. I understand that. My question still is,
14 though, could you seek recovery for those same costs
15 pursuant to (B)(2)(a)?

16 A. No, and accomplish what we were trying to
17 accomplish as part of this plan.

18 Q. And what is it you are trying to
19 accomplish?

20 A. A plan in place that is better in the
21 aggregate than the MRO and provides what I believe to
22 be a good arrangement for customers and the company.

23 EXAMINER BOJKO: So could the purchases
24 be at any cost?

25 THE WITNESS: No. I'm asking the

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 Commission to approve the authority to buy 5, 10, and
2 15 and put it in the portfolio. Then when we
3 actually execute on it, I would expect as part of the
4 fuel clause that there would be a prudence and there
5 would be a check, did, in fact, we go out and acquire
6 it in the best fashion and the lowest cost to make
7 those purchases, not in comparison to what the energy
8 supply of our own system is.

9 EXAMINER BOJKO: So the prudence check
10 would still be on the cost that you purchased it at,
11 not maybe necessarily the execution of the purchases,
12 which is what your line 21 says.

13 THE WITNESS: Well, I think it's the
14 execution of, your Honor, not the cost, because if
15 we're allowed to do it and we go out and -- we're
16 given the authority to go out and make the 5, 10,
17 15 percent purchases, just because it comes in with a
18 specific number is going to be relevant to whether
19 we -- what the market set the price at. We have to

20 show that we, in fact, did a good job of acquiring it
21 in the market and got it in the most efficient manner
22 from the market.

23 EXAMINER BOJKO: But the cost would be a
24 factor in that consideration of whether the total
25 execution was prudent or not.

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 THE WITNESS: I think cost compared to
2 what an alternative cost could be for a purchase,
3 yes, so if we didn't do the execution right.

4 EXAMINER BOJKO: Thank you.

5 Q. (By Mr. Maskovyak) Following up on the
6 Bench's question, but whether, in fact, the purchase
7 itself is prudent is not a relevant question.

8 A. I believe that if it's accepted as part
9 of the plan, it is prudent to go ahead and make the
10 5, 10, 15 purchase.

11 Q. Let's factor out -- I know you said that
12 you could not have included the cost in (B)(2)(a) and
13 accomplish the purpose of your plan, which was to
14 make the ESP better in the aggregate. Factoring out
15 the part about not accomplishing the purchase, just a
16 question of whether it's possible legally within the
17 confines of the statute, could the companies have
18 requested for recovery pursuant to (B)(2)(a)?

19 A. I don't know.

20 Q. Let's look at other components of
21 (B)(2)(a). Let's drop down to the last part of it
22 where it talks about the cost of federally mandated
23 carbon or energy taxes. If the company were to seek
24 recovery for those, could you seek recovery and do so
25 without using (B)(2)(a)?

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 A. I'm sorry, I'm trying to find where you

2 are in the --

3 Q. I'm in the same place.

4 A. You're still in (B)(2)(a). I'm sorry.

5 Q. Correct.

6 A. Okay.

7 Q. I just dropped down to the very last

8 clause of (B)(2)(a) where it talks about various

9 components that could be included as part of the

10 recovery pursuant to (B)(2)(a), and the last one is

11 the cost of federally mandated carbon or energy

12 taxes.

13 My question was, could the company seek

14 recovery of those costs but do so without using

15 (B)(2)(a) as its way to do so?

16 A. I guess we could under the "without

17 limitation," but I don't know why we would.

18 Q. Well, wouldn't you, in fact, avoid any

19 prudency review if you decided to avoid using

20 (B)(2)(a) and use the "without limitation" exception

21 that you cite?

22 A. I think I've mentioned any number of

23 times now that I'm not avoiding the prudency review

24 by the -- I am subject to a prudency review on the 5,

25 10, 15, as far as the execution of the purchase. I'm

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 asking for approval of the part of the plan which
2 says the company is allowed to go out and buy 5, 10,
3 15 percent and add it to its portfolio.

4 I don't see a parallel to the cost of
5 federally mandated carbon or energy taxes. That is
6 going to be something that the government imposes,
7 and we're going to ask for recovery very different
8 than a part of the pieces of the plan that we put in
9 to make up our ESP.

10 Q. I understand. I'm merely asking that if
11 you decided to seek recovery for those costs, could
12 you use the "without limitation" language to seek
13 recovery by not using (B)(2)(a)?

14 A. I don't know, and we wouldn't. I don't
15 think we plan on doing it that way.

16 Q. Okay. Thanks. Let's look at page 5. I
17 want to turn your attention to page -- or, lines 18
18 through 22, and you talk about the purchases -- back
19 to your two-step process that you have already

20 previously discussed.

21 A. Yes.

22 Q. Do I understand you to say that the ESP
23 contains the company's percentages, the 5, 10, and
24 15, and that is, if the ESP is more favorable than
25 the MRO, then the PUCO must allow the 5, 10, 15

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 percentages?

2 A. I'm saying that they should approve it if
3 in the aggregate it is better than the MRO, the
4 Commission will look at our ESP and decide to
5 approve, modify, or reject.

6 Q. And so since you're not using (B)(2)(a),
7 the Commission has no authority to examine prudence
8 regarding whether there should be a purchase or what
9 percentage that purchase should be.

10 A. I believe that they have the ability,
11 just as I described, to review our plan and make the
12 three potential decisions, and then it will be up to
13 the company to decide how they react to either a
14 modification or a rejection.

15 Q. I understand. But I'm asking
16 specifically about this clause. Since you're not
17 using (B)(2)(a), am I to understand that because of
18 that it's the company's position that the Commission
19 has no authority to examine prudence regarding

20 whether there should be a purchase or what percentage

21 that purchase should be?

22 A. You know, I've said it a couple of times

23 and I'll use it again, I don't tell the Commission

24 what they can and cannot do. I'm suggesting that

25 they -- the company's position is they should approve

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 it if, in fact, it's better in the aggregate than the

2 MRO.

3 Q. Thank you, Mr. Baker.

4 Can we turn to page 9? I was looking at,
5 and I would have you look at lines 5 and 6 where you
6 state: "By contrast, it is no longer certain that
7 the regulatory compact exists in Ohio given the
8 passage of Senate Bill 221." Are you saying that the
9 compact is dead?

10 A. I'm saying that in the case of generation
11 the company has no assurances that when they make an
12 investment in generation-related items, that there
13 would be recovery over the life of the items which I
14 consider to be part of the regulatory compact.

15 Q. If there is no regulatory compact now,
16 can you tell me what there is?

17 A. There's Senate Bill 221.

18 Q. And what does that mean in terms of a
19 regulatory compact --

20 A. I think --

21 Q. -- or replacement?

22 A. Sure. I think what it says is we're no

23 longer certain, and we'll know what it is when we

24 start to get some Commission orders.

25 Q. Would you say that Senate Bill 221, then,

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 really replaces or says that we no longer, or that
2 you, the companies, no longer have a duty to serve?

3 MR. RESNIK: Is this limited to
4 generation?

5 MR. MASKOVYAK: Yes.

6 A. No. I think this says, just as we've
7 laid out in the testimony, that we have an obligation
8 to supply customers generation at an SSO rate.

9 Q. Okay. Thank you.

10 I'd like to turn to page 10, and I want
11 to take a look at your chart at the bottom of the
12 page. I was noticing in reviewing the chart that the
13 time periods that you cite throughout are not
14 equivalent time periods. The months range
15 dramatically at times. The first block is five
16 months I believe in '01. The second block is there
17 months. The third is ten months. The fourth is nine
18 months. The fifth is seven months. And the sixth is
19 three months. Can you explain to me why such a

20 radically divergent range of months was decided to be
21 put in the chart?
22 A. Certainly. All we were trying to deal
23 with was the statement that the OCC witness made,
24 which is that the changing price over that two months
25 was an unusual event and, therefore, that's the

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 reason why you ought to use market quotes, and we
2 just wanted to show that, in fact, it is not an
3 unusual event for prices to move dramatically, simple
4 as that.

5 Q. Wouldn't it be better to compare standard
6 time periods as opposed to having a wide range of
7 time periods?

8 A. No.

9 Q. Why not?

10 A. Because it's intended for one purpose,
11 and the purpose is to show that there is volatility
12 in prices and that period was not unique.

13 Q. Can you explain to me, for example, then,
14 in the first period it goes through July 2001 but the
15 second period yet starts in July 2001 and includes
16 the same period of time; that same example is
17 replicated in periods five and six. So is July '01
18 included both in the change downward as well as
19 included in the change upward?

20 A. Yes.

21 Q. How does that help us understand?

22 A. It just shows that for one period, March

23 through July, it went down 47 percent, and then

24 looking at what it went down to in July, it turned

25 around between July and September and went back up to

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 33 percent. Those are significant changes in price,
2 as I see it, and I think that is consistent with what
3 OCC's witness was saying about that, there is
4 volatility in this market.

5 Q. I would like to turn to page 13. On the
6 previous page, 12, you start talking about the POLR
7 risk and Mr. Cahaan's testimony, and then at the top
8 of page 13 in lines 1 through 4 you start talking
9 about the migration risk.

10 A. Yes.

11 Q. So for the company's POLR, the provider
12 of last resort, is more -- is a charge that reflects
13 more than just what that term reflects, which is a
14 provider of last resort.

15 MR. RESNIK: Can I have that question
16 read back, please?

17 (Record read.)

18 A. In my view the POLR -- the provider of
19 last resort is the series of options that are

20 provided to customers, the right to leave the
21 customer's tariff and go back -- the SSO tariff price
22 and go to the market when it's economically
23 attractive and then come back to the SSO rate when
24 that's economically attractive. That's my definition
25 of POLR.

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 Q. So it covers -- as you state in your
2 testimony, it covers the migration risk out.

3 A. Now we're getting complicated because
4 we're talking about migration risk and whose
5 definition of migration risk. I told you what my
6 definition of POLR was so if we could stay within
7 that definition, it might make life easier for me.

8 Q. Well, I'm trying to understand since most
9 people define the POLR risk or the provider of last
10 resort risk the risk that you may have to serve
11 additional customers for which you're not prepared to
12 serve. You're saying it includes that plus much
13 more.

14 A. I'm saying it includes the rights of
15 customers -- my definition and what was intended as
16 part of our ESP, that is a charge associated with the
17 option that's provided to customers for both the
18 right to leave and the right to come back.

19 Q. So it also covers the competitive risk.

20 A. Well, isn't that all a competitive risk?

21 Q. Possibly. You're not providing anything,
22 though, to the customer who leaves.

23 A. The customer has the right to come back.

24 Q. I understand that.

25 Is the migration risk today any different

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 than it has been since Senate Bill 3 was enacted?

2 A. Help me, please, here. Are we talking
3 about the migration risk, my definition of the right
4 for a customer to leave?

5 Q. Yes.

6 A. I would say that the migration risk --
7 I'm sorry, I'm not going to use that term. You took
8 me down to almost using that.

9 Q. I'm using that term because you use it in
10 your testimony.

11 A. But I use it in context of what we did,
12 and that's ebb and flow, that's not a customer who's
13 leaving because it's economically advantageous.

14 When I talk about people leaving because
15 it's economically advantageous, today I would say the
16 risk of customers leaving is probably a little less
17 than it was at the time of Senate Bill 3, but I don't
18 know that that would be the case tomorrow.

19 Q. Okay. Thank you.

20 Let's look at page 14. You talk about
21 the aggregator and the problems associated with
22 aggregation. Actually, if I may, why don't I turn
23 you back to page 13 because you really start
24 addressing this issue in the last sentence at the
25 bottom on line 23 beginning with "While governmental

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 aggregations could notify," and it continues on
2 through line 5 on page 14. Am I to understand from
3 your testimony there that the companies believe that
4 aggregators are not likely to give notice of the risk
5 to customers?

6 MR. RESNIK: Can I have that read back.

7 EXAMINER BOJKO: Yes.

8 (Record read.)

9 MR. RESNIK: I guess I would object, your
10 Honor. The notice the statute contemplates is notice
11 to the company, not notice to customers.

12 EXAMINER BOJKO: I think he might be
13 asking that very question.

14 THE WITNESS: Could we have it read back?

15 (Record read.)

16 A. I don't think they give notice -- I don't
17 know whether they'll give notice of the risk to
18 customers. I'm not going to assume what a government
19 aggregator will do.

20 Q. But it is your belief that if customers
21 understood the financial exposure, they would not go
22 with aggregators.

23 A. No, I don't think that's what this says.
24 If I were a customer and some aggregator came to me
25 and said, "You've got a choice of going with me,

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 because it's economically advantageous, and paying a
2 POLR charge so if the market goes crazy and I have to
3 stop serving you, you can go back to the company at
4 an SSO rate," I'd say don't give them the notice that
5 I want to avoid the POLR charge. I think most people
6 would think that was a cheap option.

7 Q. So you're suggesting that the aggregators
8 will deceive.

9 A. I think I said that I didn't know what
10 the aggregator -- I'm saying that if they do the
11 following things, this is how I think customers would
12 react.

13 Q. You also state that you're not sure that
14 customers would understand the risk or the financial
15 exposure, I think is the term you use.

16 THE WITNESS: Can I have that read back?

17 (Record read.)

18 MR. RESNIK: Is that a question?

19 EXAMINER BOJKO: He was asking about his

20 statement on 3 and 4.

21 I think you were just asking if that's

22 what he said; is that right?

23 MR. MASKOVYAK: (Nods head.)

24 A. That's not what it says.

25 Q. So you believe they will understand the

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 risk if properly presented.

2 A. If customers are provided the
3 information, yes, I believe they'd understand the
4 risk.

5 Q. All right. I want to stay with this page
6 and slide down to the next question that begins at
7 line 14 where we're talking about -- and then if you
8 look at that question and your answer beginning on
9 line 18 talking about: "The value of the customer's
10 right to switch under Senate Bill 221 comes from the
11 option customers are given." Does the option include
12 the value if there are no realistic options to pursue
13 in the market?

14 A. Well, I can't accept your premise that
15 there are no realistic options.

16 Q. How about if there are few realistic
17 options?

18 A. I think that if it becomes economically
19 advantageous, there will be options for customers.

20 Q. I understand. Did I not hear you say a
21 little while ago that you believe, if anything,
22 there's less of a market today than there was in the
23 years since Senate Bill 3 was enacted?

24 A. No, I didn't say any such thing.

25 Q. Can you tell me what you did say?

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 A. What I said was -- you asked me whether
2 the risk was greater, and I said I thought the risk
3 was slightly less. It had no implications of whether
4 there's a market or not a market.

5 Q. And why would the risk be slightly less?

6 A. Because the delta between market price
7 and the SSO is different.

8 Q. So you believe that there are ample
9 providers available whom customers can switch to.

10 A. I believe there are current opportunities
11 for customers in the PJM arena, and then for
12 customers who can't access PJM, if it was
13 economically advantageous, I believe there would be
14 aggregators who would come in and attempt to serve
15 those customers.

16 Q. Would you care to opine about the
17 likelihood of those options?

18 A. It will all depend on the relative price
19 in the market to the relative SSO price, and the

20 closer they become, the more likely it is to happen,
21 and that's why we're looking at it and dealing with
22 it before the fact rather than dealing with it when
23 it actually happens.

24 Q. When you valued this option of the right
25 to switch, which I assume takes into account the fact

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 that you have lost sales as part of that equation,
2 does the value of the option also include the fact
3 that the companies will have excess power to sell
4 even if the market price of that power at that point
5 in time is less than the SSO?

6 A. This is the value to customers of being
7 able to access the market as opposed to the SSO when
8 it's economically advantageous. It doesn't look at
9 what happens to the freed-up generation for AEP, but
10 the freed-up generation would then be available to
11 sell in the market at the same kind of rates the
12 customers would be paying.

13 Q. And so I take it that the value of the
14 option also does not necessarily include whether AEP
15 chooses to buy any kind of insurance, for lack of a
16 better term, to hedge their risk of the customers
17 leaving.

18 A. We're setting this up based on the
19 Black-Scholes model determining what the value of the

20 options are and the risks that the company has. The
21 company will decide over the period of the ESP
22 whether to execute on options in order to hedge its
23 risk or not. That's the company's decision.
24 Q. Do I understand that it's still true
25 today that the company has not made a decision about

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 whether they will purchase any hedges to this risk?

2 A. That's correct, we haven't made any
3 decision.

4 Q. So it is possible that the companies will
5 assume the full risk.

6 A. That is a decision the company makes, and
7 if they do, that's their risk that they absorb.

8 Q. But this is not the same kind of risk
9 that you would be willing to offer the customer.

10 A. I don't think there are customers out
11 there who are willing to say to us we will not buy
12 SSO service, so I don't see how you'd do it.

13 EXAMINER BOJKO: I'm sorry, you said you
14 don't think there are customers?

15 THE WITNESS: No, I don't. I think that
16 we haven't had people leave, and I don't think people
17 are going to say just to avoid the POLR, I'll
18 guarantee you that I will not buy power from you for
19 the full ESP period.

20 Q. Can we turn to page 15? I'm looking at
21 your testimony on lines 14 through 17 beginning with
22 the word "finally."

23 A. Yes.

24 Q. I assume you're not conceding that the
25 risk of switching is low here.

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 A. I just saying it's not -- I don't think

2 it's a good idea to ignore risk.

3 Q. So are you saying that we must set the

4 POLR rates high in order to guard against an unlikely

5 risk because, although it's unlikely, the risk may

6 still be very great?

7 A. I make no representation the POLR risk is

8 being set high.

9 Q. Are you saying that the POLR risks or

10 rates are set where they are according to the company

11 because they have to guard against this unlikely risk

12 even though it's unlikely because the risk may well

13 be great?

14 A. Look, I'm not suggesting that the risk is

15 great or not. I'm talking about assertions that

16 others are making.

17 Q. Aren't you saying beginning at line 16

18 that the lesson is that the losses can be great by

19 not hedging against unlikely risk? Isn't that your

20 assertion?

21 A. I'm saying that I don't think it's a good
22 idea, as others have suggested, to just not look at
23 risk because right now they think the likelihood is
24 small.

25 Q. So you are saying that we must guard

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 against risks, even if they're small, because the
2 ramifications could be great.

3 THE WITNESS: Can I have that question
4 read back?

5 EXAMINER BOJKO: Yes.

6 (Record read.)

7 A. What I'm saying is that I can't agree
8 with other people's positions, as I see it, to ignore
9 the risks. We have chosen not to ignore the risks or
10 the value of the option by including the POLR as part
11 of our ESP proposal.

12 Q. If you choose not to buy POLR insurance,
13 would that be ignoring the risk?

14 A. That would be managing the risk.

15 Q. Why would it be managed?

16 A. Because the company has under that
17 proposed -- under our proposal the ability to decide
18 whether to hedge or not hedge, and that is a business
19 call for the company.

20 Q. And is that because they will have the
21 revenues generated by POLR on which to make a
22 decision about whether they should just hold on to
23 those versus -- and assume the risk by holding on to
24 those versus taking that money and purchasing a
25 hedge?

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 A. The rates will be the rates, and they
2 will be what is approved under the -- an ESP that we
3 effectively decide to accept. That's the premise my
4 question is -- my answer is going to be working on.
5 And in that case then we determine how to manage our
6 costs under the rates that we have.

7 Q. I'd like to turn to page 16. I'm looking
8 at your answer that begins at line 3. If you'd like
9 to review the question that begins on the prior page
10 down at line 21, feel free to do so, starting with
11 "Certain intervenors." I want to concentrate on that
12 part of your answer that begins on line 6 that talks
13 about the put position.

14 A. Yes.

15 Q. You say you can't use the FAC because it
16 ignores the put position. What is the value of that
17 part of the position?

18 MR. RESNIK: Your Honor, if I may, I just
19 note the testimony says the put "portion."

20 MR. MASKOVYAK: I'm sorry, put portion.

21 THE WITNESS: Can I have the question

22 read back?

23 (Record read.)

24 A. I'm not sure I understand the question.

25 Are you looking for what the dollar value of the

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 total POLR --

2 Q. Or what percentage of the POLR risk is
3 assigned to the put portion.

4 A. It's in the neighborhood of 90 percent.

5 Q. 90 percent. So I guess it would be fair
6 to say from the company's position that the risk is
7 much greater of customers leaving than returning?

8 A. No. That's not true.

9 Q. Okay. Then help me understand how the
10 90 percent rate -- what the 90 percent ratio
11 reflects.

12 A. It's the result of running a
13 Black-Scholes model comes out with those kind of
14 ratios. A simple way to think about it is that
15 the -- you only exercise the call, the second part,
16 if you've exercised the put. So you have to achieve
17 the put before you can achieve the call, and so you
18 have to have the price go down below the SSO and then
19 go up again above the SSO. And when you run that

20 through the model, it puts the majority of the value
21 of the risk in the put.

22 Q. I think that answers my question. Thank
23 you.

24 All right. Let's turn to page 19, and I
25 don't have a specific section, although I'm largely

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 looking at the last part of that page, lines 13
2 through 19. If you'd like to review that first.

3 A. Okay, I've read it.

4 Q. Would it be fair to say that it's the
5 company's belief that the Black-Scholes approach was
6 the most accurate way to determine POLR?

7 A. It was the best way to -- yes, to
8 determine the value of the combination of options
9 that we have been talking about.

10 Q. And I think we agreed previously in your
11 direct testimony that you knew of no one, and no one
12 else did, of any utility using the Black-Scholes
13 model to apply a POLR; is that correct?

14 A. When we talked about this in my direct, I
15 said there wasn't another utility outside of Ohio
16 that had the same kind of POLR risk.

17 Q. And, consequently, no other utility is
18 using the Black-Scholes model?

19 A. Well, I don't know why you would do it if

20 you don't have the risk.

21 Q. Have you found any literature, any

22 academics that discuss using the Black-Scholes to

23 calculate a POLR charge?

24 MR. RESNIK: Your Honor, I'm going to

25 object. Mr. Baker's rebuttal testimony touches on

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 two distinct features of the Black-Scholes model.
2 One is the use of the LIBOR rate, which he discusses
3 from page 16 through 18 at line 19, and then he picks
4 up the second question that had to do with a
5 reference, and actually I think it was
6 in Miss Medine's testimony, about having run the
7 model an indeterminate number of times.

8 This is not a whole rehashing of
9 Black-Scholes. We've limited it to two points that
10 came up, and I think that the cross-examination
11 should be limited in that sense.

12 EXAMINER BOJKO: I hope it's not a whole
13 rehashing. I hope you're just trying to lay a tiny
14 bit of foundation.

15 MR. MASKOVYAK: I'm almost done with
16 this.

17 EXAMINER BOJKO: Thank you. Please
18 proceed.

19 MR. MASKOVYAK: Could we reread the

20 question?

21 (Record read.)

22 A. I don't know how there would be any. If

23 I just finished stating that no one has the POLR

24 risk, the EDUs don't have the POLR risk anywhere else

25 and it just appeared in Senate Bill 221, the chance

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 of somebody writing an article on that use is pretty
2 slim. I would expect that they'll probably write
3 some articles, assuming the Commission approves it.

4 Q. Fair enough. Thank you, Mr. Baker.

5 Can we turn to page 20, and yes, I'm
6 almost finished. I'm looking at the question and
7 answer that begins at line 1 but I want to
8 concentrate where it begins at line 9 where you say:
9 "Therefore, I think it is appropriate to include a
10 provision in an ESP that provides an opportunity for
11 recovery during the ESP period of generation costs
12 that at this time are unforeseen and consequently
13 unquantifiable." So you're saying in there that we
14 don't know what these costs will be for generation.

15 A. I'm suggesting that is an alternative to
16 setting up some kind of a tracker which is not part
17 of our proposal. We are asking for automatic
18 increases that I believe are provided for in the
19 bill.

20 Q. And this is because you can't know what

21 the amount of those costs are.

22 A. It's because we're permitted to have

23 automatic increases.

24 Q. Well, don't you justify it here by saying

25 that we can't know what those costs are?

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 A. I don't think I need to justify it. I
2 think we're allowed to put automatic increases in,
3 and I'm just explaining the thought process of there
4 are reasons to put automatic increases in. It is not
5 cost based.

6 Q. So the question of whether those costs
7 will even materialize is not relevant.

8 A. No.

9 Q. No, it is not relevant?

10 A. It's not relevant because the costs could
11 be greater. So whether they're lesser or greater,
12 this is not a cost-based rate, it is a proposal for
13 an automatic increase.

14 Q. Consequently, it would not necessarily be
15 appropriate to have any mechanism to provide for any
16 unforeseen decrease in costs.

17 A. As I say, it's not cost based. It's a
18 single value.

19 Q. Can you explain the difference to me for

20 giving cost recovery that's not known or unforeseen

21 and unquantifiable and essentially what I would call

22 a blank check?

23 A. I'm not asking for cost recovery. I'm

24 asking for an automatic increase that's provided for

25 in Senate Bill 221.

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 MR. MASKOVYAK: Thank you. I have no
2 more questions, your Honor.

3 EXAMINER BOJKO: Let's go off the record.

4 (Recess taken.)

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

7 Mr. Sites, do you have any
8 cross-examination?

9 MR. SITES: I am pleased to report, your
10 Honor, I have no questions. Thank you.

11 EXAMINER BOJKO: I guess we are to
12 Mr. White.

13 MR. WHITE: Yes, just a few questions,
14 your Honor.

15 - - -

16 CROSS-EXAMINATION

17 By Mr. White:

18 Q. Mr. Baker, I'm Matt White, and I
19 represent the Kroger Company.

20 A. Yes, Mr. White.

21 Q. Just a few questions.

22 A. Certainly.

23 Q. Let me refer you to page 8 of your

24 testimony.

25 A. Yes.

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 Q. On page 8, the second question, you say:
2 "Witness Higgins and Kollen recommend the OSS margins
3 be credited to the retail FAC." And you also cite
4 4928.143(B)(2)(a), and you essentially say that OSS
5 margins are not referenced in this provision and,
6 therefore, they shouldn't be -- the credits shouldn't
7 be included in the plan; is that correct?

8 A. I think you're shortening my answer
9 significantly. I list quite a few reasons on pages 8
10 and 9, that's just one of the reasons I list.

11 Q. I understand that, but you're saying that
12 is one of the reasons you list, correct?

13 A. Yes.

14 Q. Okay. Do you have a copy of Senate Bill
15 221 with you?

16 A. Yes, I do.

17 Q. Okay. I think you referenced this
18 earlier in cross-examination, but can you read what
19 4928.143(B)(2) says?

20 A. Are you talking about the sentence that
21 says: "The plan may provide for, or include, without
22 limitation any of the following"?

23 Q. Yeah.

24 A. Okay.

25 Q. That's what I'm talking about.

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 A. I think I just read it.

2 Q. Okay. That's good.

3 And again, you referenced this earlier,
4 the term "without limitation," what does that mean
5 according to you?

6 A. That means, according to me, that the
7 company may propose as part of its ESP any of the
8 following, but we could put other things in the plan.

9 Q. Okay. Does that include crediting
10 off-system sales to customers, off-system sales
11 margins?

12 A. Are you saying would we be precluded from
13 doing that?

14 Q. Yes.

15 A. The answer is no, we would not be
16 precluded. That would not be an appropriate thing to
17 do.

18 Q. I'm just addressing how you had said in
19 your testimony that off-system sales weren't included

20 in 4928.143(B)(2)(a). That's all. I wasn't asking

21 whether or not they were included.

22 Okay, I'd like to move to page 14 of your

23 testimony.

24 A. Yes.

25 Q. On page 14 you state: "It is my

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 understanding that this current Commission can not
2 bind some future Commission which would have to
3 decide whether the Companies could flow through their
4 FAC the market price costs of serving the loads of
5 returning customers." Is that correct?

6 A. I believe that's what that says, yes.

7 Q. Are you aware whether the companies
8 proposed to defer generation charges that exceed
9 15 percent per year, whether or not the companies
10 have proposed that?

11 THE WITNESS: Could I have the question
12 read back?

13 (Record read.)

14 A. What the companies proposed was to defer
15 FAC costs if the -- in order to limit increases to
16 customers not on G, but on total bill to
17 approximately 15 percent by customer class.

18 Q. And is it your understanding that those
19 deferrals will be collected after the ESP period, the

20 proposed three-year ESP period is over, by the

21 company?

22 A. AEP's proposal would be to defer the FAC

23 charges, as I described, and to collect it in a

24 number of years after the ESP is completed.

25 Q. Okay. You also state that -- and this

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 is, just so we're clear for the record, this is in
2 regards to the proposal that would charge -- would
3 allow AEP to recover costs after the ESP period is
4 over for customers that are switching. Is that your
5 understanding of that testimony?

6 A. No, it really isn't. What this is is
7 dealing with a proposal that others have made that if
8 a customer were to shop and then wanted to come back,
9 that the company could go out and purchase power.
10 That's what I'm talking about, that the Commission
11 could in the future decide not to use that as the
12 mechanism to deal with customers who were returning.

13 Q. But when you're referencing, "It is my
14 understanding the current Commission can not bind
15 some future Commission which would have to decide
16 whether the Companies could flow through their FAC
17 the market price costs of serving the loads of
18 returning customers," that flow-through is meaning
19 the Commission can't bind -- or the Commission can't

20 bind a future commission from requiring that the
21 company recover the money that they pay for
22 purchasing power for customers that have shopped; is
23 that correct?
24 A. You're missing the point that I'm trying
25 to make.

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 Q. Okay.

2 A. You're reading words in there that aren't
3 there. The intent, and it may not be clear, but the
4 intent was to deal with the fact that people have
5 made the premise that we don't have a POLR risk
6 because we could go out and purchase power in order
7 to serve any customer that returns, regardless of
8 what our portfolio is. And that's what I'm
9 suggesting I don't think this Commission would bind a
10 future commission on, not about running it through
11 the fuel clause, but that decision. Then once they
12 change that, then you have impacts in the FAC.

13 Q. Okay. After that line we were referring
14 to earlier you state: "This concern is particularly
15 acute since Mr." -- I don't know how to pronounce his
16 name.

17 A. Mr. Cahaan.

18 Q. -- "Mr. Cahaan's suggestion would result
19 in non-shopping customers subsidizing customers who

20 did shop and then returned to the Companies' SSO."

21 Would you say the companies' POLR proposal -- under

22 the companies' POLR proposal, would nonshopping

23 customers be subsidizing shopping customers?

24 A. No.

25 Q. Okay. If that's not the case, then would

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 you say that under the company's POLR proposal
2 that -- let me clarify before I ask this question. I
3 forgot to clarify. First, this line of questioning
4 I'll be talking about is the put option, and the put
5 option is to cover the risk of customers leaving. So
6 would you say that customers will only shop or
7 exercise their put option when the electric market,
8 the cost of electricity, is below the ESP price, or
9 in the money, as they would say, in finance terms?

10 A. The assumption built into our modeling is
11 that the customers would exercise it when it was
12 economically advantageous. By that I mean that the
13 price in the market was lower than the SSO price.

14 Q. Okay. So you're saying that the
15 proposal, the POLR risk proposal, would not
16 subsidize -- the company's POLR risk proposal would
17 not cause nonshopping customers to subsidize shopping
18 customers; is that correct?

19 A. That's correct.

20 Q. Okay. Also, along those lines, would you
21 say that the company's POLR risk proposal would cause
22 shopping customers to subsidize the company?

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

25 (Record read.)

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 A. No.

2 Q. Okay. Now, I'm going to get into a
3 hypothetical here, and if you don't follow me, then
4 I'll clarify. But if I'm a writer of a put option,
5 and I sell that put option to you and the holder of
6 that -- in the security underlying that put option
7 and the value of that security goes down and the
8 holder of that put option after the value of that
9 security goes down chooses not to exercise that put
10 option when it's in the money, quote/unquote, would
11 you say that's in the economic best interest of the
12 holder of the put option?

13 A. I need -- it would help me if we could
14 work in a little bit more concrete terms, and let's
15 try to do it around -- let's just create a
16 hypothetical example. So let's assume that the
17 tariff price is \$50. I would assume --

18 Q. Well, this hypothetical is not energy
19 prices. We're talking about stock prices which

20 traditionally options are written under. We're

21 talking about a stock option.

22 A. But -- okay.

23 Q. Okay.

24 A. All right.

25 Q. So if I write a put option for \$50 or a

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 stock price at \$50, the stock price goes down to \$40,
2 the stock option would be in the money, meaning that
3 when the person who holds the option exercises the
4 option, they'll have a right to sell to the writer of
5 the option the price at \$50, correct?

6 A. Correct.

7 Q. So if the person who does not exercise
8 the put option when it's in the money --

9 A. Which person?

10 Q. The holder of the option.

11 A. So the person who could put it to the --
12 the product to the writer at 50.

13 Q. Yeah.

14 A. Okay.

15 Q. Would that be in the economic best
16 interest of that person not to exercise that option
17 when the stock price is at 40?

18 A. No; I would think it would be in their
19 economic interest to do that.

20 Q. Similarly, when the market price goes
21 below the ESP price, it's in the economic best
22 interest of customers, correct --

23 A. Yes.

24 Q. -- to switch?

25 A. Yes.

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 Q. Okay. So would you say that if the
2 holder -- and this is back to the stock option
3 example, the holder of the put option does not
4 exercise that option when it's in the money, it's a
5 windfall for the writer of the put option.

6 A. No.

7 Q. Why is that?

8 A. There was a transaction that the parties
9 agreed to, and the fact that the other party decided
10 not to exercise it, it's not a windfall. He agreed
11 to sell the option.

12 Q. Okay.

13 A. Just part of the transaction.

14 Q. Yeah, but part of the assumption under
15 your option pricing model is that all holders of
16 options will act in their economic best interests and
17 would at all times.

18 A. Okay.

19 Q. Would it not be in the holder of the put

20 option's best interest to exercise the put option

21 when it's in the money?

22 A. Yes.

23 Q. Okay. So then I'm not understanding the

24 why is it not a windfall if the actor has to act --

25 or has to act in his economic best interest, the

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 model price of the option in a way that the actor is
2 acting in the economic -- will act in the economic --
3 in his economic best interest and then he doesn't act
4 in his economic interest, why is it not a windfall to
5 the company, or to the writer of the put option?

6 A. I'm just having trouble understanding
7 what -- what you mean by the term "windfall." Would
8 they have -- would they, in fact, have had a result
9 that was more attractive to them than they would have
10 if they exercised the option? Yes, I would agree
11 with that.

12 Q. Windfall meaning that that scenario was
13 not priced into the option price. The option price
14 was not -- did not take into account the fact that
15 the holder of the option would not -- the holder of
16 the option would not exercise the option when it's in
17 his economic best interest to do so.

18 A. The price was set based on the fact that
19 the person had that option. That's why I won't call

20 it a windfall. It was the transaction. Would the
21 person who had written the put be more economically
22 advantageous than he would if the party who had the
23 put exercised it? Yes.

24 Q. Okay. Let me explain it to you slightly
25 differently, then. It's understandable that when

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 someone writes a put option they're taking the risk
2 that the stock will go down and the option will be in
3 the money, therefore, they'll have to pay out. Part
4 of the benefit is that the stock goes up and they
5 don't have to pay out and they get to keep the cost
6 of the option that's paid to them.

7 So the benefit that they receive is
8 included in the option-pricing model. However,
9 what's not included in the option-pricing model is
10 when the stock price goes down and the option is in
11 the money, and the holder of the option doesn't
12 exercise the option, even though it's in his economic
13 best interest to do so.

14 MR. RESNIK: Your Honor, I'm going to
15 object. I don't think it was a question. It sounded
16 like testimony.

17 MR. WHITE: I'm trying to clarify my
18 position.

19 EXAMINER BOJKO: Do you have a question?

20 MR. WHITE: Yeah.

21 Q. Is that true?

22 THE WITNESS: I didn't hear a question in

23 there, but we could try it again.

24 EXAMINER BOJKO: I think the question

25 was, is that true? Do you need to hear the "is that

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 true" statement part?

2 THE WITNESS: I have to.

3 EXAMINER BOJKO: Can you review that,
4 please, Maria?

5 A. Let me try to answer it without trying to
6 shortcut this. I will agree with you that the option
7 modeling, as you describe it, doesn't value a person
8 who does not do what is economically advantageous.

9 Q. Okay. So when the person doesn't do
10 what's economically advantageous, it's a windfall to
11 the writer of the option.

12 A. Okay. We're going to -- how many times
13 are we going to talk about whether it's a windfall or
14 not? I've answered that question three or four
15 times, and I told you I'm not willing to term that a
16 windfall. If you want to ask me five more times, we
17 can do that.

18 Q. Okay.

19 EXAMINER BOJKO: But then you might get a

20 nasty answer.

21 MR. WHITE: So I shouldn't ask that

22 question again, is that what you're trying to say?

23 EXAMINER BOJKO: I don't think the

24 answer's going to change. How about we move on.

25 Q. Okay. One more question, or maybe a

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 couple more questions. When the exercise -- this may
2 have been answered already, but just to clarify
3 again, when the company created the Black-Scholes
4 model, or whatever, they were under the assumption
5 that customers will switch when it becomes in their
6 economic best interest, i.e., meaning that customers
7 will switch when the market price goes below the
8 strike price or the ESP price; is that correct?

9 MR. RESNIK: Your Honor, a couple of
10 objections. Regrettably, the company didn't create
11 the Black-Scholes model, but beyond that, as I
12 indicated earlier in an objection, the testimony on
13 rebuttal that Mr. Baker has on the Black-Scholes
14 model is very limited to two points, and, again, it
15 sounds to me that we're getting back into a rehashing
16 of the Black-Scholes model.

17 EXAMINER BOJKO: Well, again, I think
18 that -- I hope that I'll give the same courtesy as I
19 have extended to everybody else today and allow

20 Mr. White a little bit of leeway to give some

21 foundation.

22 But I don't think you meant to imply that

23 the company or Mr. Baker here created the

24 Black-Scholes model because he obviously didn't win

25 the Nobel Peace Prize.

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 MR. CONWAY: It's not a peace prize.

2 MR. WHITE: I would withdraw that.

3 EXAMINER BOJKO: I think what you were
4 trying to say is that when the company decided to
5 use the model, these are the assumptions that they
6 made.

7 MR. WHITE: Yeah.

8 EXAMINER BOJKO: Is that what -- can you
9 answer it, or do you need him to rephrase the entire
10 question?

11 A. I'll try again. The use of the
12 Black-Scholes model, as I said, doesn't build in a
13 customer who does not take the economic option, but I
14 would say that that doesn't discount the use of the
15 model, number one, or necessarily say the number is
16 wrong because in doing it, as we've told you, we took
17 a lot of conservative approaches on the other side
18 which kept the POLR down.

19 So there are balancings, for example, the

20 fact that we used a single ESP price rather than
21 increasing it for the price of the ESP for each of
22 the three years, which would have driven it up
23 significantly higher, or the change in market prices
24 that some people have suggested. So there are things
25 on both sides of the model, so I think it's a valid

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 number.

2 Q. Okay. Also, in your testimony you talk
3 about customers subsidizing customers that shop
4 versus customers that don't shop, but according to
5 your model how could there be customers that do shop
6 if all customers act in their economic best interest
7 and -- how could there be customers that do shop and
8 customers that don't shop? If all customers act in
9 their economic best interest, if it's in their
10 economic best interest to exercise their option,
11 i.e., switch when the market price goes down in the
12 ESP, wouldn't all customers shop, if they're acting
13 in their economic best interest, or not shop?

14 A. I was responding to somebody else's
15 proposal that assumed only some people would shop. I
16 think that's where I was coming from, and therefore
17 saying you would have this unfair proposal. If
18 everybody shops and acts in their economic interests,
19 there would not be any subsidy.

20 MR. WHITE: No further questions, your

21 Honor.

22 EXAMINER BOJKO: Thank you.

23 Mr. Kurtz?

24 MR. KURTZ: Thank you, your Honor.

25 - - -

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 CROSS-EXAMINATION

2 By Mr. Kurtz:

3 Q. Good evening, Mr. Baker.

4 A. Good evening, Mr. Kurtz.

5 Q. We're talking about the beginning of your
6 testimony, the cost-of-service portion. I don't want
7 to be repetitive because there have been a lot of
8 questions on that already, but do I understand that
9 basically one of the things you're saying is that
10 anybody who thinks Senate Bill 221 reregulated
11 generation is incorrect?

12 A. I believe it did not create a
13 cost-of-service type approach to ratemaking for
14 generation, is what I'm saying.

15 Q. Okay. Do you agree that Senate Bill 221
16 did reregulate utility earnings?

17 A. Are we talking, Mr. Kurtz, about
18 generation, or are we talking about wires, or what?

19 Q. Total earnings, generation, distribution,

20 transmission, any earnings that hits the utility's
21 income statement or any revenue that hits the
22 utility's income statement.
23 A. There is definitely a significantly
24 excessive earnings test, so the bill provides for
25 that.

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 Q. Okay. And to determine Ohio Power or
2 CSP's earnings, we start with the income statement;
3 is that correct?

4 A. Yes.

5 Q. And the income statement will include, as
6 I just mentioned, does it not, all of the
7 generation-related revenues that the utilities
8 collect?

9 A. It would include -- it would include the
10 revenues and some of those would be generation
11 related.

12 Q. And it would also include expenses on the
13 income statement that would then -- revenues minus
14 expenses equals the net income?

15 A. Yes.

16 Q. Okay. And those expenses would include
17 generation-related expenses.

18 A. Yes.

19 Q. Such as fuel -- fuel.

20 A. Yes.

21 Q. Depreciation on existing generating
22 units?

23 A. All of those are things that are on the
24 income statement.

25 Q. Let me read a list, and I think you'll

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 agree: Variable O&M associated with generation,
2 fixed O&M associated with generation, property taxes
3 on the power plants, insurance on the power plants,
4 emission allowances. Are all those included on the
5 income statement as expenses and, therefore, factored
6 into the earnings equation?

7 A. They can be.

8 Q. Is it your position that any -- that the
9 definition of reasonable under the statute is a set
10 of ESP rates that are more favorable in the aggregate
11 than what the MRO would have been?

12 A. Yes.

13 Q. Does it make any difference what
14 constitutes the ESP set of rates as long as it's more
15 favorable in the aggregate than an MRO? Can anything
16 be in the ESP as long as it's better than the MRO?

17 A. You're taking me to a place that I'm
18 not -- I don't know how to answer that question.
19 Anything? You know, in an ESP that's pretty broad.

20 Q. Well, can you make up -- well, it is
21 broad. It is broad. Do the elements of the ESP have
22 to be legitimate expenses of the utility?

23 A. No.

24 Q. I'm sorry?

25 A. No.

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 Q. So that as long as -- that was my
2 anything.

3 You can include in the ESP elements that
4 are not legitimate expenses so long as the ESP is
5 less -- is more favorable than what the MRO would
6 have been; that's your definition of reasonable under
7 the statute?

8 THE WITNESS: Could I have that read
9 back?

10 (Record read.)

11 A. I believe the statute provides for
12 noncost-based inclusions, for example, the automatic
13 increases. And the test is whether or not it is more
14 favorable in the aggregate than an MRO.

15 Q. Okay. Change subjects. The 5, 10,
16 15 percent purchases.

17 A. Yes.

18 Q. The first year purchase for one of the
19 utilities is estimated to be how much? Is it a

20 hundred million for CSP, 120 million for Ohio Power?

21 Just give me a number to work with.

22 A. The numbers that are in my Exhibit JCB-2

23 in my original testimony were 100 million for

24 Columbus & Southern, 120 million for Ohio Power.

25 Mr. Hess has modified those numbers, and I don't know

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 whether your witness did as well, to reflect a
2 different set of market prices.

3 Q. And let's just use Ohio Power,
4 120 million year 1. Then your Exhibit 2 shows it
5 doubles year 2, 5 percent to 10 percent of
6 240 million, and ultimately a purchased power expense
7 of 360 million in year 3. I know that's a forecast
8 but that's what your exhibit shows.

9 A. Yes.

10 Q. Now, year 1, \$120 million expense, assume
11 that's the correct expense, the utility incurs an
12 expense that then passes it through to consumers so
13 it buys something for \$120 million and it collects
14 \$120 million. There's no effect on earnings, just a
15 straight pass-through with no markup; is that right?

16 A. The question is around deferrals and
17 whether those get treated as earnings. If you
18 assumed, and I don't believe you can do this, just
19 look at a single element and say is it in one place,

20 then it's in the other. It's in rates, but if I go
21 with your hypothesis that I have a hundred million
22 dollars of cost and I get a hundred million dollars
23 of recovery, under that hypothesis there would be no
24 impact on earnings, assuming no deferrals.
25 Q. Okay. Since there's no impact on

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 earnings, the hundred million dollar expense is
2 matched by a hundred million dollars in revenue. Why
3 does AEP want to impose this hundred million dollar
4 expense on consumers?

5 A. It is part of our plan to reflect the
6 fact that we have taken megawatts out of our
7 portfolio in order to serve Ormet, and we would be
8 doing the same thing for Mon Power under the bill
9 that -- or, the ESP as we've got filed.

10 Q. Is the real motivation that when you buy
11 a hundred million dollars worth of power, 5 percent
12 of the energy needs of Columbus & Southern in this
13 example, it frees up an equivalent amount of power of
14 self-generation to be sold off system?

15 A. No, I don't think that's a good
16 characterization. What I said was we had lost
17 generation from our -- we would be losing generation
18 from our portfolio to serve these customers and we're
19 trying to replace it.

20 Q. Strike the motivation part of the
21 question. Would the physical effect of buying that
22 amount of megawatt-hours be to displace other
23 generation that would be available for sale
24 off-system?

25 A. If you hold everything else equal, yes.

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 Q. Now, the profits from off-system sales
2 are allocated among the AEP East operating companies
3 according to the interconnection agreement; is that
4 correct?

5 A. Yes.

6 Q. Okay. And basically each of the
7 operating companies, Ohio Power, Columbus & Southern,
8 Kentucky Power, Indiana and Michigan, and Appalachian
9 Power, get their member load ratio share of
10 off-system sales profits no matter whose power plant
11 generated the electricity for the sale.

12 THE WITNESS: Could I have the question
13 read back just to make sure I am clear on all the
14 words?

15 (Record read.)

16 A. I would just -- I would call it
17 off-system sales margins, but they get their MLR
18 share regardless of who supplies the power, yes.

19 Q. So under this hypothesis where you're

20 buying 5 percent, 10 percent, 15 percent of power and
21 then freeing up electricity for sale off system, the
22 AEP shareholders do not get all of that additional
23 margins from off-system sales; is that correct?
24 A. Again, you're going back to a premise
25 that, as I said, it's to replace power that we have

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 to now provide to Ormet and Mon Power, and if
2 whatever comes out of any off-system sales, just as a
3 general proposition, we share that in some
4 jurisdictions with customers.

5 Q. And in other jurisdiction it's a straight
6 flow-through to the ratepayers of that jurisdiction.
7 Is that correct?

8 A. In some cases it is a direct
9 flow-through; in other cases there's sharing.

10 Q. So the consumers in West Virginia,
11 because there is an automatic flow-through of profits
12 from off-system sales through their ENEC clause,
13 their version of the fuel adjustment, those
14 customers, if your 5 percent, 10 percent, 15 percent
15 proposal in Ohio is adopted, the increase in
16 off-system sales margins will actually benefit West
17 Virginia ratepayers in the sense that they'll get
18 their share, their member load ratio share of the
19 additional off-system sales margins; is that correct?

20 A. I think you have to keep in mind that
21 without this they would be disadvantaged with where
22 they would have been had the company not had Ormet
23 and Mon Power. It takes them back to where they
24 would have been if Ormet and Mon Power hadn't been
25 done.

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 Q. Is the answer yes, that the West Virginia
2 consumers will benefit?

3 A. Their customers will be put back in
4 the position they were if we hadn't entered into
5 those.

6 Q. Really, any native load growth on any of
7 the operating companies' systems reduces the amount
8 of power that can then be sold off-system just as a
9 matter of physical reality or mathematics; isn't that
10 right?

11 MR. RESNIK: Your Honor, I'm going to
12 object. I tried to adhere to your prior rulings
13 about seeing if the foundation was being laid for
14 something that was relevant to Mr. Baker's rebuttal
15 testimony, and --

16 MR. KURTZ: I'll withdraw the question.

17 Q. One last. You opposed the proposal of
18 OEG and Kroger that off-system sales margins or
19 profits be used as a credit in the fuel adjustment

20 clause?

21 A. Yes.

22 Q. How much profit from off-system sales did

23 Ohio Power earn in a representative year, 2007 for

24 example?

25 A. I don't have that number.

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 Q. Did you read Mr. Kollen's testimony where
2 he has quantified the off-system sales profits in
3 2007 for Ohio Power Company at 146.7 million and for
4 Columbus & Southern 124.7 million?

5 A. I read Mr. Kollen's testimony. I don't
6 remember those numbers, and I didn't verify those
7 numbers.

8 Q. Okay. There's nothing in your rebuttal
9 testimony or anybody's rebuttal testimony that takes
10 issue with those amounts?

11 A. No. I don't think there's any need to
12 because we're not proposing to flow it back.

13 Q. I guess my only -- this is a large dollar
14 item we're talking about, the margins from off-system
15 sales.

16 A. Relative to what?

17 Q. Relative to the cost increases that AEP
18 is proposing.

19 A. It is a significant number relative

20 to the rate increases that the company is proposing.

21 MR. KURTZ: Thank you, your Honor.

22 EXAMINER BOJKO: OCC?

23 MS. ROBERTS: Thank you.

24 - - -

25

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 CROSS-EXAMINATION

2 By Ms. Roberts:

3 Q. Mr. Baker, let's start on page 4 of your
4 testimony. On line 9 you indicate that there is no
5 restriction on the company of including the items
6 you've listed, POLR and FAC, et cetera, in their ESP
7 plan; is that correct? Page 4, line 9.

8 A. Yes, that's what the sentence starts
9 with. "An ESP is in no way restricted from having
10 the provisions" and then lists the provisions.

11 Q. By the same token the Commission is not
12 restricted in deciding that the company shouldn't be
13 allowed to recover any of those items, is it?

14 THE WITNESS: Could I have that one read
15 back?

16 (Record read.)

17 A. The Commission has the ability to
18 approve, modify, or disapprove our plan, and so those
19 are what they can do. It is -- what we have

20 suggested is that they should do that based on
21 whether or not the ESP in the aggregate is more
22 beneficial to customers than the MRO.

23 Q. And on line 17 of that page in response
24 to the question you have identified three items that
25 you believe warrant the Commission modifying the ESP;

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 is that correct?

2 MR. RESNIK: Your Honor, I'll object.

3 EXAMINER BOJKO: Grounds?

4 MR. RESNIK: It mischaracterizes the

5 testimony, particularly the use of the word

6 "warrant."

7 MS. ROBERTS: I just asked him if that's

8 what he did.

9 EXAMINER BOJKO: Yeah, I think that's

10 what it says, doesn't it?

11 MS. GRADY: Unless you want to strike

12 that?

13 MR. RESNIK: No. No. Thank you.

14 Appreciate the offer, though.

15 EXAMINER BOJKO: Can you answer the

16 question?

17 THE WITNESS: Could I have it read back?

18 (Record read.)

19 A. I don't disagree that the word "warrant"

20 shows up in the question. What I did in the answer,
21 though, was to say ways that I could see a Commission
22 modifying the ESP, and it lists three possible ways
23 or three possible reasons.

24 Q. And I just want to ask this question, are
25 there any other circumstances that you can identify

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 that you think would warrant the Commission modifying
2 the ESP?

3 A. I have not done an exhaustive research.

4 What I did was I came up with three when I was
5 writing the testimony.

6 Q. All right. If you turn to page 9 of your
7 testimony --

8 A. Certainly.

9 Q. -- on line 13 you make a statement about
10 off-system sales that if the General Assembly in Ohio
11 intended to require a more significant item like OSS
12 margins to be credited against the fuel, they surely
13 had the opportunity to incorporate that mechanism in
14 SB 221. Do you see that?

15 A. Yes, I see that sentence.

16 Q. In fact, the General Assembly made no
17 indication of whether they thought it was or was not
18 appropriate to have a crediting of off-system sales
19 in an ESP, did they?

20 A. I believe that we say in the beginning of
21 that paragraph that in the entirety of Senate Bill
22 221, OSS margins are not mentioned. But I would note
23 that it isn't a secret about what AEP does in the
24 wholesale market, and to -- in the response that I
25 did to Mr. Kurtz, it's a significant number.

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 In Virginia where they were going through
2 a similar "what do we do after the current bill takes
3 place," they knew about it, they decided to put in a
4 sharing arrangement.

5 I think if the General Assembly had
6 wanted to do that, they would have.

7 Q. But the statute speaks for itself;
8 wouldn't you agree?

9 A. I stand by in the entirety, it's not
10 mentioned.

11 Q. Thank you.

12 On page 10 of your testimony you had
13 testified on direct that when -- and correct me if I
14 mischaracterize this. I'm sure you or Mr. Resnik
15 will do that -- that when the ESP application was
16 prepared, that the company used the most recent data
17 in an effort to get the most representative data; is
18 that correct?

19 THE WITNESS: I'm sorry, can I have that

20 read back?

21 (Record read.)

22 A. No, I wouldn't characterize it that way.

23 I don't believe that's what I said.

24 Q. You didn't use the most current fuel

25 prices to provide the most representative fuel prices

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 in the ESP filing?

2 A. We're talking here about the competitive
3 benchmark?

4 Q. No, I'm laying some foundational
5 questions regarding your direct testimony to ask
6 about page 10.

7 A. Okay. Can we start over then?

8 Q. Sure.

9 A. I thought -- you pointed me to page 9 so
10 I assumed we were talking about the competitive
11 benchmarks.

12 Q. I apologize, Mr. Baker.

13 A. Okay.

14 Q. In your direct testimony you testified,
15 didn't you, that in preparing the ESP application the
16 company attempted to use the most current prices, for
17 example fuel prices, or in the example of
18 Black-Scholes, the most current LIBOR interest rates,
19 in an effort to present the Commission with the most

20 representative filing of what the rate would be

21 during the ESP period.

22 A. I think you'd have to point me to a spot

23 in my testimony or my -- or the transcript. I don't

24 remember using those words. I may have, but I'd like

25 to see it in the context of where I said it.

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 Q. All right. Here on page 10 you seem to
2 make an argument that I would summarize as that if we
3 update -- if we update, for example, energy prices,
4 as OCC has suggested, then you can never update them
5 enough because they would be out of date by the time
6 the Commission issued an order. Is that a fair
7 summary of your statement here on lines 5 through 9?

8 A. No. That's not a fair summary. What I'm
9 saying is to pick a specific instant or a specific
10 small period of time for the purposes of setting the
11 competitive benchmark, this is all-around setting the
12 competitive benchmark, that's not a valid way to
13 approach it.

14 You need to look over a longer period of
15 time as we did where we looked over effectively
16 almost a nine-month period, and if -- once you do
17 that, you get some stability to the pricing which
18 should be more reflective of the future pricing than
19 picking out a 1 day period or one 5-day period or one

20 15-day period, whatever choice it is, for one small
21 spot. I just don't think that's a good approach.
22 Q. All right. Regarding the question on
23 this page beginning on line 10, the last sentence,
24 you say: "Do you agree with the assertion that the
25 recent price decline marks the beginning of a trend?"

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 Mr. Baker, have you done any studies to determine
2 whether the recent decline in prices is or is not a
3 trend?

4 A. Have I done a study? We don't -- I've
5 said before I don't have a forecast -- I don't
6 forecast what the future price is. I don't think any
7 of us know it. This is around the point that was
8 made that it was an unusual event and that,
9 therefore, you should use it because it creates --
10 it's a trend. And I'm saying that this is not an
11 unusual event because it's happened before and you
12 shouldn't -- this is support for the idea that you
13 don't pick a single point in time.

14 Q. Are you also saying that the decline in
15 prices is not a trend?

16 A. How long's a trend?

17 Q. That's your word, a trend. You're saying
18 it's not a trend.

19 A. I would say I look at trends and I say

20 long periods of time. For example, in this case the
21 three years, that's what you're looking at, the
22 period of the ESP, and I would say that it does
23 not -- it marks the beginning of a trend but the
24 trend may be up.

25 Q. But you don't know.

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 A. I've said that I don't know.

2 Q. Yeah. All right.

3 On page 12 of your testimony in the
4 question on line 4 it says, "If the Companies'
5 competitive benchmark were adjusted lower, as Staff
6 Witness Johnson and OCC Witness Medine have
7 proposed," and then it goes on. Can you identify for
8 me where or when OCC Witness Medine proposed that the
9 benchmark be reduced?

10 A. Ms. Medine said that we were kind of fast
11 and loose, is my recollection, I'm kind of
12 paraphrasing, with our choices for the inputs to our
13 Black-Scholes model. And one of them I think she
14 talked about was the market price, and so I just took
15 the fact that another witness had said that the
16 market prices were lower today and said what would it
17 be if we used the prices as done by Miss Smith.

18 Q. Can you tell me if you agree that if the
19 ESP price is updated, whether the MRO price should

20 also be updated?

21 THE WITNESS: I'm sorry, can I have that

22 read back?

23 EXAMINER SEE: Yes.

24 (Record read.)

25 A. I don't think we're proposing to update

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 the ESP price.

2 Q. No, but if they were updated,
3 hypothetically speaking, if the ESP prices were
4 updated in the Black-Scholes model, do you also agree
5 that the MRO prices should be updated?

6 A. I need you to help me out here. Are you
7 saying if we updated the ESP prices to have three
8 years of ESP prices as forecasted? Is that what
9 we're talking about here?

10 Q. If they were updated by the Commission in
11 any way, would the MRO price also need to be updated
12 to establish the appropriate inputs to the model?

13 MR. RESNIK: Can I have just the last
14 part of that question, inputs what?

15 THE REPORTER: To the model.

16 Q. I'm sorry. I'm sorry. For the benchmark
17 it should be. Let me say that again.

18 If the ESP price were updated, benchmark
19 price were updated, would it also be appropriate to

20 update the MRO price so that they would be presented

21 on a similar basis?

22 MR. RESNIK: Your Honor, I'm going to

23 object. The witness has indicated the company is not

24 proposing to update the ESP. There's nothing in his

25 testimony -- in his rebuttal testimony that says that

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 we want to change the ESP from what we had filed so I
2 think the question is irrelevant; if not irrelevant,
3 at least outside the scope of rebuttal.

4 MS. ROBERTS: I think he opened the door,
5 your Honor.

6 EXAMINER SEE: And I'm going to allow
7 Mr. Baker to answer the question to the extent that
8 he can.

9 THE WITNESS: Okay. I'm going to need it
10 reread.

11 EXAMINER SEE: That's fine.

12 (Record read.)

13 A. We are not proposing, except in the case
14 of the POLR, that the competitive benchmark be used
15 in the ESP. We have used it for comparative purposes
16 only to look at one versus -- look at the ESP and the
17 fact that we have proposed a 5, 10, 15 percent
18 purchase and priced that to make them -- to create an
19 apples-to-apples situation.

20 Q. But you used similar time periods over
21 which you expected these rates to be in effect; isn't
22 that correct?

23 A. We used similar time frames to compare
24 the ESP/MRO, yes.

25 Q. Yes. And you also had the rates in terms

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 of making an apples-to-apples comparison as
2 consistent as possible regarding their inputs and how
3 they were calculated?

4 A. We attempted to use the same numbers in
5 the analysis that I provided in JCB-2.

6 Q. And that's what you believe to be the
7 appropriate way to develop a comparison between the
8 two.

9 A. Yes.

10 Q. If you turn to page 16 of your
11 testimony --

12 MR. RESNIK: I'm sorry, which page?

13 MS. ROBERTS: Sixteen.

14 Q. -- you begin to talk about the
15 Black-Scholes model. In your first answer you refer
16 to the risk-free interest rate. Would you agree that
17 the term "risk-free interest rate" is a term of art
18 in the financial service industry?

19 A. Yeah, I think that's probably fair.

20 Q. Okay. And you address the intervenors'
21 challenges to your calculation of Black-Scholes in
22 your rebuttal; is that correct?

23 THE WITNESS: Could I have the question
24 read back?

25 (Record read.)

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 A. I think the only place I do it, and if
2 I'm wrong you can help me out, is the discussion of
3 the LIBOR rate.

4 Q. And it's your premise in offering the
5 Black-Scholes model to the Commission, isn't it, that
6 it accurately reflects the risks to the company of
7 the POLR obligation?

8 A. I think I've said it values the option
9 that's provided to customers.

10 Q. Is there any basis upon which you have
11 assumed that the value to the risk of the company is
12 the same as the option value to the customers?

13 A. The POLR was calculated based on the
14 value to customers.

15 Q. Have you -- has the company included --
16 AEP-Ohio -- in its 2009 budgeting, has it accounted
17 for any shopping customers in 2009?

18 MR. RESNIK: Your Honor, are we still on
19 the Black-Scholes, if I may inquire?

20 MS. ROBERTS: Yes.

21 MR. RESNIK: Well, I would object again.

22 The testimony on rebuttal is limited to two discrete

23 points. The degree of shopping assumed or not

24 assumed is not one of those points addressed in

25 Mr. Baker's rebuttal testimony. I can't see it

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 becoming a foundation for anything that's relevant.

2 EXAMINER BOJKO: Well, we'll

3 give Ms. Roberts the same courtesy.

4 I don't know if you're just asking for my

5 response, but let's see where it's gone.

6 THE WITNESS: Could I have the question

7 read back?

8 (Record read.)

9 A. I believe what it would represent is the

10 amount of shopping customers that we're experiencing

11 today.

12 Q. What is included in the 2009 budget would

13 be reflective of the shopping customers today; is

14 that what you mean by your answer?

15 A. That's what we would have put for

16 budgeting purposes. That doesn't mean that's what's

17 going to actually happen and that's not

18 necessarily -- well, I'll leave it at that's not

19 what's actually going to happen. It's a budget.

20 Q. All right. On page 17 of your testimony,
21 on line 4 your answer begins "U.S. Treasury rates and
22 the LIBOR, the two most commonly used proxies for the
23 risk-free interest rate." What authority do you use
24 to support that statement?

25 A. Discussions with people who are in the

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 industry who use U.S. Treasury rates and LIBOR.

2 Q. And who would that be?

3 A. I've talked to our finance people, I've
4 talked to our commercial operations people, all of
5 who use LIBOR as part of their day-to-day business.

6 Q. And in supporting the Black-Scholes model
7 in your testimony, did you make the selection of what
8 interest rates were used in that calculation?

9 A. People in commercial operations and I got
10 together and talked about the various inputs, and one
11 of the things we were trying to do was get a proxy
12 for the risk-free rate, and the people who use the
13 model on a day-to-day basis chose LIBOR.

14 Q. And on page 18 of your testimony, the
15 answer beginning on line 5, you have a lot of data
16 here over how the Treasury has compared to LIBOR over
17 the last eight years. Where was this data sourced
18 from?

19 A. I believe it was Bloomberg.

20 Q. And specifically on line 6 of that page
21 you talk about the spread between LIBOR and the
22 Treasury rates has ranged from a high of 107 basis
23 points to a low of 26 basis points; is that correct?

24 A. Yes.

25 Q. And that looks like what is actually

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 reflected on your Exhibit 2F, the chart of the LIBOR
2 versus the Treasury rates. Is that correct?

3 A. That was the source of that, yes.

4 Q. Okay. The data that you used to evaluate
5 that was -- what was the most recent source of the
6 data you used to make that determination? Let me say
7 that a different way. What was the most recent data
8 you used in making that determination?

9 A. Well, since it's historical data on this
10 chart, it would be the date that the data -- it would
11 be those points in time.

12 Q. Okay. But the most recent data point
13 would be 7/25/08; is that correct?

14 A. Yes, that's the most recent point.

15 Q. Do you know whether the spread between
16 LIBOR and the U.S. Treasuries has changed since July
17 of '08?

18 A. Yeah, I believe there was a short period
19 of time, and I'm not sure exactly how many months or

20 weeks, but during -- there was a period after Lehman
21 fell that there become a spread because of the fact
22 that the LIBOR was frozen for a period of time while
23 the rate was dropping. I understand that they have
24 now come back into the kind of tracking that we see
25 here.

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 MS. ROBERTS: Your Honor, may I approach
2 the witness?

3 EXAMINER BOJKO: You may.

4 Q. It was your testimony, wasn't it,
5 Mr. Baker, that the higher the interest rate used in
6 the POLR calculation, the lower the POLR charge,
7 resulting POLR charge?

8 A. Yes, that's what I said. And what I
9 said, was it had a -- on lines 10 through 12, that it
10 is not a big driver for the POLR charge.

11 Q. You used there an interest rate
12 differential of a hundred basis points, isn't that
13 correct, to make that determination?

14 A. Yes.

15 Q. All right. I've handed you a document
16 from the Financial Trade Industry dated September
17 16th, and I would direct your attention to -- and I
18 highlighted it on your copy but I didn't keep it on
19 mine -- the second full paragraph. Is this your

20 recollection, that it was in September that the LIBOR

21 rate rose precipitously?

22 A. Precipitously is a "beauty in the eyes of

23 the beholder" kind of word. So I -- what I would say

24 is this was the period that I understood that there

25 was a spread that developed that I indicated has come

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 back to more normal historical values.

2 Q. But if you look at your chart, Mr. Baker,
3 for July, what is the LIBOR rate shown there, for
4 July 25th, 2008? Looks like it's about 4 percent,
5 doesn't it?

6 A. It's slightly above 4, yeah.

7 Q. And in September the LIBOR rate rose, it
8 says, 3.3 percent to 6.44 percent. Would you
9 consider that a significant increase in the LIBOR
10 rate?

11 A. Yes, that's an increase in the LIBOR
12 rate. Yes.

13 Q. And do you know whether the spread
14 between the LIBOR and the U.S. Treasuries has
15 remained through the current period of this week?

16 A. In talking to people who deal with this,
17 they told me that the spreads have come back to more
18 normal values.

19 Q. Between 26 basis points and 107 basis

20 points, is that what you consider to be the normal

21 spread?

22 A. They felt that it was still -- that it

23 was back within the range, that it hadn't gotten out

24 of kilter like it did in the September time frame.

25 Q. I'm trying to understand what you

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 consider the normal range to be. Do you consider it
2 the range to be shown on your chart on page 17, which
3 is a range between, you testify, 26 basis points to
4 107 basis points?

5 A. It was a normal range as defined by
6 people in our company who borrow money based on the
7 LIBOR.

8 Q. All right. Well, did the people in your
9 company consider your testimony, your answer on
10 line -- page 18, line 5, to be considered a spread in
11 the normal LIBOR range?

12 A. I didn't ask them.

13 Q. So you don't know whether the current
14 LIBOR spread is correlated in any way to your
15 testimony on page 18?

16 A. The purpose of this was to refute a
17 position that I heard during this hearing that
18 there -- that LIBOR is highly volatile and it was in
19 reference to the Treasury. And the purpose of this

20 chart was purely to show that they tracked pretty
21 closely, and so if you consider one to be volatile,
22 then the other is to be volatile. I believe that's
23 what the testimony says.

24 Q. I understand. But your testimony on page
25 18, the answer beginning at line 5, you discuss the

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 spread between LIBOR and the Treasury rate over the
2 last eight years. And what I'm asking you is whether
3 you can establish that there's any correlation
4 between this spread and what the people you talked to
5 consider to be a normal spread.

6 A. I did not show them this spread and say,
7 "Do you see a correlation?" But if I look back at a
8 chart like this, I would say -- and I'm looking at,
9 you know, a seven-year time frame. If I'm in that
10 kind of business and I look and I say, gee, look at
11 what the spreads were for the last period, I think
12 they would consider that in their decision, but I
13 didn't talk to them about it.

14 Q. Okay. Regarding the run of the
15 Black-Scholes model an indeterminate number of times,
16 Mr. Baker, in running the model you used the same
17 Black-Scholes model but what you changed were the
18 inputs in that indeterminate number of runs; is that
19 correct?

20 A. Yeah. Boy, I sure wish I hadn't used the
21 word "indeterminate," but we did run it more than
22 once, and what we did was we changed some of the
23 inputs. For example, we would not have changed the
24 term because it was three years from the start, it
25 was three years at the end.

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 We would have changed it for the, for
2 example, for the ESP. As that developed and it
3 changed over time, we would rerun it. And we would
4 rerun it for changes in market price at various
5 times.

6 Q. And interest rates?

7 A. I don't remember whether we reran it
8 specifically for a change in interest rates, but I
9 would think --

10 Q. Do you know whether it was --

11 MR. RESNIK: Can he finish his answer,
12 please?

13 MS. ROBERTS: Oh, I'm sorry.

14 EXAMINER BOJKO: Yes.

15 A. I would assume that the last time we ran
16 it we updated to have the most current interest
17 rates.

18 MS. ROBERTS: Thank you, Mr. Baker. I
19 have no other questions.

20 EXAMINER BOJKO: Let's go off the record.

21 (Discussion off the record.)

22 EXAMINER BOJKO: Let's go back on the

23 record. Mr. Bell.

24 MR. BELL: Thank you.

25 - - -

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 CROSS-EXAMINATION

2 By Mr. Bell:

3 Q. Mr. Baker, do you remember the line of
4 examination of Mr. Randazzo relative to the inclusion
5 of all of the generating -- Ohio generating plant in
6 rate base in past rate proceedings?

7 A. I remember the discussion we had on the
8 inclusion of all the generating assets that were
9 owned by the company at that time.

10 Q. Is it not the company's position that the
11 Commission in evaluating the company's ESP in this
12 case should not consider the past recovery of capital
13 or the return on capital in evaluating the current
14 ESP? For instance, is it your position effectively
15 that if the company, in fact, had recovered its total
16 capital investments in generating assets, that that
17 would be immaterial in reviewing the appropriateness
18 of the company's ESP plan?

19 A. I don't think this is a cost-of-service

20 bill, and the premise of the bill, as I understand

21 it, is you take your current rates and you make

22 adjustments to that.

23 Q. I think your answer is yes, you're saying

24 then that the cost -- this is not cost of service, it

25 could be entirely possible for AEP to have recovered

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 its total capital investment in generating assets to
2 the point that it now has a zero capital investment
3 through past depreciation, et cetera, et cetera, and
4 earned a reasonable return on the investment that
5 existed in the past, that that is totally irrelevant
6 from the company's perspective in the Commission's
7 review of its current ESP, correct?

8 THE WITNESS: Could I have the question
9 read back?

10 (Record read.)

11 A. To answer the question that she just read
12 back --

13 Q. Yes.

14 A. -- I don't think it's possible that the
15 company could have recovered all of its cost of
16 capital and a fair rate of return.

17 To finish the answer, I do not believe
18 that that, since it is a cost of service, that where
19 we are in recovery of investment is an appropriate

20 determinant.

21 Q. Thank you. That's fair. You have given
22 me what I want, Mr. Baker. We're working together.

23 A. We'll try.

24 Q. Following up on a line of examination by
25 Mr. Petricoff, you've been involved in the regulatory

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 arena for several decades, have you not, Mr. Baker?

2 A. I have had some experience in the
3 regulatory arena for several decades. I've only had
4 responsibility for regulatory over the last seven
5 years.

6 Q. Does the term, quote, public interest
7 have any meaning to you?

8 A. Yes.

9 Q. Would you agree that within the context
10 of the regulatory arena that, quote, public interest,
11 end quote, transcends the parochial economic interest
12 of either the company's shareholders or its
13 ratepayers?

14 A. I don't -- can you help me with where
15 that definition came from?

16 Q. I just made it up.

17 A. Well then that's --

18 Q. It's a concept.

19 A. Well, then I probably won't agree with

20 you.

21 Q. Are you being facetious, Mr. Baker?

22 A. No, I'm not being facetious. I'd like to

23 know where the quote came from, and if you can tell

24 me that -- is it in the Federal Power Act? Is it in

25 Senate Bill 221? Is it in the predecessor, Senate

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 Bill 3? I need to know where it came from.

2 Q. Do you then -- would you agree, Mr. --

3 A. Baker.

4 Q. -- Baker, that to the extent that Senate

5 Bill 221 does not define for the Commission the

6 parameters by which the Commission is to ascertain

7 whether the ESP is better than the MRO, that the

8 Commission may, in use of its enlightened judgment,

9 make that determination based upon its finding of

10 what is in the, quote, public interest, end quote?

11 A. I believe what the Commission needs to do

12 is make an evaluation of our ESP and compare it to

13 the MRO and determine whether to accept, modify, or

14 reject our plan.

15 Q. Didn't you in response to a question by

16 Mr. Petricoff, say, and I quote, "The Commission can

17 and will do what it needs to do"? And I think I got

18 that word for word.

19 A. You may have. I'm surprised I threw

20 "needs" in, but if that was my statement, I may have

21 said it.

22 Q. And in determining what is, quote, more

23 favorable, it is up to the Commission to consider --

24 to determine what factors it will consider, what time

25 frame it will consider those factors influencing, as

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 well as the circumstances under which those factors
2 evidence themselves?

3 MR. RESNIK: Your Honor, I'm going to
4 object. We've had more foundations built this
5 afternoon than would be built at a mason's
6 convention. I think that it is beyond the scope of
7 the rebuttal testimony. The other foundations didn't
8 seem to go anywhere. I don't think this one's going
9 to either.

10 EXAMINER BOJKO: Well, I hate to deny
11 Mr. Bell the same courtesy that I have offered to all
12 the other masonry workers today.

13 MR. BELL: I'll wrap this up very
14 shortly.

15 EXAMINER BOJKO: That's what I was going
16 to ask.

17 MR. BELL: Yes.

18 EXAMINER BOJKO: If there's any way we
19 could shortcut this, that would be great.

20 Q. (By Mr. Bell) Picking up on the line of
21 Mr. Petricoff, do you believe the Commission should
22 approve a proposed ESP plan that has been
23 demonstrated not to be in the, quote, public
24 interest, even though such a plan in the aggregate is
25 found to be more beneficial than the MRO over the

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 period of the plan?

2 A. I would say that since there are two
3 options customers will be served under, either an MRO
4 or an ESP, that if the ESP is more favorable than the
5 MRO, it's in the public interest.

6 Q. Would you agree, Mr. Baker, that an
7 appropriate measure of the benefits of the ESP would
8 be the likely end result produced by the ESP over the
9 period of the ESP, that is, testing the benefits by
10 the results produced by the ESP?

11 A. I believe the Commission should be
12 looking at the qualitative and the quantitative
13 impacts of the MRO and the ESP in evaluating whether
14 to approve it.

15 Q. That's fair. So that on page 5 where you
16 state: "The plan to make purchases" -- and this is
17 in respect to Purchase Power Proposal, that element
18 of the plan you said "should be approved if the total
19 ESP, including the purchases, is in the aggregate

20 more attractive than an MRO."

21 By the use of the term "attractive," you

22 do not there mean to imply a cosmetic attractiveness.

23 A. No, I didn't mean cosmetic.

24 Q. What you meant there, I trust then, is

25 that it has to be substantively demonstrated to be

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 more attractive or more beneficial.

2 A. It has to be a better option for
3 customers than the MRO.

4 Q. And in your testimony going to the
5 Commission doing what it's going to do, what the
6 Commission is going to do, would you agree that the
7 Commission in so doing can effectively alter the
8 period of the company's proposed plan or any of its
9 facets?

10 A. The Commission will put out an order, and
11 if they modify the plan, they modify it, and then we
12 will review it and determine whether that
13 modification is acceptable.

14 Q. Does 221 in any way, shape, or form
15 limit, for instance, the Commission in reducing the
16 period of the plan, say, from three years to one
17 year, if the Commission were to find that given the
18 economics, the economy of the state of Ohio, it's in
19 the public interest to abbreviate the period of the

20 plan from three years to one?

21 A. I don't believe that the bill limits how

22 the Commission can modify.

23 Q. And that is true with respect to the

24 various components of the plan as well; is it not?

25 A. Yeah. I was going to finish the

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 sentence.

2 Q. I'm sorry, I thought you finished.

3 A. They can modify -- I read the bill to say
4 they can modify the plan. I don't see any limit as
5 to what they can change. The impact, though, is that
6 then becomes a modification to the plan and it then
7 goes back to the company to decide what action to
8 take.

9 Q. I'm not questioning the company's ability
10 to accept or reject. I'm -- the question was solely
11 directed toward the ability of the Commission to
12 completely refigure, reconfigure, if you will, the
13 company's proposed ESP leaving the Commission's
14 reconfigured ESP then for either acceptance or
15 rejection by the company.

16 A. I don't see anything that limits the
17 Commission in the modification other than -- I read
18 it that they're supposed to look at it consistent and
19 approve it consistent with if it's more favorable

20 than the MRO.

21 Q. So that such a modification can have --

22 such a modification can be motivated and predicated

23 upon public interest factors as may be identified by

24 the Commission.

25 A. And I go back to my statement I made

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 earlier, that I think if it's better than the MRO, it
2 would be in the public interest.

3 Q. The Commission's modification of the
4 company's proposed plan can be directed towards
5 making it even more beneficial than the benefits
6 bestowed in the company's proposed ESP, may it not?

7 MR. RESNIK: Your Honor, I'm going to
8 object. I know we've had questioning of nonattorneys
9 on this, but the statute specifically says that the
10 Commission shall approve the plan that's more
11 favorable. It does not give the Commission latitude
12 to make it even more favorable.

13 MR. BELL: I'll withdraw the last
14 question. I think Mr. Baker sufficiently responded
15 for purposes of my inquiry, and I did hold to my
16 representation that my cross would be limited.

17 EXAMINER SEE: To 15 minutes?

18 MR. RINEBOLT: Of fame.

19 EXAMINER SEE: Mr. Rinebolt.

20 MR. RINEBOLT: Thank you, your Honor.

21 - - -

22 CROSS-EXAMINATION

23 By Mr. Rinebolt:

24 Q. Good evening, Mr. Baker.

25 A. Good evening, Mr. Rinebolt.

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 Q. I know we've sat at the same witness
2 table in the past involving this issue and we had
3 different views then. I'm sure that that continues
4 to this day, so I just want to clarify a couple of
5 your points.

6 In your mind is cost-based regulation
7 inherently the same as cost-of-service regulation?

8 A. I think -- I was thinking of cost of
9 service in the broad sense, Mr. Rinebolt. When you
10 were looking at how you determine rates, you look at
11 all the costs of the company, determine a revenue
12 requirement. When I'm using the term "cost based," I
13 was tending to use that in reference to certain items
14 of our ESP.

15 Q. So there are certain items that are cost
16 based from your perspective.

17 A. Yeah. I would say the FAC is cost based.

18 Q. Based on your familiarity with the
19 statute, do you believe that an MRO, a market rate

20 option standard service offer rate is a cost-based

21 rate?

22 A. Not in its entirety.

23 Q. Well, let me -- if I understand an MRO

24 correctly, a bidding scheme is developed, the right

25 to supply or that is -- the need for that supply is

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 bid out in the market in some form or fashion, and
2 the lowest price wins. Is that your understanding of
3 an MRO?

4 A. For whatever percentage a company is
5 allowed to blend in that piece of it, yes.

6 Q. Okay. And the excess earnings test,
7 there's obviously a revenue analysis involved in
8 that, so that would also be a cost-based measure
9 that's included in the statute. Is that a reasonable
10 assessment?

11 A. I don't consider an earnings test that's
12 a stand-alone to be a cost-based approach. It's a
13 piece of the statute that deals with significantly
14 excessive earnings. I wouldn't characterize anything
15 more than that.

16 Q. Okay. At the top of page 3 you say that
17 many parties have -- or, many parties for the
18 legislative debate proposed a just and reasonable
19 standard for evaluating costs. Does the statute in

20 section 4928 still call for a reasonable rate for

21 customers?

22 A. I'm sorry, would you point me to --

23 Q. 4928.02(A).

24 MR. RINEBOLT: Withdrawn. It's in the

25 statute. No need to ask this.

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 On page 4 at the very, very top you --
2 and it actually begins on page 3, but you basically
3 take the position that since the Ohio legislation
4 doesn't look anything like the Virginia legislation,
5 that there's no cost basis -- there's no reason to
6 use cost in establishing rates. Is that basically
7 your point, that Virginia -- Ohio's legislation isn't
8 Virginia's?

9 A. No. My statement's about the cost of
10 service is what's covered in the two Q and As above
11 that.

12 Q. Okay.

13 A. This was just an example of another state
14 that had a choice to do market, some kind of -- I
15 guess they could have done a hybrid, I don't remember
16 there ever being any discussion, or going back to a
17 more traditional cost of service, and they chose to
18 go back to a more traditional cost of service.

19 Q. On page 15 at line 9 you indicate that:

20 "The cost of the POLR obligation for the Companies
21 arises from the fact that the Companies must manage
22 their portfolio." What kind of a portfolio are you
23 discussing, Mr. Baker, are you referring to?

24 A. The generation portfolio.

25 Q. Generation. So AEP as a company has the

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 ability to manage a generation portfolio, I take it.

2 A. Yeah. We do it on a day-in/day-out

3 basis.

4 Q. Okay.

5 A. It doesn't mean there aren't risks

6 imposed by certain actions that may lead you to

7 manage it differently.

8 MR. RINEBOLT: Your Honor, that's all I

9 have.

10 Mr. Baker, thank you very much.

11 THE WITNESS: You're welcome.

12 EXAMINER SEE: Thank you.

13 Mr. Jones or Mr. Margard?

14 MR. JONES: No questions, your Honor.

15 EXAMINER SEE: Any redirect for

16 Mr. Baker?

17 MR. RESNIK: No, we have no redirect,

18 your Honor.

19 EXAMINER SEE: Okay.

20 MR. RESNIK: I wasn't sure if there were

21 questions from the Bench.

22 EXAMINER SEE: No, there are no questions

23 from the Bench.

24 MR. RESNIK: In that case, your Honor,

25 I'd move for the admission of Companies' Exhibit 2E

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 and 2F.

2 EXAMINER SEE: Are there any objections
3 to the admission of 2E and 2F?

4 Hearing none, Companies' Exhibits 2E and
5 2F are admitted into the record.

6 MR. RESNIK: Thank you.

7 (EXHIBITS ADMITTED INTO EVIDENCE.)

8 EXAMINER SEE: And since we have already
9 determined the briefing schedule, it's December
10 30th for initial briefs and reply briefs are due
11 January 14th.

12 If there's nothing else to be addressed
13 in this case --

14 MR. RESNIK: There's one other thing.

15 MS. GRADY: Your Honor.

16 EXAMINER SEE: I'm sorry?

17 MS. GRADY: I thought it was the 31st.

18 EXAMINER SEE: 30th.

19 MS. GRADY: The 30th.

20 EXAMINER SEE: It is the 30th.

21 MS. GRADY: Thank you.

22 EXAMINER SEE: Yes, Mr. Resnik.

23 MR. RESNIK: I would just like to

24 indicate our, and my guess is probably other

25 people's, appreciation for a lot of patience that was

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

1 shown from the Bench, both you and Hearing Examiner
2 Bojko. It's been a tough several weeks. Sometimes
3 we may enjoy ourselves down here more than you're
4 enjoying yourself up there, but I just wanted to note
5 that for the record.

6 EXAMINER SEE: Thank you. We also
7 appreciate you allowing, all of you allowing us to
8 tag team because it allowed us to address other tasks
9 that we're faced with.

10 Thank you very much.

11 MR. BELL: I think the same can be said
12 for the reporter. She's put up with a lot.

13 MR. MASKOVYAK: Hear, hear.

14 EXAMINER SEE: Thank you all. That's
15 all.

16 (The hearing concluded at 6:31 p.m.)

17 - - -

18

19

20

21

22

23

24

25

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

CERTIFICATE

I do hereby certify that the foregoing is
a true and correct transcript of the proceedings
taken by me in this matter on Wednesday, December 10,
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.

(3314-MDJ)

- - -

20

21

22

23

24

25

ARMSTRONG & OKEY, INC., Columbus, Ohio (614) 224-9481

This foregoing document was electronically filed with the Public Utilities

Commission of Ohio Docketing Information System on

12/29/2008 1:54:42 PM

in

Case No(s). 08-0917-EL-SSO

Summary: Transcript AEP Volume XIV 12/10/08 electronically filed by Mrs. Jennifer D. Duffer
on behalf of Armstrong & Okey, Inc.