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BEFORE THE PUBLIC UTILITIES COMMISSION OF OHIO

- - -

In the Matter of the :
Application of Columbus :
Southern Power Company and: :
Ohio Power Company for :
Administration of the :
Significantly Excessive : Case No. 10-1261-EL-UNC
Earnings Test Under :
Section 4928.143(F), :
Revised Code, and Rule :
4901:1-35-10, Ohio :
Administrative Code. :

- - -

PROCEEDINGS

before Ms. Greta See and Jeffrey Jones, Attorney
Examiners, at the Public Utilities Commission of
Ohio, commencing at 9 a.m., on Wednesday, October 27,
2010, in Hearing Room 11-A, 180 East Broad Street,
Columbus, Ohio.

- - -

VOLUME III

- - -

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INDEX

- - -

WITNESS	PAGE
Richard Cahaan	
Direct Examination by Mr. McNamee	436
Cross-Examination by Mr. Randazzo	438
Cross-Examination by Mr. Smalz	498
Cross-Examination by Ms. Grady	511
Cross-Examination by Mr. Kurtz	555
Cross-Examination by Mr. Conway	581

- - -

STAFF EXHIBITS	IDFD	ADMTD
1 - Prefiled Testimony of Richard Cahaan	437	604

- - -

1 Wednesday Morning Session,
2 October 27, 2010.

3 - - -

4 EXAMINER SEE: Let's go on the record.
5 We'll take up the matter of rebuttal testimony after
6 we finish with Mr. Cahaan.

7 Mr. McNamee.

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

10 EXAMINER SEE: Mr. Cahaan, please raise
11 your right hand.

12 (Witness sworn.)

13 EXAMINER SEE: Thank you.

14 Mr. McNamee.

15 - - -

16 RICHARD CAHAAN
17 being first duly sworn, as prescribed by law, was
18 examined and testified as follows:

19 DIRECT EXAMINATION

20 By Mr. McNamee:

21 Q. Mr. Cahaan, can you state and spell your
22 name for the record, please?

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

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

1 A. I am employed by the Public Utilities
2 Commission of Ohio, I am serving under contract with
3 the utilities department.

4 Q. What is your business address, sir?

5 A. Physically I'm working here at the
6 Commission.

7 Q. Okay.

8 MR. McNAMEE: Your Honor, at this time
9 I'd ask to have a multipage document filed in this
10 case on October 20th denominated "Prefiled Testimony
11 of Richard Cahaan," I would ask to have that marked
12 as Staff Exhibit 1.

13 EXAMINER SEE: The exhibit is so marked.

14 (EXHIBIT MARKED FOR IDENTIFICATION.)

15 Q. Mr. Cahaan, do you have before you what's
16 just been marked for identification as Staff Exhibit
17 1?

18 A. I do.

19 Q. What is it?

20 A. It is the prepared prefiled testimony
21 that I wrote for this proceeding.

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

24 A. Yes.

25 Q. Are the contents of what's been marked

1 for identification as Staff Exhibit 1 true to the
2 best of your knowledge and belief?

3 A. Yes.

4 Q. If I were to ask you the questions that
5 are contained within what's been marked for
6 identification as Staff Exhibit 1 again here this
7 morning, would your answers be as represented
8 therein?

9 A. Yes.

10 Q. Do you have any corrections to make to
11 what's been marked for identification as Staff
12 Exhibit 1?

13 A. No, I do not.

14 Q. Okay. Do you adopt what's been marked
15 for identification as Staff Exhibit 1 as your direct
16 testimony in this case?

17 A. Yes, I do.

18 MR. McNAMEE: Your Honor, with that the
19 witness is available for cross-examination.

20 EXAMINER SEE: Mr. Randazzo.

21 MR. RANDAZZO: Sure.

22 - - -

23 CROSS-EXAMINATION

24 By Mr. Randazzo:

25 Q. Mr. Cahaan, welcome back.

1 A. Thank you. It's a pleasure.

2 Q. Good to see you again. Your testimony is
3 always a good read, some fiction, some nonfiction,
4 something for everybody.

5 A. I try.

6 Q. Now, I just want to see if you're up to
7 speed on some current events. You are aware, are you
8 not, that AEP has increased its dividend?

9 A. Yes, I believe there was a news release
10 of that perhaps just yesterday or in the very recent
11 past.

12 Q. And would you accept, subject to check,
13 that that increase was 4 cents a share?

14 A. I'll accept that subject to check.

15 Q. And would you accept, subject to check,
16 that AEP has approximately 479,440 outstanding
17 shares? Excuse me. 479,440,000 outstanding shares.

18 A. It's a matter of public record, I
19 certainly can accept it subject to check.

20 Q. Right. And if we were to multiply the 4
21 cents a share increase in the dividend by the
22 outstanding shares, we would have some appreciation
23 for the annual cash flow that's associated with the
24 increase in dividend, right?

25 MR. CONWAY: Objection.

1 A. You've got me confused.

2 MR. CONWAY: Objection.

3 EXAMINER SEE: What basis, Mr. Conway?

4 MR. CONWAY: Relevance, your Honor.

5 We've been hearing continuously throughout this
6 proceeding that the earnings and the cash flows and
7 the various indicators of the parent are not relevant
8 to consideration of the performance of the --

9 MR. RANDAZZO: I'll withdraw the
10 question.

11 MR. CONWAY: -- the EDU.

12 MR. RANDAZZO: I'll withdraw the
13 question.

14 Q. (By Mr. Randazzo) Mr. Cahaan, I'd like to
15 talk to you a little bit about the structure of AEP.
16 Now, the operating companies are, such as Columbus &
17 Southern and Ohio Power, are wholly owned by the
18 parent, AEP corporate, correct?

19 A. That is correct.

20 Q. And that means that AEP corporate owns
21 100 percent of the common equity of Columbus &
22 Southern and Ohio Power, right?

23 A. Yes, my understanding.

24 Q. All right. And when Columbus & Southern
25 and Ohio Power pay dividends, they're actually paying

1 dividends to the parent organization, correct?

2 A. Yes.

3 Q. And it's the dividends paid by Columbus &
4 Southern and Ohio Power that provide AEP corporate,
5 at least in part, with the wherewithal to pay
6 dividends to its shareholders, correct?

7 A. Yes.

8 Q. Now, if Columbus & Southern has
9 significantly excessive earnings, does it have a
10 greater facility to pay dividends to the parent
11 corporation?

12 A. That's true almost by definition.

13 Q. Okay. Now, let's return to our
14 discussion about the quantification of the impact of
15 the increased dividend declared by AEP corporate. I
16 think we got to the point where it was 4 cents a
17 share.

18 MR. CONWAY: Objection. Your Honor, that
19 dividend increase is not even applicable until the
20 future, it has nothing to do with 2009, let alone the
21 earnings of Columbus Southern Power in 2009.

22 EXAMINER SEE: The objection is
23 sustained.

24 Q. Okay. Mr. Cahaan, to the extent AEP is
25 increasing its dividend, would you take that as a

1 sign of any indication that there were financial
2 difficulties at the operating company level?

3 MR. CONWAY: Your Honor, I'll continue
4 the objection on the grounds of relevance. This is
5 all clearly --

6 MR. RANDAZZO: I'll withdraw the
7 question.

8 MR. CONWAY: -- related to
9 Mr. Randazzo's --

10 MR. RANDAZZO: I withdrew the question,
11 you won.

12 Q. Is there a difference between the equity
13 ratios of Ohio Power and Columbus Southern?

14 MR. CONWAY: Excuse me. Can I have the
15 question reread, please?

16 EXAMINER SEE: Yes.

17 (Record read.)

18 A. I believe there is. I meant to bring up
19 a piece of paper that showed this, and I forgot to do
20 so. I believe there's a difference, but I don't have
21 the number.

22 Q. Is it handy?

23 A. No.

24 Q. No?

25 A. I'd have to go down and get it.

1 Q. Perhaps if we take a break, you might be
2 able to do that.

3 You say at page 3 of your testimony that
4 reasonableness becomes the criterion of judgment.
5 And you say, I think, something similar, if I
6 understand your testimony, at page 16; the idea of
7 significantly excessive earnings is a concept of
8 fairness. Have I got the thrust of your testimony
9 correct?

10 A. Definitely.

11 Q. Now, are you familiar with the state
12 policy that applies to electric utilities in Chapter
13 4928?

14 A. I was familiar with that two years ago,
15 but I haven't even looked at it or thought of it
16 since.

17 Q. Okay. So for purposes of preparing your
18 testimony you did not give that policy any explicit
19 consideration.

20 A. Correct.

21 Q. On page 1, unnumbered 1, of your
22 testimony at line 19 --

23 A. I see it.

24 Q. -- you have the words "electric
25 utility's" apostrophe S; do you see that?

1 A. Yes.

2 Q. When you prepared your testimony, did you
3 understand that there is a specific statutory
4 definition associated with "electric utility" in the
5 state of Ohio?

6 A. At the time of the preparation of my
7 testimony I was not thinking of "electric utility" as
8 a statutory term.

9 Q. Okay. And with regard to your
10 descriptions of the SEET test that appear on
11 unnumbered page 1, you were not attempting there to
12 offer a legal opinion, were you?

13 A. Certainly not.

14 Q. You're more there describing conceptually
15 how you approached preparing the testimony you
16 provided here today, correct?

17 A. Yes.

18 Q. And on page 2, line 4, you use the word
19 "Company."

20 A. I see it.

21 Q. Which company are you speaking of there?

22 A. I was referring to CSP, Columbus Southern
23 Power, when I used the word "Company" in this
24 testimony.

25 Q. Okay. Thank you. That's helpful.

1 So your testimony, you really didn't
2 focus on Ohio Power.

3 A. No.

4 Q. Okay.

5 A. It was focused on this case, on Columbus
6 Southern Power.

7 Q. You say at line 9 "that the proposed
8 quantification by the Company is incomplete." Do you
9 really mean there that it is both incomplete and not
10 symmetrical?

11 A. Incomplete's a shorthand for a number of
12 errors contained in the company's quantification. It
13 didn't go far enough in terms of what it addressed.
14 I'm not sure whether symmetry is a specific problem
15 with the calculations I was dealing with, but there
16 are some major symmetry issues involved in the issues
17 that are relevant to the calculation of the company's
18 ROE. So symmetry is a major concern.

19 MS. GRADY: Your Honor, may I have that
20 question and answer reread, please?

21 EXAMINER SEE: Sure.

22 MS. GRADY: Thank you.

23 (Record read.)

24 MS. GRADY: Thank you.

25 Q. Page 10 of your testimony, line 4, you

1 use the word "utility." Are you using that word
2 there merely without regard to any specific utility?

3 A. Yes. The methodology that was being
4 looked at at that point was applicable to a broad
5 range of utilities, maybe not the total universe of
6 utilities, but certainly a broad range, and so this
7 does not apply to any specific utility.

8 Q. Okay. Now, if we could on that same page
9 go to the end of the answer there, and I guess I was
10 not sure what you were attempting to communicate to
11 us, I'm sure it's brilliant, I'm just not sure what
12 it is, the portion of your sentence that begins at
13 page 12 --

14 A. Page --

15 Q. Or line 12, excuse me, line 12 that says
16 "Especially when capital structure of a subsidiary is
17 so obviously at the discretion of the parent
18 company." What are you saying there and how does it
19 apply in this specific case?

20 A. I'm expressing a concern about simply
21 mechanically looking at leverage and the capital
22 structure of a subsidiary without further
23 examination. It is a more complicated thing than
24 saying here is the number and that's all. Because if
25 you have a stand-alone company with a stand-alone

1 capital structure, shareholders, and all the rest,
2 the capital structure that it has is logically
3 dictated by the company's own needs that it has -- if
4 a stand-alone utility will have a capital structure
5 at least theoretically that will be appropriate for a
6 lowest cost total capital -- cost of capital.

7 It will be directly influenced by the
8 cost of equity and the cost of borrowing in the bond
9 market.

10 If you have a holding company situation
11 where the subsidiary has a capital structure of
12 something, its capital structure isn't necessarily
13 dictated by the lowest cost capitalization of the
14 subsidiary, but basically it's how that subsidiary
15 fits into the entire capital structure of the entire
16 corporation. And I'm not pointing fingers at any
17 particular holding company, I'm saying logically
18 that's how it would work.

19 Q. All right.

20 A. The bond market takes this into account
21 when it looks beyond the single subsidiary and talks
22 in terms of the entire corporation. Equity owners of
23 the subsidiary don't exist, that is the holding
24 company, so it's not a question of simply saying here
25 is the leverage and here is the number, we'll plug

1 this into our calculations without thinking further,
2 and that's the misgiving that I'm expressing in this
3 paragraph.

4 Q. Okay. And, for the record, the leverage
5 that you're talking about basically is the ratio in
6 the capital structure between common equity and
7 debt --

8 A. Yes.

9 Q. -- correct?

10 And the idea there is that a company can
11 borrow money perhaps more cheaply and then get -- and
12 finance investments and obtain earnings on those
13 investments and make a margin out of the proceeds
14 from the debt capital, correct?

15 MR. CONWAY: Objection. Your Honor, this
16 has been going on really from the outset now. It's
17 friendly cross, he's using leading questions on top
18 of it being friendly, and it's objectionable on both
19 bases. It ought to be precluded because it's
20 friendly, and in any event he should be limited, if
21 he's going to be doing another direct exam of this
22 witness for his own purposes, he should be limited to
23 use nonleading questions, but he really ought to be
24 precluded from the cross-examination in its entirety.

25 EXAMINER SEE: Do you want to respond,

1 Mr. Randazzo?

2 MR. RANDAZZO: Pardon?

3 EXAMINER SEE: Were you standing to
4 respond?

5 MR. RANDAZZO: I was, your Honor, but --
6 if necessary, I'd be happy to.

7 EXAMINER SEE: Go ahead.

8 MR. RANDAZZO: Your Honor, I believe that
9 Mr. Cahaan's analysis is incomplete and in order to
10 demonstrate that, I've got to ask him what he means
11 by his testimony. It may be that I'm wrong, it's
12 happened, but I've got to be able to ask him what he
13 means by these words.

14 MR. CONWAY: Well, it may be incomplete,
15 but Mr. Randazzo has the same opportunity that
16 everyone else had to put his own witness on to
17 provide his perspective and the questions, and the
18 manner of the examination is clearly friendly. He's
19 trying to enlist Mr. Cahaan to help make the --
20 provide the testimony that he could have prefiled and
21 we could have reviewed and cross-examined based on
22 the review.

23 EXAMINER SEE: The objection is
24 overruled. As a party to this proceeding
25 Mr. Randazzo is entitled to cross-examine the

1 witness.

2 MR. RANDAZZO: Thank you, your Honor. I
3 believe there may have been a question pending.

4 (Record read.)

5 A. I'm not sure I understand the question.

6 Q. All right. Did you look at the, I asked
7 you this question previously based upon this
8 statement, did you look at the capital structures of
9 Ohio Power and Columbus & Southern as they might
10 compare to the other operating companies and the
11 parent organization of AEP?

12 A. I looked at the capital structures of
13 Ohio Power and Columbus & Southern, and I looked at
14 that specifically in detail and also over time. I'm
15 aware of the capital structure, roughly aware of the
16 capital structure of the parent although I just sort
17 of glanced at that, and as far as the other
18 subsidiaries, I did not look at their capital
19 structures.

20 Q. Well, did you look at the dividend
21 payment practices of Columbus & Southern and Ohio
22 Power?

23 A. Yes, I did.

24 Q. Did those dividend payment practices
25 indicate to you that Ohio Power and Columbus &

1 Southern are being operated as independent companies?

2 A. Ohio Power stopped paying a dividend at
3 all, I can't remember, three years ago or four years
4 ago, somewhere around there. Columbus Southern has
5 continued to pay dividends. Columbus & Southern's
6 dividend amounts bounce around which is something, I
7 mean most -- let me start again.

8 Most stand-alone companies would have a
9 policy of a stable dividend or stable but moderately
10 increasing dividend over time. They please their
11 stockholders by such patterns. And you do not find
12 most companies, of any size anyway, whose dividends
13 are erratic unless there's painful reasons for that
14 or one-time reasons in the sense of paying out a cash
15 dividend because they just happened to have a lot
16 more money than they could possibly use and they
17 return it to the shareholders.

18 So the pattern of dividend payments by
19 both Ohio Power and Columbus & Southern are not
20 indicative of what the stand-alone company would be
21 doing.

22 Q. Well, let me ask you mathematically,
23 Mr. Cahaan, if Ohio Power is not paying a dividend,
24 that would tend to maintain its common equity ratio
25 at a higher level, all other things being equal,

1 would it not?

2 A. All other things being equal, in the
3 sense of if it were paying a dividend or paying a
4 proportion of a dividend, absolutely, yes.

5 Q. And to the extent that Columbus &
6 Southern is paying dividends to the parent
7 organization, that would tend to reduce the common
8 equity ratio of Columbus & Southern, all things being
9 equal.

10 A. Yes.

11 Q. And, of course, the SEET calculation as
12 you have performed it is a calculation that compares
13 the earned return to the common equity balance,
14 correct?

15 A. Yes.

16 Q. And so in the parent company construct
17 that you've identified here there are opportunities
18 to affect the SEET calculation through dividend
19 payment policies, correct?

20 A. Yes, and that was one of the aspects of
21 the -- let me just simply agree with you and say
22 yes --

23 Q. Okay.

24 A. -- and not go on further.

25 Q. And again, you haven't looked at Ohio

1 Power for purposes of conducting a SEET analysis,
2 correct?

3 A. I mean, I looked at what their earned
4 return was over time, but I have not looked at this
5 in terms of a SEET analysis, no.

6 Q. All right. On page 12 you characterize
7 the current process as, your opinion of course, as
8 being one of reinventing the wheel. And I'd like to
9 talk to you about that because of the facts in this
10 case. You were involved in the ESP proceeding
11 associated with Columbus & Southern and Ohio Power,
12 correct?

13 A. I believe my testimony has an attachment
14 that is the testimony I provided in that case at
15 08-917.

16 Q. You were involved in more capacities than
17 just providing testimony in that, correct? You
18 evaluated the positions of other witnesses, you
19 assisted your counsel, you were actively involved in
20 that case?

21 A. I've been emersed in this process ever
22 since it was dumped on us.

23 Q. Fair description.

24 Now, the process that we're currently
25 engaged in ultimately, in the ESP context, is one

1 that benchmarks the ESP against the market, right?

2 Against what the alternative would be in the
3 marketplace, right?

4 A. I don't know if I could characterize it
5 like that. I'm not sure I understand what you mean
6 by that.

7 Q. Okay. Well, do you recall what the staff
8 used as the market price for purposes of benchmarking
9 the ESP that was proposed by Columbus & Southern?

10 MR. CONWAY: Objection. Relevance.

11 EXAMINER SEE: Objection is sustained.

12 Q. Mr. Cahaan, how long has Columbus &
13 Southern been earning a return on equity in excess of
14 15 percent?

15 A. Over the past ten years Columbus &
16 Southern has earned returns on equity that have been
17 above 15 percent a number of years. There have been
18 some when it has been below 15 percent. That piece
19 of paper downstairs that I don't have with me would
20 show me that, but there have -- definitely a number
21 of years that it's been above 15 percent.

22 Q. All right. And 15 percent is higher than
23 the 10.7 percent you used for purposes of
24 benchmarking, right?

25 MR. CONWAY: Objection.

1 MR. RANDAZZO: I'll withdraw the
2 question. I think everybody can do that math.

3 Q. Mr. Cahaan, do you think it's fair to say
4 that at the time that the ESP for Columbus & Southern
5 was approved, that it was obvious that Columbus &
6 Southern was going to produce significantly excessive
7 earnings?

8 MR. CONWAY: Objection.

9 EXAMINER SEE: Mr. Conway, did --

10 MR. CONWAY: He's asking the witness to
11 reach a legal -- offer his opinion about a legal
12 conclusion. Whether a company has significantly
13 excessive earnings in the end is a decision the
14 Commission makes based on the record and the
15 arguments.

16 MR. RANDAZZO: Okay, fair statement.
17 I'll withdraw the question.

18 Q. Mr. Cahaan, I'll rephrase the question.
19 Do you think it was obvious at the time that the ESP
20 was approved that the ESP for Columbus & Southern
21 would produce excessive earnings?

22 A. To be quite frank about the matter, in
23 addition to the normal uncertainties regarding
24 predicting the future and whether profitability will
25 be maintained or diminished, given the parent and

1 holding company relationships and the nature of
2 organizations, and a certain degree of skepticism,
3 there was some expectation that the issue of
4 significantly excessive earnings might be avoided by
5 taking actions, for instance, to reduce -- excuse me,
6 to increase the equity or other methods that could be
7 done.

8 I'm not saying I had any knowledge, I'm
9 simply saying that an expectation that earnings would
10 be excessive in some way could not be necessarily
11 made at that time. There are too many normal and
12 other normal, supernormal variables here.

13 Q. Well, how much -- how much did your piece
14 of paper indicate that Columbus & Southern was
15 earning in 2008 before rates were increased as a
16 result of the ESP?

17 A. Roughly, I believe it was around
18 19 percent.

19 Q. All right. And do you recall Mr. Kollen
20 was on the stand yesterday?

21 A. Yes.

22 Q. Did you review his testimony in the ESP
23 proceeding for Columbus & Southern; do you recall?

24 A. Two years ago?

25 Q. Yes, sir.

1 A. I did.

2 Q. Yeah.

3 A. But I don't recall what I reviewed,
4 actually.

5 Q. Well, if we really wanted to stop
6 reinventing the wheel, one way to do that would be to
7 avoid giving utilities too much money the first
8 instance, right?

9 MR. CONWAY: Objection. It
10 mischaracterizes the witness's testimony. The
11 witness never said anything close to the position
12 that Mr. Randazzo just asked him, basically whether
13 he was saying in his testimony --

14 MR. McNAMEE: I object as well.

15 EXAMINER SEE: The objection is
16 sustained.

17 Q. Well, Mr. Cahaan, do you think it would
18 be good regulatory practice, as somebody that's
19 worked for the Commission for 20 years, to authorize
20 rate increases that you knew were going to put you in
21 the position of having to worry about the
22 significantly excessive earnings test?

23 MR. McNAMEE: Objection.

24 MR. CONWAY: Objection.

25 EXAMINER SEE: Sustained.

1 Q. Mr. Cahaan, did parties to the Columbus &
2 Southern ESP proceeding attempt to alert the
3 Commission that the order approved by the Commission
4 was going to produce excess earnings for Columbus &
5 Southern?

6 MR. McNAMEE: Objection.

7 MR. CONWAY: Objection. Relevance. The
8 fact that Mr. Randazzo's had a belief, well based or
9 not, two years ago that there would be excessive
10 earnings or significantly excessive earnings in the
11 future is not relevant to this proceeding and
12 Mr. Cahaan's awareness of whether or not he had that
13 view two years ago is not relevant to this
14 proceeding.

15 MR. RANDAZZO: Your Honor, if I may be
16 heard on this.

17 EXAMINER SEE: Go ahead.

18 MR. RANDAZZO: Mr. Cahaan is saying in
19 his testimony that we're talking by each other. My
20 point -- my point is that if people would have
21 listened to the people that were talking when the ESP
22 plan was approved, we wouldn't be in this situation.

23 MR. CONWAY: And that's an argument he
24 can make in his brief, he doesn't need to go through
25 it with Mr. Cahaan here.

1 EXAMINER SEE: And I agree, the objection
2 is sustained.

3 A. And if I may be permitted some more
4 latitude, I'm talking about reinventing the wheel,
5 not eliminating the road.

6 Q. So you think the road should be open to
7 giving utilities excessive earnings?

8 A. I am not discussing that in my testimony,
9 I'm just pointing out the fact that almost everyone
10 in this room was here two years ago and almost all
11 the testimony provided in this case was, with small
12 modification, provided two years ago, and that's the
13 reinvention of the wheel that I'm referring to.

14 Q. Well, let's talk about the staff position
15 two years ago. As part of the Columbus & Southern
16 ESP proposal, Columbus & Southern proposed to adjust
17 distribution rates and the staff took the position
18 that the distribution rates shouldn't be adjusted
19 upwards without there being a full-blown rate case,
20 right?

21 MR. McNAMEE: Objection.

22 EXAMINER SEE: On what grounds,
23 Mr. McNamee?

24 MR. McNAMEE: Your Honor, we are not here
25 to re-litigate the SSO case. We are here to

1 determine whether these companies have significantly
2 excessive earnings or not and not to re-litigate that
3 case, that case is currently pending at the Ohio
4 Supreme Court.

5 EXAMINER SEE: Correct. The objection is
6 sustained.

7 MR. RANDAZZO: Okay.

8 Q. (By Mr. Randazzo) Mr. Cahaan, if you
9 would turn to page 13, there you say your
10 recommendation is to use 10.7 percent of the
11 benchmark ROE for purposes of this proceeding and
12 prior to that you say "with a bit more evidence
13 arguing for a higher side of this range." Do you see
14 that?

15 A. Yes.

16 Q. Okay. But 10.7 is the number that you're
17 recommending based upon you arguing for the high side
18 of the range, right?

19 A. Yes. I am putting forward my thought
20 process as best I can and I am saying that I
21 definitely think that 10 to 11 is clearly indicated
22 given the evidence that has been presented and that
23 looking at this I personally feel that something
24 slightly higher than the average would be warranted,
25 but that is just basically my take on this evidence

1 and I'm trying to present the evidence in such a way
2 as anybody else can reach their own conclusion.

3 But I would feel that given the numbers
4 that I'm looking at, that 10.7 is a reasonable
5 interpretation of what the evidence is.

6 Q. Okay. And you are at the same time
7 critical of Dr. Makjija for using what you describe
8 as a black box, right?

9 A. Yes.

10 Q. And here the only thing we know is you
11 think it's 10.7, because the range is 10 to 11, and
12 you have not identified one factor, one objective
13 factor, to inform us as to why customers should be --
14 the interests of customers are any better protected
15 by a 10.7 percent versus a 10 percent number, right?

16 A. Dr. Makjija's black box bothers me mainly
17 with respect to its standard deviation. He produces
18 a sample which generates a mean of 11.4 -- 11.04. I
19 think that should be taken into consideration. But
20 if you're asking have I produced specific reasoning
21 besides the fact that I don't dismiss Dr. Makjija's
22 mean for saying that it shouldn't be the bottom, no,
23 I have not.

24 But I think that there's not specific
25 reasoning to say it shouldn't be the top of that

1 range, either.

2 Q. Well, what you're saying is you haven't
3 offered us any objective criteria by which anybody
4 can make a judgment or understand how you landed on
5 10.7 versus 10 or 11 or 11.4 or anything else, right?

6 A. I've explained the reasoning and the
7 limits of it, which is what you're addressing, in my
8 testimony. So yes is my answer, I agree with you
9 that I have not made any specific objective criteria
10 for saying one point in the range is better than
11 another point in the range except that I think the
12 various evidence that comes out from the various
13 means of the sample groups would argue for something
14 slightly higher than the midpoint.

15 Q. Okay. Now, page 18, top of the page, you
16 say that "I think that a higher threshold is
17 warranted to take account of the asymmetrical risk
18 problem." What is the "asymmetrical risk problem"?

19 A. The asymmetrical risk problem is caused
20 by the fact that the significantly excessive earnings
21 test is totally one sided in its application; that if
22 a firm company is found to have significantly
23 excessive earnings, then action can be taken to cause
24 a refund or some other action to reduce, in effect,
25 these earnings to compensate for these earnings. I'm

1 not getting into the mechanism here.

2 Q. Good.

3 A. But the test operates in one direction if
4 you're found to have significantly excessive
5 earnings. If you're found not to have -- well, a
6 question was asked yesterday regarding significantly
7 deficient earnings, would that be actionable, and of
8 course the answer is no, so that's one aspect of
9 asymmetry, but that's not the only thing I was
10 thinking of.

11 If a company has significant excessive
12 earnings one year and then not anywhere near the
13 threshold the next year, they can't average the two.
14 Or, alternatively in this case, because of the
15 relationship between Ohio Power and Columbus &
16 Southern as legally two separate companies, if
17 they're combined, they may not have a significant
18 excessive earnings, if we were allowed to combine
19 them for the purpose of the test, but since they are
20 treated separately the mathematical probabilities are
21 greater that one of them might have the -- not pass
22 the test while the other one the test is not a -- is
23 not in a sense relevant because they're underneath
24 that safe harbor clause.

25 All of these basically are forms of

1 asymmetric risk in the operation of the SEET.

2 Q. Okay. Now let's talk a little bit
3 about -- by the way, is that answer based upon advice
4 of counsel?

5 A. No. I don't take my counsel's advice,
6 usually.

7 MR. McNAMEE: It's so true.

8 Q. I have many clients like you, Mr. Cahaan.
9 And they are wiser, I'm sure.

10 Let me ask you about this asymmetrical
11 risk theory. You remember the proceedings involving
12 Monongahela Power when Monongahela Power wanted to go
13 to market pricing towards the end of its market
14 development period?

15 A. Yes.

16 Q. So do I. I think Mr. McNamee may as
17 well.

18 Do you understand that utilities have a
19 constitutional right to receive fair compensation
20 regardless of what state law says? You've testified
21 on this subject numerous times in rate cases talking
22 about open blue field.

23 A. Yeah, I'm trying to avoid objections of
24 legal opinions here.

25 MR. McNAMEE: Yeah, I think I will object

1 on two bases, I don't think he ever has testified
2 about open blue field.

3 THE WITNESS: Well, it's in the staff
4 report every time we put out a staff report --

5 MR. RANDAZZO: It's worth reading.

6 THE WITNESS: -- as justification for the
7 rate of return.

8 MR. McNAMEE: Then I'm wrong. I'm sorry.

9 THE WITNESS: See, that's why I don't
10 take advice of counsel.

11 Q. (By Mr. Randazzo) You've given rate of
12 return testimony numerous times in the ratemaking
13 context, have you not?

14 A. Yes.

15 Q. And there are two principal Supreme Court
16 cases, United States Supreme Court cases, that are
17 instructive relative to what you must do for purposes
18 of recognizing your obligation to provide just and
19 reasonable compensation to utilities.

20 A. Yes.

21 Q. Right?

22 A. Both in Blue Field, 1923 I believe is
23 one --

24 Q. Right.

25 A. -- and I can't remember the other.

1 Q. Right. Do you recall the federal court's
2 decision in Monongahela Power?

3 MR. McNAMEE: Let me object.

4 EXAMINER SEE: What basis, Mr. McNamee?

5 MR. McNAMEE: Shall I speak to my
6 objection?

7 EXAMINER SEE: Yes, please.

8 MR. McNAMEE: The Monongahela case was an
9 interesting one and I was indeed involved. I don't
10 see how it's relevant to the determination of SEET in
11 this case at all.

12 MR. CONWAY: Your Honor, I join the
13 objection. I was also involved in the Monongahela
14 Power case and it dealt with the constitutional test
15 applied in a forward-looking manner, it had nothing
16 to do with the retrospective character that we're
17 involved in in this case.

18 MR. RANDAZZO: Absolutely false.

19 MR. CONWAY: And it's irrelevant.

20 MR. RANDAZZO: Absolutely false.

21 EXAMINER SEE: You wanted to respond,
22 Mr. Randazzo?

23 MR. RANDAZZO: Your Honor, the
24 Monongahela Power case, and Mr. Conway's law firm --
25 I was surprised about his questions on asymmetrical

1 risk yesterday, his law firm was involved in that
2 case, I was involved in that case, Mr. McNamee was
3 involved in that case. Monongahela Power, as the
4 case decision will show, challenged Senate Bill 3,
5 the restructuring legislation adopted by this state
6 because Monongahela Power took the position it denied
7 it an opportunity under the Constitution to have just
8 and reasonable compensation. And in that federal
9 court action it sought, it sought to be made whole
10 retroactively.

11 Am I correct, Mr. McNamee?

12 MR. McNAMEE: I don't believe that I'm
13 here to be cross-examined, Mr. Randazzo.

14 MR. RANDAZZO: The facts will speak for
15 themselves. You can cite the case.

16 Q. Do you recall Monongahela --

17 EXAMINER SEE: The objection was based on
18 relevance to this proceeding.

19 MR. RANDAZZO: Yes. This witness has
20 talked about asymmetrical risk and said that the SEET
21 is one sided. I'm suggesting to you, your Honor,
22 that there is a body of law well known, existing for
23 more than a century that requires, regardless of the
24 ratemaking methodology adopted by this state,
25 utilities be compensated based upon fair, just, and

1 reasonable standards articulated by the U.S. Supreme
2 Court.

3 MR. CONWAY: Your Honor, we're
4 degenerating into a legal argument here.

5 EXAMINER SEE: Thank you, Mr. Conway.

6 That's your position, you can take it up
7 on brief. The objection is sustained.

8 Q. (By Mr. Randazzo) Mr. Cahaan, in making
9 this observation about asymmetrical risk you did not
10 consider any Supreme Court decisions for reaching
11 your conclusion; is that correct? U.S. Supreme
12 Court.

13 A. That is correct. My considerations of
14 asymmetrical risk are closed set confined to this
15 case and to the SEET test. I'm not putting it inside
16 of any broader context.

17 Q. Well, but your observations regarding the
18 return on equity are not confined to this context,
19 are they?

20 A. I'm not sure I understand.

21 Q. Well, let's back up. Let's talk about
22 the SEET test. Who gets to choose whether or not
23 there is a SEET test at all? Let me strike the
24 question.

25 Mr. Cahaan, is it your understanding that

1 an electric distribution utility must accept an
2 electric security plan?

3 A. No. An electric distribution utility
4 need not accept a security plan, no.

5 Q. Would it be fair to say that it's your
6 understanding that an electric utility has the
7 absolute right to veto an electric security plan
8 approved by this Commission if that plan is modified
9 based upon what the utility proposed?

10 A. I think that is the case, yes.

11 Q. Okay. And if the utility, the electric
12 utility, proposes an electric security plan that is
13 longer than three years, there is no SEET test at all
14 in the first three years, right?

15 MR. CONWAY: Objection.

16 Q. If you know.

17 A. Well, there's two --

18 EXAMINER SEE: Hold on, Mr. Cahaan.

19 MR. CONWAY: It calls for a legal
20 conclusion, first of all, and secondly, it's
21 inapplicable. It's irrelevant.

22 MR. RANDAZZO: Strike the question.

23 Q. Mr. Cahaan, I'd like you to assume the
24 following: I'd like you to assume Section 4928.143,
25 the electric security plan section --

1 MR. CONWAY: Which division?

2 EXAMINER SEE: I'm sorry?

3 A. (E).

4 Q. (E), thank you, Mr. Cahaan. You're
5 obviously familiar with it.

6 A. I'm familiar with (E).

7 Q. Well there's two sections, (E) and (F),
8 right?

9 A. And one applies to security plans
10 under -- three years or under, or under three years,
11 and the other is if it's not.

12 Q. Right. And if the utility -- in terms of
13 your discussion about asymmetrical risk and the SEET
14 test, if the utility elects, we've already
15 established that it has the veto right for electric
16 security plans, if the utility elects to file an
17 electric security plan that is longer than three
18 years, is it your understanding that the SEET test
19 does not apply in the first three years?

20 A. I think so but I can't say that with
21 absolute confidence. Two years ago I was familiar
22 with both sections, and I'm not familiar with the
23 other section anymore.

24 Q. But you are absolutely certain that it's
25 the utility that gets to choose.

1 A. They submit the plan and they determine
2 the length of the plan that they submit. In that
3 sense they choose which section of the legislation
4 they would fall under assuming the Commission
5 approves the plan.

6 Q. And they also get to reject a decision by
7 the Commission on the electric security plan to the
8 extent that the Commission modifies that plan, right?

9 A. I believe so.

10 Q. And customers have absolutely nothing to
11 say about, nor the Commission, about those choices
12 that are made by the utility, right?

13 A. I mean, I really --

14 Q. Excuse me. The Commission cannot
15 interfere with the utility's choice, nor customers,
16 by operation of law, correct?

17 MR. CONWAY: Objection.

18 MR. McNAMEE: Objection.

19 EXAMINER SEE: On what grounds? Start
20 with you, Mr. McNamee.

21 MR. McNAMEE: We're asking for Mr. Cahaan
22 to interpret the legal structure that we're operating
23 here, we're asking for a legal conclusion and
24 arguably an irrelevant legal conclusion as well.

25 EXAMINER SEE: Did you have anything to

1 add to that, Mr. Conway?

2 MR. CONWAY: I believe that this line of
3 questioning is focused on division (E) and plans of
4 longer than three years so I think it's irrelevant.
5 On top of that I think he keeps interrupting the
6 witness and cutting him off and it's more like a
7 testifying experience for Mr. Randazzo than it is for
8 Mr. Cahaan at this point. It's not just pure
9 argument.

10 MR. RANDAZZO: I think Mr. Cahaan can
11 handle himself.

12 EXAMINER SEE: I'm going to sustain the
13 objection.

14 MR. RANDAZZO: Okay.

15 EXAMINER SEE: And I would ask that you
16 allow the witness to finish his response.

17 MR. RANDAZZO: Okay. Absolutely, I
18 apologize, your Honor, and to the extent you see me
19 drifting out of the zone of reasonableness, please --

20 EXAMINER SEE: I'll let you know.

21 MR. RANDAZZO: Please.

22 Q. (By Mr. Randazzo) Now let's, with regard
23 to your asymmetrical risk observation, Mr. Cahaan, do
24 electric utilities have an opportunity to seek
25 emergency rate relief?

1 MR. CONWAY: Objection.

2 Q. If you know.

3 MR. CONWAY: It's irrelevant. Emergency
4 rate relief is a forward-looking measure, it's not a
5 retrospective measure. It has nothing to do with
6 what we're involved with here.

7 MS. GRADY: Your Honor.

8 EXAMINER SEE: Ms. Grady.

9 MS. GRADY: Mr. Cahaan testifies about
10 asymmetry associated with the SEET test. We have
11 much more than the SEET test here, we have a law, an
12 entire law, and I believe that questions on whether
13 the law as a whole is symmetric is very valid and
14 relevant to this proceeding and that's what these
15 questions are going to, and I plan on asking
16 questions similarly along those lines because I think
17 it is important that if we're going to call something
18 asymmetric, that we take a large look at the law.

19 MR. McNAMEE: Your Honor, maybe I can
20 have a word here too.

21 EXAMINER SEE: Go ahead, Mr. McNamee.

22 MR. McNAMEE: We can argue about brief --
23 on brief about the law all we want to. The witness
24 has already indicated that his comment here is meant
25 to be encapsulated or constrained within the

1 structure of the SEET test as it exists, and he does
2 not mean to speak to any other aspects of the law
3 outside of the SEET test as it is on the books.

4 So I would suggest we are wasting a great
5 deal of time rehashing arguments that will simply
6 appear on brief no matter what Mr. Cahaan says one
7 way or the other.

8 EXAMINER SEE: The objection is
9 sustained.

10 Q. (By Mr. Randazzo) Okay, Mr. Cahaan, in
11 forming your opinion regarding asymmetrical risk
12 would it be fair to say that you have not considered
13 any requirements of the United States Constitution,
14 you've not considered any provisions dealing with
15 emergency rate relief, you've not considered any
16 provisions in the ESP that give the utility the
17 opportunity to come in and seek additional moneys as
18 a result of unanticipated closures of generating
19 plants, you've not considered any of those things,
20 correct?

21 A. Correct.

22 Q. Now, the numbers that appear at line 11,
23 the net income number --

24 A. Which page are we on?

25 Q. Page 19. I'm sorry.

1 A. Yes, I see it.

2 Q. The 271.5 million, that would be a total
3 Columbus & Southern Company number?

4 A. Yes, it would.

5 Q. Yeah. And when I say "total," as you
6 understand it it's referring to all the various lines
7 of business that Columbus & Southern is in? That
8 would include wholesale, retail, and other.

9 A. Oh, definitely.

10 Q. All right. Now, I'd like to talk to you
11 a little bit about your testimony that begins at page
12 18, but more specifically your effort to reflect the
13 exclusion of off-system sales as it effects the
14 common equity ratio.

15 A. Okay.

16 Q. Are you with me?

17 A. Yes.

18 Q. And there the adjustment that you
19 proposed is based on the view that a only-generation
20 plant is involved in off-system sales, correct?

21 A. The method I used worked only with
22 generation as an adjustment factor. I could not
23 figure out a way of cleanly encapsulating -- rather,
24 utilizing other aspects of the company's assets. It
25 seemed to be a simpler and cleaner way to utilize,

1 that is simpler to simply say that we're going to use
2 this as the way in which we adjust the equity.

3 I'll give you an example. There was a
4 question of transmission, transmission does -- sales
5 of any kind go across the wires, wheeling goes across
6 the wires, everything goes across wires, and there's
7 no way I could even begin to imagine how I would say
8 that is a component of off-system sales that I should
9 be able to address by using transmission especially
10 because I suspect, although I don't know for sure,
11 that transmission costs are a part of the net that
12 are netted out of the profits from off-system sales.

13 Now, that's how my logic worked in this
14 case; is that responsive to your question?

15 Q. Well, I guess. And I'm not sure I call
16 it logic.

17 You were here when Mr. Hamrock testified,
18 right?

19 A. Yes.

20 Q. Do you disagree with him that for every
21 wholesale transaction there is a transmission
22 transaction?

23 A. Do I disagree with him?

24 Q. Yeah.

25 A. No.

1 Q. Well, let me just ask you -- strike the
2 question.

3 Is it your understanding that for every
4 wholesale transaction there is a corresponding --
5 wholesale generation transaction there is a
6 corresponding wholesale transmission or transmission
7 for resale transaction?

8 A. I cannot speak to, you know, the facts of
9 that. The answer is no, I do not understand that to
10 be the case one way or the other. I will say that
11 implicit in the idea that I'm taking generation as my
12 method of allocation is that the wholesale -- the
13 transmission aspects of a wholesale transaction are
14 netted out of the gain from the -- the net gain.

15 Q. Well, did you do anything to verify that
16 fact?

17 A. No.

18 Q. So you just made a black box assumption,
19 right?

20 A. Yes.

21 Q. Now, if you included -- well, strike
22 that.

23 You proceed, after making the assumption
24 that only generation plant is involved in off-system
25 sales, you proceed then to use another allocator for

1 purposes of making or illustrating the adjustment to
2 common equity that you describe in your testimony,
3 right?

4 A. Yes.

5 Q. And the allocator that you use in that
6 next step is revenue, right?

7 A. Actually, it's -- actually I better --
8 one second.

9 Q. Well, at page 20, line 13, you say you
10 used the ratio of sales for resale revenues to total
11 sales revenues, which was 13.9 percent.

12 A. Yes, that's what I used.

13 Q. Okay.

14 A. There's some discussion I had with
15 someone that made me want to double-check that.

16 Q. Okay.

17 A. Yes.

18 Q. All right. Now, revenues are a function
19 of prices, right?

20 A. Yes.

21 Q. And is it your understanding that the
22 wholesale market is a competitive market?

23 A. Yes. Somewhat competitive.

24 Q. Okay. So are you aware of any
25 information that's in the record that AEP is making

1 less money on off-system sales than it's making on
2 the sales to Columbus & Southern customers, retail
3 customers?

4 A. When I looked at the sales revenues from
5 Columbus & Southern, it was clear that the revenues
6 per kilowatt-hour from certain -- for the residential
7 sector, for instance, were higher than the revenues
8 per kilowatt-hour from the commercial, which were
9 higher than the industrial, and that the sales to
10 ultimate consumer revenues were higher on the average
11 than the wholesale sales numbers.

12 Q. Okay. So -- and what you're saying there
13 is that if you compared the average price per
14 kilowatt-hour for retail activity to the average
15 price per kilowatt-hour during 2009 for wholesale
16 activity, the average price for wholesale would be
17 less than the average price for retail, right?

18 A. Yes. The price per kilowatt-hour average
19 for retail transactions was higher than the price per
20 kilowatt-hour for wholesale transactions --

21 Q. Now --

22 A. -- as FERC Form 1, I believe it's page
23 219 or something, shows.

24 Q. All right. And, hypothetically speaking,
25 if the retail side of the business was subsidizing

1 the wholesale side of the business, the revenue
2 allocation factor that you've used in your testimony
3 would embed the subsidy in the allocation, correct?

4 MR. McNAMEE: Objection.

5 EXAMINER SEE: On what basis,
6 Mr. McNamee?

7 MR. McNAMEE: It assumes a subsidy. That
8 is a fact not in evidence.

9 MR. RANDAZZO: I'll withdraw the
10 question.

11 Q. Mr. Cahaan, do you believe that the
12 retail side of the business is subsidizing the
13 wholesale side of the -- in the case of Columbus &
14 Southern?

15 A. I can't answer that question. The fact
16 that the prices are higher on the retail side than
17 the wholesale side does not necessarily indicate some
18 concept of subsidy because the, what I'll call the
19 quality of the kilowatt may be different.

20 I don't know, for instance, if the
21 wholesale side transactions are as firm as the retail
22 side transactions. I would rather expect they are
23 not nearly as firm and, therefore, the quality --
24 even though the kilowatt may be the same in physical
25 energy terms, the quality of the economic service may

1 be different and I would expect that it is different.

2 Q. Mr. Cahaan, I didn't ask you about
3 whether retail was subsidizing off-system sales. I
4 asked you if retail was subsidizing wholesale. So is
5 it your understanding that the only wholesale
6 transaction that Columbus & Southern engages in is
7 off-system sales?

8 A. I think they have a contract with perhaps
9 Westerville, which would not be off-system, and that
10 would be a wholesale transaction. I don't know --

11 Q. How about the pool? The AEP pool
12 transaction.

13 A. I'm not considering these as separate
14 from off-system sales. I have not made a specific
15 distinction there.

16 Q. So you would treat -- for purposes of
17 your testimony we should understand that when you use
18 off-system sales, you really mean all wholesale
19 transactions? And that's a question.

20 A. I am trying to make an adjustment to the
21 capital structure based upon what the company wishes
22 to exclude from the numerator of earnings. I am
23 assuming that the off-system sales that they are
24 talking about as excluding from earnings, the net
25 margins, have a correspondence in generation.

1 The issue of the pool arrangements is not
2 entering into that analysis, and I am not making that
3 distinction. I'm not -- I may, therefore, be
4 implicitly assuming that system sales counts pool or
5 not, I am not sure of that.

6 Q. So you really don't know what is in
7 off-system sales, right?

8 A. Other than that it's 30 -- it is a
9 certain amount of sales dollars and a certain amount
10 of net margins that they wish to exclude, you're
11 right.

12 Q. And you're relying on AEP's
13 representation with regard to those values?

14 A. Yes.

15 Q. And to the extent that those values are
16 inappropriate, then your adjustment would be
17 incorrect as well, right?

18 A. I am correcting in my analysis what they
19 claim to be the adjustment that they want to make.
20 If the adjustment that they want to make is in dollar
21 terms itself wrong, then of course my correction
22 would be wrong as relative to the revised numbers.

23 Q. Are you finished?

24 A. I'm working with their numbers, period.

25 Q. Well, it's more than that, Mr. Cahaan,

1 isn't it? I mean, the adjustment that you describe
2 in your testimony is an adjustment at least
3 directionally that is required if the company's
4 position on off-system sales is accepted in order to
5 have a symmetrical operation of that adjustment,
6 correct?

7 A. I use the word "symmetrical" there but an
8 appropriate adjustment. They're missing something.
9 If you want to characterize that as symmetry, that's
10 okay, but they are adjusting the numerator of a ratio
11 and I am saying if you are going to adjust that
12 numerator, there is a corresponding adjustment that
13 you are missing to the denominator that is
14 corresponding to the adjustment to the numerator.
15 That's what I'm doing there.

16 Q. Well, you're doing more than that,
17 Mr. Cahaan. You are actually attempting to quantify
18 what the adjustment looks like, right?

19 A. Corresponding to their adjustment to the
20 numerator, yes.

21 Q. Right. And in your attempt to quantify
22 the corresponding adjustment to the numerator that
23 Columbus & Southern has made, you have assumed that
24 there's no transmission associated with off-system
25 sales, right?

1 A. I'm assuming -- implicitly assuming that
2 there's no transmission associated with off-system
3 sales margins, that the transmission costs are
4 already accounted for in creating the margins from
5 the revenues.

6 Q. Did you look at what your adjustment to
7 the -- adjustment that you had described at the
8 portion of your testimony that we've been talking
9 about would be if you were to use megawatt-hours as
10 an allocator?

11 A. Yes. I don't have the numbers with me,
12 but it would be significantly different.

13 Q. And why, if you looked at it, why didn't
14 you put that information in your testimony?

15 A. I put it in in the following sense: I
16 decided the appropriate method of looking at this
17 problem was to look at it as a financial problem, and
18 as a financial problem I'm tracking dollars and I'm
19 saying the dollars that are generated by the assets,
20 if you're going to take away the dollars, you got to
21 take away the proportion of the dollars that are
22 generated -- the proportion of the assets that
23 generate those dollars, not a physical relationship
24 with kilowatts.

25 And the reason -- two reasons there, one

1 reason is that it's a financial issue to me, not a
2 physical issue. And the second is that kilowatts are
3 of a different quality so the economic value of them
4 is different.

5 From a financial perspective, which is
6 where I'm going with this, to the balance sheet, from
7 a financial perspective I'm just tracking dollars.
8 This means that a dollar of off-system sales is
9 associated with the same dollars of plant -- excuse
10 me, same dollar of equity through the plant
11 calculation as a dollar of on-system sales.

12 I had -- that was the reasoning that I
13 chose to use dollars rather than kilowatt-hours as
14 the allocator.

15 Q. Mr. Cahaan, but you know that's not true,
16 don't you?

17 A. I'm sorry, I think it is true.

18 Q. Well, you've seen in the record the
19 earned returns from the other AEP operating
20 companies, have you not, for 2009?

21 A. Yes, I have seen it in the record.

22 Q. All right. And for the other operating
23 companies that are served out of the AEP pool are
24 there any of them excluding I&M that are even in
25 double digits on the return on equity?

1 MR. CONWAY: Objection, relevance your
2 Honor, for the same reasons that Mr. Nourse
3 articulated yesterday. These comparisons are
4 irrelevant.

5 EXAMINER SEE: The objection is
6 sustained.

7 Q. Mr. Cahaan, if two utilities -- well,
8 strike that.

9 If you lower the return on common equity,
10 is the revenue requirement in traditional ratemaking
11 one that would also be lower?

12 A. In traditional ratemaking if I lowered
13 the authorized return on common in a rate case, would
14 the rates that would be subsequently set be lower, is
15 that the question?

16 Q. Yes.

17 A. Yes.

18 Q. And would the average price per
19 kilowatt-hour also be lower as a result of the
20 reduction in the return on equity in that context?

21 A. Working through the reduction in the
22 rates, then the -- what am I looking for at the end,
23 the average?

24 Q. The average price per kilowatt-hour.

25 A. Yes, it would be lower.

1 Q. Okay. And if we had two firms, two
2 utilities, that were otherwise identical in all ways,
3 same type of generation, same cost of providing
4 service, same type of customer, in fact make it
5 easier, each of them only have one customer.

6 A. My kind of hypothetical.

7 Q. The only thing that was different was
8 that. And they were owned in common, okay?

9 A. Okay.

10 Q. Operated as a pool. Are you with me?

11 A. I am definitely with you.

12 Q. And the only thing that was different
13 between the two firms was that one had a 7 percent
14 return on common equity and the other one had a
15 10 percent return on common equity. That's the only
16 thing that was different. Are you with me?

17 A. I am with you. These are ex post earned
18 returns, right?

19 Q. That's right.

20 Now, the customer of each of these
21 utilities is also identical.

22 A. Okay.

23 Q. Now, if we allocate responsibility for
24 revenue between the two utilities and we use your
25 revenue-based allocator, which of the two utilities

1 gets the greater responsibility for revenue?

2 A. What is a "responsibility for revenue" in
3 this case? That's what I don't understand.

4 Q. It doesn't matter, does it?

5 A. No, I don't understand what it is, not
6 the value, but I'm not sure what is meant by the
7 responsibility.

8 Q. Let's say it's a million dollars. The
9 pool responsibility for revenue for both utilities is
10 a million dollars, all right? Both utilities are the
11 same. Both of the utilities' customers are the same.
12 The only thing that's different is one of them has a
13 7 percent return on equity and one of them has --

14 A. And they have the same amounts of equity.

15 Q. Everything's identical.

16 A. Everything's identical except one is
17 actually making more revenues -- higher profits than
18 the other --

19 Q. Right.

20 A. -- which I could assume is only, given
21 the identical nature of the two, is because one has
22 higher prices than the other.

23 Q. You're with me.

24 A. Okay.

25 Q. Yes.

1 A. So one has higher prices than the other,
2 and it's the next step that I'm not sure I
3 understand.

4 Q. Using your revenue-based allocation
5 methodology that we've been talking about in your
6 testimony.

7 A. So there's some common stuff coming back
8 that has to be allocated.

9 Q. Yes.

10 A. Okay.

11 Q. Let's review the bidding again. The
12 utilities are identical. The customers are
13 identical. The two operating companies in this
14 hypothetical are operated in a pool structure.

15 A. Okay.

16 Q. Common costs throughout.

17 A. And we're equal costs or are we going to
18 allocate those costs somehow?

19 Q. Everything is identical, the only thing
20 that is different between the two enterprises is the
21 return on equity.

22 A. And the prices they charge to their one
23 customer each.

24 Q. That's correct, necessarily.

25 A. Yes.

1 Q. Are you with me now?

2 A. This step I'm good for.

3 Q. Okay. If we use your method allocating
4 responsibility in your testimony, which is revenue
5 based --

6 A. So something has to be allocated.
7 There's, for instance, a gizmo that has to be
8 purchased jointly.

9 Q. Right.

10 A. Okay.

11 Q. If we use your revenue-based allocation
12 factor in your testimony, which of the utilities gets
13 the greater responsibility for the item that is being
14 allocated?

15 A. If this is a cost item, then the utility
16 which has the higher prices and therefore the higher
17 revenues will have the higher responsibility even
18 though they are identical in all physical respects.

19 Q. Okay. And isn't it that by using your
20 revenue allocator here you are, in effect,
21 attributing -- strike that.

22 Now, page 22, last line of your
23 testimony, almost the last line, last substantive
24 line before the general usual closing, you say you
25 want to keep the arithmetic straight.

1 A. Yes.

2 Q. Why is that important?

3 A. Because the -- I viewed that the
4 company's calculations were incomplete and needed to
5 be corrected to allow for appropriate -- excuse me,
6 scratch the word "appropriate." To allow for an
7 adjustment to the denominator that I thought should
8 accompany the adjustment they were seeking to the
9 numerator.

10 Q. Is that principle of keeping the
11 arithmetic straight important more generally?

12 A. I think it would be very useful to keep
13 the arithmetic straight on all of the things that
14 we're considering.

15 Q. Okay. And is it possible to keep the
16 arithmetic straight if somebody is using a black box
17 for purposes of providing recommendations to the
18 Commission?

19 A. If we're talking about accounting
20 changes, recommendations that are essentially
21 accounting in nature, the arithmetic should be kept
22 straight and can be kept straight if we look at the
23 various magnitudes carefully.

24 If we're talking about economic
25 estimates, the concept of arithmetic doesn't apply

1 and being able to look at specific data that is of
2 the quality of accounting data is nonexistent. We
3 leave the world of the particular and enter another
4 world that, frankly, I agree with a lot of people, is
5 more the world of the twilight zone.

6 So I would not adopt the idea of keeping
7 the arithmetic straight for issues that are involved
8 in things like Black-Scholes or things like rate of
9 return analysis or even the question of the
10 appropriate benchmark, unless there's actual errors
11 in the presented arithmetic, of course.

12 Q. Okay. You indicated that you took a look
13 at allocating common equity to off-system sales using
14 a megawatt-hour statistic, and I believe you
15 indicated that the results would have been
16 significantly different than those that you show in
17 your testimony.

18 A. Yes.

19 Q. Directionally, or if you have more
20 specifics, directionally can you tell me what happens
21 if you were to perform the same allocation and
22 include transmission as well as generating plant, but
23 to use megawatt-hours as an allocator.

24 A. I can tell you that if I used
25 megawatt-hours rather than revenues -- sales as the

1 allocator, that the result would be that the
2 20.84 percent return that the company is claiming is
3 the calculation of the rate of earned return, without
4 any adjustments, would go down only a few basis
5 points, something on the order of 20.7 or something
6 like that, as compared to the amount it goes down if
7 you use the, either the company's approach or my
8 adjustment to the company's approach based upon sales
9 revenues.

10 So I can tell you that the result would
11 be a minuscule reduction in the earned return
12 calculation if megawatt-hours were used with
13 generation. I have not at all looked at it with
14 respect to transmission, and I don't know how I would
15 even do that.

16 Q. Well, again, for purposes of your
17 observation there what megawatt-hours were you using?
18 Were you using megawatt-hours only associated with
19 the pool? Were you using megawatt-hours associated
20 with off-system sales?

21 A. It's that piece of paper that's
22 downstairs. I was using megawatt-hours as reported
23 on FERC 1 as sales for resale.

24 Q. Okay. But for reasons -- never mind.

25 A. I mean, for clarity you have sales for

1 resale and sales to ultimate consumers in FERC 1, and
2 you have that expressed in terms of dollars and you
3 have that expressed in terms of megawatts.

4 Q. Megawatt-hours.

5 A. Megawatt-hours. That's the basis of the
6 calculations I'm talking about.

7 Q. Okay. And if one were to do the
8 allocation based on megawatt-hours, the statistics
9 that one would use to do that allocation are in the
10 FERC Form 1 for Columbus & Southern?

11 A. Yes. As a matter of fact, it's on page
12 300 of FERC Form 1, specifically.

13 Q. By the way, Mr. Cahaan, you've got
14 another, what I'll call inspirational phrase in your
15 testimony, and this is my last subject area, maybe my
16 last question. At page 22, lines 3 through 5, you
17 say there that "there is a need to be aware of
18 arguments that effectively are attempting to get the
19 better of cost (regulation) or market at all times."
20 Can you help me to understand more specifically what
21 it is that you're talking about?

22 A. Well, first I want to point out that I
23 have experienced many times this same kind of
24 argumentation from consumer groups so this is not a
25 one-sided perspective. In terms of the current

1 situation, the idea of excluding off-system sales,
2 because these are really market transactions and have
3 nothing to do with what is a regulated activity or
4 semi-regulated activity in terms of the SEET test, is
5 a perspective that says use market as a criteria.

6 At the same time, I'm aware that we have
7 just received -- the Commission has just received an
8 application for cost recovery of an AEP power plant,
9 the Sporn plant. Now, without commenting on the
10 validity of that application, I would point out
11 simply that this is a perspective that says cost
12 recovery under regulation is the way things should be
13 viewed.

14 So in many cases there's lots of claims
15 made from the perspective of there is a market out
16 there and these things should be considered in terms
17 of being nonregulated and when regulation benefits,
18 well, it's a regulated entity. Pick and choose. And
19 that's all I'm pointing out, that should be avoided.

20 Q. Okay. And if one were to be inspired and
21 follow through with your observation there, it would
22 require us to take a broader look at everything that
23 is going on, wouldn't it?

24 A. I think that one of the problems involved
25 in analyzing this business of significantly excessive

1 earnings is a fundamental problem of understanding
2 where the earnings are coming from and what they
3 mean. There is not a clear knowledge on this --
4 these facts or lack of facts, so we have numbers that
5 are presented in total without an understanding of
6 causation and yet the nature of the test somehow, and
7 I mean very loosely because I do not understand it,
8 seeks to deal with causation.

9 So, yes, it would be better to have a
10 more clear understanding of the particulars and how
11 things are created in terms of all of these numbers.

12 Q. And that observation would also extend to
13 taking into account all the individual silos of
14 applications that are proceeding at the Commission
15 and bringing more of a holistic view to the
16 resolution of this case in harmony with others,
17 correct?

18 A. Well, I was speaking from the perspective
19 of just doing an analysis in this case of where in
20 2009 did the earnings come from. Now, I think you're
21 talking somewhat broader that in 2010 what is going
22 on with the company as far as its total business plan
23 vis-a-vis the state of Ohio, and that's beyond my
24 focus.

25 Q. Okay.

1 MR. RANDAZZO: That's all I have,
2 Mr. Cahaan, pleasure as always.

3 THE WITNESS: Same here.

4 MR. McNAMEE: Your Honor, if I might ask,
5 this might be a good time to take a break.

6 EXAMINER SEE: Well, we're going to need
7 to take a break at 11 for the Commission meeting, so
8 I think Mr. Maskovyak indicated that he thought his
9 questions would last approximately ten minutes.

10 MR. MASKOVYAK: And maybe not at all if I
11 follow OCC.

12 EXAMINER SEE: Well, I have the time for
13 you between now and the Commission meeting, I do not
14 have time --

15 MR. MASKOVYAK: Could I confer with
16 co-counsel for a moment?

17 EXAMINER SEE: Go ahead.

18 (Discussion off the record.)

19 EXAMINER SEE: Let's go back on the
20 record. Mr. Maskovyak.

21 MR. MASKOVYAK: Your Honor, Mr. Smalz is
22 going to do limited cross.

23 MR. SMALZ: Yes, I'm confident we'll
24 finish before 11.

25 EXAMINER SEE: Okay.

CROSS-EXAMINATION

1
2 By Mr. Smalz:

3 Q. Good morning, Mr. Cahaan.

4 A. Good morning.

5 Q. I have just a few questions. First, on
6 page 12 of your testimony, line 8, you state that in
7 the future, the staff may want to put forward a
8 benchmark ROE based upon an index or combination of
9 indices announced well in advance so that the parties
10 could get a good idea of the resulting benchmark of
11 ROE well in advance. That's not what you've done in
12 this case, though, is it?

13 A. No.

14 Q. In this case your recommendations as to
15 SEET are focused just on the year 2009; is that
16 correct?

17 A. Yes.

18 Q. And that would be true of your benchmark
19 ROE and your range and your threshold, your SEET
20 threshold ROE, they're focused on the year 2009,
21 right?

22 A. Yes.

23 Q. Okay. Now, turning your attention to
24 your testimony on page 16, line 20, where you say
25 "Frankly, I am concerned about what might happen over

1 time in the economy, if the present deflationary
2 tendencies are replaced by highly inflationary ones."

3 Now, given that we're focused on the year
4 2009 and we were slipping into the most severe
5 economic downturn we've had since the Great
6 Depression, was there any reason in 2009 to suspect
7 inflationary tendencies?

8 A. Well, 2009 tendencies were a matter of
9 the past. The numbers -- the change in prices,
10 whether it's positive or negative, I believe it may
11 even have been a slight negative, they are what they
12 are. So that's not what is being addressed here at
13 all.

14 The only purpose of this is to set up a
15 system that would not be bizarre if inflation were to
16 kick in in the future. If you have an absolute
17 number of basis points, then if there was a
18 significant -- oops, I don't really want to use that
19 word; it has no meaning.

20 If there was a lot of inflation, then the
21 interest rates would be much, much higher, let's just
22 say 30 percent as a rhetorical device, and if
23 interest rates were 30 percent and you still had a
24 hundred basis point criteria, it becomes negligible.
25 It has no meaning at all -- or no impact at all.

1 Putting it in percent terms is just a
2 convenient way of setting up a system that would be
3 independent of the nature of inflation.

4 Q. Okay. Well, I think I understand that,
5 Mr. Cahaan, but again, going back to 2009 and even
6 before 2009, at the time of the ESP proceeding,
7 wasn't it clear that 2009 was not going to be an
8 inflationary year, that there was not going to be
9 significant inflationary risk in 2009?

10 A. I have never addressed inflationary risk
11 here and never incorporated anything like that in
12 this analysis.

13 Q. So it has no relevance to your analysis.

14 A. It has relevance only in the sense that I
15 am suggesting that instead of using a number of basis
16 points as a criteria for defining "significantly" in
17 the significantly excessive earnings test, instead of
18 using an absolute number of basis points, I am
19 proposing a percentage number, in effect.

20 You can go -- given the benchmark ROE,
21 there's a clear correspondence between the absolute
22 number and a percentage number. You compute the
23 absolute number directly from the percentage number.
24 I am suggesting those, in effect. But I'm suggesting
25 that going forward the formulation should be in

1 percentage terms, not in absolute terms. It's
2 cleaner, in my opinion.

3 Q. Well, you criticize Dr. Makjija's SEET
4 methodology I think quite accurately as running
5 counter to common sense. Couldn't the same criticism
6 be made premising your SEET approach on possible
7 inflationary tendencies?

8 A. I am not premising my SEET approach on
9 possible inflationary tendencies. You have to
10 explain why you say that.

11 Q. Well, again, looking at reality as
12 opposed to abstraction. We not only are looking at
13 the past, but we knew at the time, before 2009, that
14 we were more likely to have deflationary than
15 inflationary tendencies and so in developing a SEET
16 test for 2009 specifically, I don't understand why
17 that would be a factor. And I realize you've
18 explained your answer and I'll take it for what it's
19 worth but, frankly, it still doesn't make any sense.

20 A. I think you'd need to explain to me how
21 you see that I have utilized any consideration of
22 inflation in developing my approach to the SEET test
23 with the exception of at the end, the definition of a
24 "significant" being formulated in a percentage term
25 rather than its equivalent basis point term.

1 Q. Thank you, Dr. Cahaan, I won't belabor
2 the point.

3 Now, there was considerable discussion
4 during Mr. Randazzo's cross-examination about the
5 notion of asymmetric risk. And I'll try not to
6 retread that same ground, I just have a couple of
7 questions.

8 Again, focusing on the year 2009 and the
9 period preceding -- immediately preceding 2009, was
10 there any reason, based on CSP's past earnings
11 history, let's say its earnings history over the
12 previous ten years, to think that CSP would
13 experience deficient earnings in 2009?

14 A. No.

15 Q. Given the fact that the company, CSP,
16 shows its ESP -- presented its ESP plan and had the
17 right to drop it entirely and switch to an MRO if it
18 didn't like the outcome, if it was modified in any
19 respect, wouldn't that suggest to you that CSP
20 thought they were going to earn at least adequate
21 earnings, if not more, based on that ESP?

22 A. The fact that CSP chose an ESP instead of
23 an MRO indicates to me that they thought they would
24 earn more under an ESP than an MRO. That's all it
25 can tell me.

1 Q. Now, I believe during the prior
2 cross-examination there was some reference to the
3 ability of CSP to seek additional moneys in the event
4 of plant closures. Do you recall that testimony or
5 discussion?

6 A. The issue of seeking money in terms of
7 plant closures has been mentioned in this proceeding,
8 I will certainly agree with that.

9 Q. And would you say that the ability of CSP
10 to seek those additional moneys in the event of a
11 plant closure mitigated its asymmetric risk to some
12 degree?

13 A. Personally, I view the issue of
14 asymmetric risk as a narrow technical thing within
15 the SEET process. The ability of the company to have
16 heads I win, tails I break even in terms of its files
17 is a different thing entirely. So these -- the
18 ability to have in other areas what could be
19 considered asymmetrical policies is a separate
20 question.

21 I'm focusing on the application of the
22 significantly excessive earnings test itself in terms
23 of whether a company would, for instance, be able to
24 balance off one year's excess versus another year's
25 nonexcess over time or whether it would be able to

1 balance off things with respect to affiliates. All
2 these things accentuate the problem if they're not,
3 if they're not there, they accentuate the problem
4 that the company if it has high earnings can be, to
5 use the technical term, dinged, and if it doesn't
6 have high earnings, it's not able to do anything.

7 I would also point out that the
8 recommendations that I made in the previous case two
9 years ago were based upon a different perspective as
10 to what the nature and the magnitude of the
11 asymmetrical risk was and that's the reason I'm
12 particularly -- I'm mentioning the topic so much in
13 this case, because the things that I discussed two
14 years ago, some of those considerations which would
15 have mitigated and reduced asymmetrical risk did not
16 come about. So that's the rationale for the focus on
17 it in my testimony.

18 Q. I see.

19 What I don't understand, Mr. Cahaan, is
20 you have been so eloquent and cogent in criticizing
21 the theoretical methodology, this abstract twilight
22 zone methodology of Dr. Makjija --

23 MR. CONWAY: Objection.

24 Q. -- and yet -- and yet --

25 EXAMINER SEE: Based on the

1 characterization of the question, Mr. Conway?

2 MR. CONWAY: It's a cheap shot. It's a
3 rhetorical, it's beyond being a rhetorical device.
4 It's completely argumentative and it's not based in
5 any evidence that's in the record.

6 EXAMINER SEE: Mr. Conway, I --

7 MR. CONWAY: It's objectionable.

8 EXAMINER SEE: And I need you to speak up
9 so that myself and the court reporter can hear you.

10 Mr. Smalz, if you could rephrase the
11 question, please.

12 Q. (By Mr. Smalz) Mr. Cahaan, as I say,
13 you've been quite eloquent in criticizing the theory
14 propounded, theoretical methodology of Dr. Makjija,
15 and yet here you seem more willing to ignore concrete
16 reality and focus on this theoretical asymmetrical
17 risk when there's nothing -- there are no objective
18 factors that suggest there is such a risk.

19 MR. CONWAY: Objection. It assumes so
20 much in that question that is not in the record, in
21 fact is rebutted by what this witness has already
22 said, that it's objectionable. It's misleading.

23 EXAMINER SEE: I'm going to allow
24 Mr. Cahaan to answer the question, I think he can
25 address it.

1 A. First of all, in all fairness I need to
2 make sure that you understand that my reference to
3 twilight zone was not limited to Dr. Makjija but was
4 focused on myself as well and to an extent maybe the
5 whole economics profession these days.

6 Moving beyond that, however, the issue of
7 asymmetrical risk is not the kind of issue of
8 specific costs and cost recovery. The issue of
9 asymmetrical risk is a logical problem of the
10 construction of the test itself. There is no doubt
11 that the logical structure of the test creates a
12 situation where there is a symmetrical risk. All of
13 the witnesses in this case have agreed with that
14 concept.

15 Now, the magnitude of this asymmetrical
16 risk in terms of being expressed as any given amount
17 of adder or premium is, frankly, a judgment call that
18 is based upon what you think ought to be taken
19 account of in this asymmetrical risk issue.

20 You can say that, well, there's no risk
21 at all. There is risk, but it's minuscule, and if
22 you can find reasons to argue that, fine. But what
23 I'm saying is that the level of asymmetrical risk
24 that I assumed in my previous testimony, whether
25 that -- excuse me, that level of asymmetrical risk

1 corresponded to a recommendation that had as its top
2 end of the range 400 basis points. Perhaps that view
3 was wrong, that that correspondence was wrong, but
4 that's what I said two years ago.

5 Given that fact, that was the
6 recommendation two years ago, if you look at the
7 amount and degree of asymmetrical risk that the
8 company faces in terms of the structure of this test,
9 now that certain rules have been made regarding what
10 is to be considered, and compare that to the
11 discussion of the same stuff in my previous
12 testimony, the nature of the situation is such that
13 the level of asymmetrical risk is higher now than it
14 was thought to be when I made the recommendations for
15 that 400 basis points.

16 Q. Could you --

17 A. So you've got two places to argue that I
18 was wrong with 400 two years ago and that going from
19 400 to what amounts to be 525, that additional 125 is
20 wrong because of what, I don't know, you can make
21 that argument. But that's the logic of what's going
22 on here, the company faces, in the logical structure
23 of this test, a level of asymmetrical risk that was
24 greater than it was, from my perspective, two years
25 ago.

1 Q. Thank you, Dr. Cahaan. You do not have
2 an opinion, then, as to whether that risk now, or for
3 that matter in 2009, was minuscule or not. You
4 couldn't characterize it one way or the other.

5 A. I'm not going to characterize it one way
6 or the other, but if you and I could play a game in
7 which the rules were heads I win, tails I break even,
8 I would love to do that. That's the nature of the
9 asymmetrical risk here.

10 MR. SMALZ: One moment, your Honor.

11 EXAMINER SEE: Sure.

12 MR. SMALZ: That's all for my questions,
13 your Honor.

14 EXAMINER SEE: Okay. Thank you. We have
15 a couple minutes before 11 o'clock. Let's just take
16 a break until 11:15 and we'll reconvene.

17 (Recess taken.)

18 EXAMINER SEE: Let's go back on the
19 record.

20 Mr. McNamee.

21 MR. McNAMEE: Yes, your Honor. During
22 the break Mr. Cahaan has obtained and we have
23 distributed a document that includes the information
24 that, it is the sheets I guess that Mr. Cahaan
25 referred to several times, three times I believe

1 during Mr. Randazzo's cross-examination, of
2 information that he meant to have with him but had
3 left in his office, return on common equity over the
4 years for Columbus Southern and several other topics.

5 For the sake of clarity I might suggest
6 that, or completeness, I might suggest that we could
7 mark these three sheets as a staff exhibit and put
8 that information in the record in that way.

9 EXAMINER SEE: Mr. Conway, you have some
10 objections?

11 MR. CONWAY: Yes, your Honor. The
12 companies would object to the introduction of the
13 three-page document into the record. I believe that
14 Mr. Cahaan's testimony indicated that they were not
15 papers that he relied upon in preparing the testimony
16 that he presented, and I do believe that he was --
17 Mr. Randazzo, for example, was able to inquire about
18 the subject matters that he was interested in and
19 Mr. Cahaan I think answered them -- answered his
20 questions, and I think that it's just not appropriate
21 to be bringing in documents from Mr. Cahaan's office
22 into the record at this point after cross-examination
23 by Mr. Randazzo is done. They're not work that
24 support his testimony or his position, it's just like
25 additional discovery is being conducted.

1 MR. McNAMEE: If I might be heard.

2 EXAMINER SEE: Go ahead, Mr. McNamee.

3 MR. McNAMEE: The only thing I can
4 suggest, your Honor, is the witness indicated that
5 this was information that he did prepare for the
6 hearing, he intended to have it with him here this
7 morning, and, you know, I simply don't want to -- I'm
8 concerned that we're leaving ambiguity in the record
9 or lack of completeness in the record and we don't
10 intend to do that. You know, this was stuff he meant
11 to have with him. I put it out there for what it's
12 worth.

13 MR. CONWAY: And then the second level of
14 the objection is I think it would be inappropriate
15 also to just allow another round of cross-examination
16 because this document is being brought in after half
17 the cross has been completed. That's also not
18 appropriate and it's unfair, we don't need to drag
19 things out in that fashion.

20 EXAMINER SEE: Mr. Conway, I'm going to
21 need you to speak up. You trail off at the end. I
22 caught it this time.

23 MR. CONWAY: All right.

24 EXAMINER SEE: Thank you.

25 I believe that after considering the

1 admission, bringing in the document that Mr. Cahaan
2 now has with him and considering the questions that
3 were asked later, I think that the record is
4 sufficient and complete. He did answer the questions
5 and there's no need to bring in something that was
6 not a workpaper used by him to prepare his testimony.

7 MR. McNAMEE: Okay. Thank you, your
8 Honor.

9 EXAMINER SEE: Now let's continue with
10 cross-examination. Let's go to Ms. Grady.

11 MS. GRADY: Thank you, your Honor.

12 - - -

13 CROSS-EXAMINATION

14 By Ms. Grady:

15 Q. Good morning, Mr. Cahaan.

16 A. Good morning.

17 Q. Let's go to page 2 of your testimony. If
18 you would, specifically at page 2 on lines 1 and 2
19 you explain that, you say you will explain in your
20 testimony why a 50 percent adder to the comparable
21 ROE is a reasonable interpretation of the concept
22 significantly in excess. Do you see that reference?

23 A. Yes, I do.

24 Q. Do you believe that there are other
25 reasonable interpretations of the concept

1 "significantly in excess"?

2 A. Numerical? I guess what I'm asking, do I
3 believe that other numbers besides 50 percent are
4 reasonable, or do I believe some other method than
5 using a percentage adder are reasonable?

6 Q. Let's start with do you believe that
7 there are other numerical interpretations of the
8 concept of "significantly in excess" that are
9 reasonable?

10 A. Definitely. It's a judgment call, and I
11 have suggested that one way of looking at this
12 situation is to look, as I put it, in both
13 directions. I have suggested that you should pay
14 attention roughly to the bond ratings as a method on
15 the down side to get a sense of what you can call
16 sufficiently deficient so you can know where to go on
17 the up side. There may be lots of other reasonable
18 ways of approaching this. This is really a question
19 of how much is too much, which is a judgment call in
20 and of itself.

21 Q. Thank you.

22 Now, let's go the other way and let's
23 pose the question do you believe that there are other
24 reasonable methods of determining what is
25 "significantly in excess" other than the method that

1 you propose?

2 A. I believe that it would be possible for
3 somebody to propose another reasonable method if
4 after hearing it I felt it was reasonable. So I
5 can't answer the question in the abstract, I can say
6 that I'm open to hearing, personally open to hearing
7 other reasonable methods.

8 I have a very strong opinion as to the
9 unreasonableness of using what I call a statistical
10 definition, a standard deviation definition, to
11 determine what "significantly" means, I've got a very
12 strong opinion about that one and I've expressed it
13 at length.

14 Q. I've seen that.

15 A. I'll be happy to express it at length
16 again, but if somebody were to come up with another
17 method of determining "significantly" that made
18 sense, I'd be happy to hear it and so I'm not
19 precluding other ideas as being unreasonable at all.

20 Q. And when you say you're not precluding
21 other ideas as being unreasonable at all, you're not
22 precluding the analysis done by Dr. Woolridge as
23 being unreasonable, are you?

24 A. Well, if you're talking about the word
25 "significantly" and "significantly excessive" the

1 adder part --

2 Q. Yes.

3 A. -- Dr. Woolridge adopted the
4 recommendation I made two years ago. At that time
5 that was a good recommendation. I am raising that
6 recommendation, I'm coming from that recommendation
7 and raising it for reasons that I've put in this
8 testimony. I think that's reasonable. That's, if
9 Dr. Woolridge is going to use my basis, then he's
10 going to have to say -- reason from that, I should
11 say. Is that clear? I'm not sure it's clear to me.
12 But is that clear to you?

13 Q. I think it's as good as I'm going to get.
14 Thank you. I do appreciate it. I caught some of it.
15 I don't know that I caught all of it, but I caught
16 some of it.

17 A. If he wants to make an argument, I'd be
18 happy to listen to it, but the argument he's making
19 is the one I used to make and I've changed it for
20 reasons I've given.

21 Q. And at that time it was a reasonable
22 argument, would you agree, that you made in 08-917?

23 A. I made it, didn't I? Of course it was
24 reasonable.

25 Q. Now, let's talk about part 1 of your

1 analysis where you say, and it begins on page 2, it
2 is about determining a comparable return on equity.

3 Do you see that?

4 A. Yes.

5 Q. And on lines 14 and 15 you discuss that
6 you reviewed not only Dr. Makjija's analysis, but you
7 also reviewed Dr. Woolridge's analysis and later on
8 then you say you also reviewed Dr. Vilbert's
9 analysis. Do you see that?

10 A. Yes, I do.

11 Q. And also indicated that in addition to
12 looking at these analyses that you looked at the
13 return on equity of two published and market trade
14 indices in your analysis?

15 A. Yes, I did. I see that.

16 Q. Now, on page 3 of your testimony you
17 discuss the different models that were used to
18 determine the comparable return on equities, and you
19 indicate, again on lines 4 and 5 of page 3, that
20 essentially that there's -- everyone went about it a
21 different way, but the results are really not too far
22 apart. Do you see that?

23 A. Yes, I do.

24 Q. And in fact, you state in your testimony
25 that "taken together," and I'm assuming you're

1 talking about all the results there, "they tend to
2 define a zone of reasonable consideration." Do you
3 see that reference?

4 A. Yes, I do.

5 Q. Focusing on the fact that you are
6 defining a zone of reasonable consideration, you
7 would then consider that a comparable ROE for CSP to
8 be 9.58 percent as well as a 9.45 percent?

9 A. I am saying that looking at the evidence
10 of the different approaches I'm -- I'm saying that a
11 zone of 10 to 11 is the zone of reasonable
12 consideration. I understand that Dr. Woolridge is
13 putting forward a number of either 9.58 or 9.55, but
14 I think that there are elements in the analysis that
15 would argue that that's a bit low because of mainly
16 the inclusion of a company that is kind of bizarre to
17 be in there, I'm not saying it didn't pass the
18 screening, but it's strange to be where it is for
19 very unusual reasons, and, therefore, I think that a
20 range of 10 to 11 is a zone of reasonable
21 consideration.

22 Q. And going on, you're traveling along the
23 road nicely because that's where my next set of
24 questions come from, you talk about Dr. Woolridge's
25 approach beginning on page 3 on 12, and then you go

1 on to page 4 where you indicate that you examined
2 Dr. Woolridge's output and you found that one member
3 of the group is an anomaly or could be considered an
4 anomaly, correct?

5 A. Absolutely. Definitely.

6 Q. And that would be the Servidyne, Inc.?

7 A. Yes.

8 Q. And you characterize it as an outlier
9 because it has a 12.41 percent loss as its return on
10 equity?

11 A. I characterize it as an outlier because
12 it is an outlier in terms of the number compared to
13 the rest of the companies.

14 Q. And then is it fair to say that you also
15 characterized an outlier on the other end, that being
16 DP&L, with the highest return?

17 A. In his approach I looked at that one too,
18 yes.

19 Q. And you indicate on page 5, lines 3
20 through 7, that it's your experience that it's not
21 unusual to eliminate both the highest and the lowest
22 observations in a sample that calculates the mean.

23 A. Yes.

24 Q. And then your testimony goes on to state
25 that if you eliminate both these outliers, the mean

1 would increase from 9.56 percent to 9.75 percent --

2 A. Yes.

3 Q. -- do you see that? And then you further
4 go on to say that if only Servidyne was eliminated,
5 the resulting mean would be 10.06 percent.

6 A. Yes.

7 Q. Is it your understanding that
8 Dr. Woolridge's recommended return on equity
9 threshold utilized the median and not the mean?

10 A. I'm not sure. In his recommendation
11 initially the two were like one basis point apart.
12 I'm not sure which he did.

13 Q. Would you accept, subject to check, that
14 Dr. Woolridge's recommended ROE threshold utilized a
15 median?

16 A. I'll accept it subject to check.

17 Q. And would you agree, then, if the median
18 return on equity was calculated by Dr. Woolridge, it
19 would be unaffected by the adjustments that you
20 propose?

21 A. Yes.

22 Q. Now, on page 6 of your testimony, lines
23 10 through 12, you indicate that "there is nothing
24 more frustrating than setting up a carefully
25 specified set of screening criteria and finding a

1 sample so small as to be meaningless or unusable"; do
2 you see that?

3 A. Yes.

4 Q. Do you consider Dr. Woolridge's sample to
5 be so small as to be meaningless or unusable?

6 A. No.

7 Q. Now, Dr. Cahaan, you looked at two
8 exchange-traded funds that are related to utilities
9 and those would be the iShares, Dow Jones, and the
10 Utilities Select Sector SPDR Fund; is that correct?

11 A. Yes.

12 Q. And on page 11 of your testimony on lines
13 10 and 11 you indicate that they are conceptually
14 close to the criteria used by Dr. Woolridge?

15 A. I'm sorry, what's the referencing page?

16 Q. That would page 11, lines 10 and 11.

17 A. I see the reference. Yes.

18 Q. Do you believe the criteria used by
19 Dr. Woolridge were appropriate?

20 A. I believe Dr. Woolridge's approach is an
21 appropriate approach and I believe that his criteria
22 are reasonable criteria. I have no problem with what
23 he's done except for the way certain things, certain
24 companies have, what I'll call snuck through.

25 Q. I'm sorry?

1 A. Well, strike that. With the way certain
2 companies -- Servidyne, basically. But I'm not
3 criticizing Dr. Woolridge's approach saying this is
4 unreasonable or wrong in any way.

5 Q. Thank you.

6 Now, on page 11 on line 11 you indicate
7 that the groupings that you have come up with through
8 the two indices are likely to be very stable and
9 individually understandable. Do you see that?

10 A. Yes.

11 Q. Would you also believe that
12 Dr. Woolridge's groupings were likely to be very
13 stable and understandable?

14 A. The basic method that he is using is one
15 that I would think would be stable and definitely --
16 and this I want to make a definite point of
17 agreement, that the kind of approach Dr. Woolridge
18 used is indeed exactly the kind of approach that is
19 understandable, otherwise you wouldn't be -- one
20 wouldn't be able to go inside of it and say what if
21 there was a company that didn't belong or not. It is
22 to be commended, in my opinion, as a useable
23 technique because people can sit around and discuss
24 it on a technical basis. So yes, it is
25 understandable and it probably is going to be pretty

1 stable although I can't say for sure.

2 Q. Now, when you looked at your two indices,
3 you found 11.39 percent earned return on equity and
4 11.15 percent earned return?

5 A. Yes.

6 Q. And you indicate these are average
7 returns; is that right?

8 A. Yeah. Weighted average returns.

9 Q. So they essentially represent a mean?

10 A. Yes.

11 Q. Now, on page 12, lines 1 and 2 of your
12 testimony you say that as far as you're concerned,
13 the 11.39 percent and the 11.15 percent tend to
14 confirm the reasonableness of the other estimates.
15 Do you see that reference?

16 A. Yes.

17 Q. And by that are you including the
18 estimated return on equity calculated by
19 Dr. Woolridge?

20 A. I'm referring more to the -- first place,
21 yes, in the sense that as far as I'm concerned
22 everybody's estimate, although this means a lot of
23 money in between, but if you consider a sense the
24 range of all possible numbers and look at the ranges
25 of all these firms, you have two percentage points

1 difference between the lowest estimate that's being
2 put out, the one from Woolridge --

3 Q. Yes.

4 A. -- and the highest one, that is the one
5 that I computed by sticking Columbus & Southern's
6 specific data into Dr. Vilbert's formula; there's a 2
7 percentage point difference.

8 Now, I'm not saying this is unimportant,
9 but if you step back a second and look at the ability
10 to tell things like even forecasting inflation or
11 anything, 2 percentage points is not huge in terms of
12 the errors that exist in this world. And that's what
13 I'm saying is that here's a 10-1/2 and that's, you
14 know, it's in the same ballpark.

15 Now, we can't live with a ballpark of 2
16 whole percentage points. We have to get a little bit
17 better than that. But I think that you have to
18 recognize the degree of precision that is
19 conceptually possible in this endeavor ***is not as
20 nice as accountants, I don't want to put down
21 accountants, but not as nice as people who deal with
22 precise numbers would prefer to have come at them.

23 Q. Understood.

24 A. And I only have to point you to the
25 experience of the last few years to show the

1 imprecision of the whole process in terms of
2 specifying numbers that you can rely on as being
3 actually true ex post.

4 Q. Are you referring to the earned returns
5 on ROE?

6 A. No, I'm referring to our economic
7 situation that's pretty bad.

8 Q. I'm sorry.

9 A. That's pretty bad, and let's not get
10 started on that, I suppose.

11 Q. Now, on page 12, line 18, you present
12 your recommendation of a 10.7 percent benchmark ROE;
13 do you see that?

14 A. Yes.

15 Q. And on that same page on lines 19 and 20
16 you indicate that you had reason to believe that the
17 9.58 might be low for the reasons explained above.
18 Do you see that reference?

19 A. Yes.

20 Q. And we're talking about the 9.58 percent
21 coming from Dr. Woolridge?

22 A. Yes.

23 Q. And are -- when you say "for the reasons
24 explained above," are you specifically referring to
25 the presence of outliers -- of the outliers Servidyne

1 and DP&L that you took out of the mean calculation of
2 Dr. Woolridge?

3 A. I'm specifically referring to the outlier
4 Servidyne which I took out because it just, when we
5 look at the specifics of the case, it felt -- it
6 seemed to me that it really did not belong in that
7 comparable group. I certainly could not make a case
8 that DP&L should not be on the basis of this business
9 activity and the basis of what it's doing in a
10 comparable group. It was an outlier, but whether it
11 should be in a comparable group of electric
12 utilities, after all it's CSP's neighbor and I think
13 that there's no conceptual basis for excluding it.

14 So it's more on the -- it's basically on
15 the elimination of the Servidyne.

16 Q. Do you know if DP&L was in the comparable
17 group used by Dr. Makjija in his analysis?

18 A. No, I don't know that specifically.

19 Q. Now on page 13, on lines 2 through 4, you
20 indicate that considering the totality of the
21 information developed, that you think a range of 10
22 to 11 percent is reasonable with a bit more evidence
23 arguing for the higher side of the range. Do you see
24 that?

25 A. Yes, I do.

1 Q. And you had some questions this morning
2 from Mr. Randazzo with respect to that so I'm going
3 to try not to be repetitive, but can you tell me what
4 evidence you have that argues for the higher side of
5 the range there?

6 A. I'm basically saying that although I
7 don't want to do any kind of averaging of the
8 numbers, the evidence of the indices argues for the
9 higher side and the evidence from plugging in CSP's
10 data into Vilbert's method argues for the higher
11 side.

12 If I were to do an average by plugging
13 these numbers in and doing an average calculation of
14 the various methods, I would get a number that's
15 higher than 10.7. I'm not doing an average, I'm not
16 treating them equally, I'm simply saying that the
17 three other pieces of information that I looked at,
18 the two indices and the adaptation of the Vilbert
19 method, are all on the higher side of the middle of
20 my 10 to 11 and so I'm leaning a little bit north of
21 the 10-1/2 which would be the absolute middle.

22 Q. Would you agree with me that there may be
23 evidence that argues for the lower side of that
24 range?

25 A. I would agree that there's always the

1 possibility of evidence not considered in my analysis
2 that would argue for lower or higher, and I would
3 appreciate reading the arguments from, which I'm sure
4 will appear on brief regarding that.

5 Q. Now, Dr. Cahaan, would any point in that
6 range, from that 10 to 11 percent range, be a
7 reasonable point to say that it is a comparable ROE
8 to utilize in the SEET test?

9 A. I believe so.

10 Q. So, for instance, 10 percent would be a
11 reasonable point to say that it is a comparable ROE
12 to utilize in the SEET test, according to your
13 testimony.

14 A. What I am doing is defining a range and
15 within that range it is my opinion, seems to me that
16 the midpoint is a valid starting point of looking at
17 this and that, looking at the other numbers in this
18 evidence, leaning slightly above the midpoint is
19 reasonable. All of these are reasonable points so I
20 am defining 10 to 11 as a reasonable range.

21 Q. Now, you indicate on page 13, lines 13
22 and 14, that the level of statistical significance
23 proposed by the company in the ESP proceeding was
24 egregiously excessive. Do you see that?

25 A. Yes.

1 Q. Is the level of statistical significance
2 proposed by the company in this case egregiously
3 excessive?

4 THE WITNESS: Could I have the question
5 read?

6 (Record read.)

7 Q. Let me --

8 A. I can answer it very simply. It's the
9 same level as before.

10 Q. So it would be egregiously excessive.

11 A. I think it's similarly egregiously
12 excessive as before.

13 Q. Thank you.

14 A. I have a long discussion of the use of a
15 2-1/2 percent tail on a probability distribution as a
16 standard of definition of significance equivalent to
17 beyond a reasonable doubt in a legal proceeding; I
18 made that argument in my previous testimony which is
19 an attachment to this one. I think that the level of
20 statistical significance proposed by the company is
21 equivalent to putting the entire burden of showing
22 excessive earnings on the part of the other parties
23 and then setting up a system such that it's extremely
24 unlikely that that would be ever able to be done. So
25 "egregiously excessive" is a moderate term.

1 Q. Is it your understanding that the law
2 provides that the burden of proof shall be on the
3 utility to show that it is not earning significantly
4 excessive earnings?

5 A. Yes.

6 Q. Now, on page 13 at the bottom you are
7 discussing reasons in your mind to reject the use of
8 the statistical definition of SEET. Do you see that?
9 And the discussion then carries over to page 14.

10 A. Yes.

11 Q. And you present an example in your
12 opinion that shows that reliance on the statistical
13 approach to define "significantly excessive" can
14 produce results that are counter to common sense and
15 the ordinary use of English language?

16 A. Yes.

17 MR. CONWAY: Your Honor, at this point
18 I'll make the same objection I made earlier when
19 Mr. Randazzo was at the outset of his
20 cross-examination. This is friendly cross. She's
21 using, which is objectionable by itself, and on top
22 of it she's using leading questions. If it's going
23 to be done, it should be done without the use of
24 leading questions, but in any event it's simply
25 enlisting the witness in a friendly manner to advance

1 her own cause and that's objectionable.

2 EXAMINER SEE: Ms. Grady.

3 MS. GRADY: Your Honor, in response, as
4 your Honor knows, the staff witnesses are not subject
5 to the normal rules of discovery in these
6 proceedings. In fact, under 4901-1-21 there's no
7 deposition allowed of the staff witnesses. And
8 there's no discovery attributable to the staff in
9 this case.

10 I would argue, your Honor, that there
11 should be greater leeway in the cross vis-a-vis
12 alleged friendly cross given the role of the staff in
13 this proceeding as well as others.

14 MR. CONWAY: Your Honor, if I could just
15 speak to that. This is not -- we're not talking
16 about doing discovery here. This is
17 cross-examination and what is the proper scope of
18 cross and what's the proper conduct of
19 cross-examination. And I will leave it to your
20 Honors to recall what you've just heard over the last
21 five to ten minutes and make your own judgment as to
22 whether or not that's friendly cross-examination. If
23 it isn't, then there is none at this Commission would
24 be my position.

25 EXAMINER SEE: The objection is

1 overruled.

2 MS. GRADY: I'm not sure, is there a
3 question pending?

4 EXAMINER SEE: Go back and let's see if
5 there's a question.

6 No, there isn't.

7 Q. Now, your testimony on page 14 where you
8 are talking about -- let me strike that.

9 In your testimony filed 08-917-EL-AIR,
10 did you have what you called a sanity check, what you
11 characterize as a sanity check on the test?

12 A. I believe so.

13 EXAMINER SEE: I'm sorry, what case was
14 that, Ms. Grady?

15 MS. GRADY: 08-917-EL-AIR attached to
16 your Staff Exhibit 1.

17 EXAMINER SEE: 08-917?

18 MS. GRADY: I believe so.

19 THE WITNESS: Yes. EL-SSO.

20 EXAMINER SEE: Yes.

21 MS. GRADY: Yes.

22 Q. Now, under your sanity test you basically
23 say that if we define profits as significantly
24 excessive, that we need to accept that same term or
25 that same logic with respect to profits being

1 significantly deficient; is that right?

2 A. Yes, that's the sanity check I'm
3 proposing.

4 Q. And then in your example in your
5 testimony here, and I'm looking at page 14, lines 10
6 through 12, you take Dr. Makjija's comparable return
7 on equity and you apply his adder of 11.47 to get it
8 to the threshold return on equity of 22.51 percent,
9 correct?

10 A. Yes.

11 Q. And then you did the reverse, taking the
12 11.04 comparable mean return on equity and subtract
13 the adder of 11.47 and come up with a negative
14 .43 percent?

15 A. Yes. The statistical test assumes a
16 normal distribution which is symmetrical and I'm just
17 saying if you're looking in one direction, you need
18 to look in the other direction to establish meaning
19 here.

20 Q. And you conclude on lines 18 and 19 that
21 under this kind of a sanity check that it
22 demonstrates that it does not make sense and a
23 statistical definition is not useful here.

24 MR. CONWAY: Objection. Same objection,
25 your Honor. This line of questioning will continue

1 on --

2 MS. GRADY: I can withdraw my question.

3 MR. CONWAY: -- for a couple more pages
4 where Mr. Cahaan indicates his disagreements with
5 Dr. Makhija's approach as does her witness
6 Dr. Woolridge, and we'll continue to have cumulative,
7 repetitive piling on by this lawyer with this witness
8 who are perfectly aligned on this point.

9 EXAMINER SEE: Ms. Grady, did I hear you
10 say you will withdraw your question?

11 MS. GRADY: Yes.

12 EXAMINER SEE: Thank you.

13 Q. (By Ms. Grady) Now, Dr. Cahaan, if you
14 take Dr. Woolridge's 9.58 percent and you add his 200
15 to 400 basis point recommendation, you would get to a
16 return on equity threshold of between 11.58 to 13.59?

17 A. I wasn't hearing that, but it sounds like
18 the arithmetic's right and we'll assume that.

19 Q. And then let's do the reverse of your
20 test, the other part of your sanity check. You take
21 the 9.58 percent and subtract the adder of 200 to 400
22 basis points and you come up with a 5.58 to
23 7.58 percent as representing a threshold for
24 significantly deficient under your sanity check?

25 A. That's --

1 MR. CONWAY: And once again, I object,
2 your Honor. This is just the converse of what we
3 just heard which is instead of using Mr. Cahaan to
4 support her position, it's in opposition to
5 Dr. Makjija, she's now pursuing a line which attempts
6 to use Mr. Cahaan, enlist him in support of her own
7 witness's approach which is in alignment in this
8 respect, I'm sure, with Mr. Cahaan.

9 MS. GRADY: To the extent that you would
10 like a response, I believe Mr. Cahaan went through
11 this same exercise with another witness, what happens
12 when you take this out, and I'm just pursuing what
13 happens when you take it out with Dr. Woolridge's
14 numbers. He's presenting them what happens when you
15 take this out with respect to Dr. Makjija's numbers.
16 I think it's helpful to the record. It's relevant.

17 MR. CONWAY: The difference depends on
18 which side of the issue your witness happens to be
19 aligned for purposes of the examination.

20 MS. GRADY: If Dr. Woolridge is proposing
21 a 200 to 400 basis points adder, which Dr. Cahaan has
22 testified he is not supporting.

23 EXAMINER SEE: Okay. And again, the
24 objection is overruled.

25 MS. GRADY: Thank you, your Honor.

1 A. Let me pick the first, the higher number
2 first, the use of a 200, that would give you, as you
3 have done, a 7.58 threshold of significantly
4 deficient. Now, all of this is a judgment call as to
5 what does this mean. Given the fact that there's a
6 number of companies, some of which are AEP companies,
7 that are already earning less than 7.58, given that
8 the bond rate -- the embedded cost of debt for CSP is
9 6-something, I don't think I personally would
10 characterize 7.58 to be significantly deficient,
11 period.

12 Regarding 5.58, now you're in an area
13 that may, with judgment, roll off the ear as, yeah,
14 that's significantly deficient. It may. I mean,
15 that's the 400 basis point difference as opposed to
16 what amounts to my 525 basis point difference. So
17 5.58 doesn't hit my ear as being a definite no, but
18 on the other hand it's -- so that I would say that
19 applying this test with Dr. Woolridge's, 5.58 may be
20 a significantly deficient number. That's with
21 Dr. Woolridge's mean or, rather, recommendation,
22 though.

23 That 5.58, if it were coming off of the
24 10.7, would be approximately exactly what I'm
25 recommending.

1 Q. Now, on page 16, lines 9 and 10, you
2 refer to a system which is designed to avoid false
3 positives at almost any cost, which is what is being
4 proposed. Are you saying that that system is being
5 proposed by a party in this proceeding?

6 A. I am saying -- the answer, the simple
7 answer is yes. And I am saying that all of this
8 emphasis in the entire discussion regarding
9 significantly excessive, whenever the statistical
10 test has been put forward, has stressed the
11 importance of not having -- rather, reducing false
12 positives to a very low level. Nowhere is it ever
13 discussed the implication of reducing false
14 negatives.

15 So this concept of false positive is
16 meaningful only, by the way, using a statistical
17 test. If you're using a different basis of judgment,
18 the words "false positive," "false negative" have no
19 meaning, they're not there.

20 But yes, this is -- I think in this case
21 proposals to use statistical definitions of the word
22 "significance" combined certainly with large standard
23 deviations is really strongly creating a situation
24 where false positives are reduced and avoided at
25 almost any cost.

1 Q. Now, on page 16, on lines 18 through 19,
2 you indicate there that you're not continuing your
3 recommendation of a 200 to 400 basis point adder as
4 threshold in this case, correct?

5 A. Yes, as we've discussed before.

6 Q. And, rather, in this case you've proposed
7 to define the threshold, or the threshold ROE as a
8 percentage of the benchmark ROE?

9 A. Yes.

10 Q. And you indicated that one of the bases
11 for changing your mind is your concern that you list
12 on line 20 over what might happen in the economy if
13 the present deflationary tendencies are replaced by
14 the higher inflationary ones.

15 A. That is a reason why I'm switching from a
16 basis point to a percentage, not for the level of the
17 recommendation.

18 Q. Understood.

19 A. Okay.

20 Q. And I think you in response to questions
21 by APJN, you said that 2009 was not a -- there were
22 deflationary tendencies in 2009 rather than higher
23 inflationary tendencies in 2009.

24 A. I think in -- I'm not sure whether the
25 CPI or any other measure of inflation went down

1 slightly or was up slightly. Basically, there was no
2 inflationary tendencies certainly in 2009, and so
3 the -- I could leave this in a basis point type of
4 approach for this year because we're not having
5 inflation this year and right now I know that, as you
6 can see right at the top of page 17, 50 percent
7 standard is 535 basis points, we all know the numbers
8 today. I'm setting it up in my recommendation as a
9 percentage so that in the future it's more applicable
10 because as a basis point recommendation in the future
11 it might get ridiculous.

12 Q. Did you understand Dr. Woolridge's
13 proposal to be limited to this proceeding only?

14 A. His proposal of what?

15 Q. Of using the 200 to 400 basis points
16 adder.

17 A. Yes.

18 Q. Now, on page 17 on lines 9 through 10 you
19 indicate that the 200 basis points from the return on
20 equity is so low as -- might be so low as to
21 discourage efficiency improvements that might benefit
22 everyone in the long run. Do you see that?

23 A. Yes.

24 Q. Dr. Cahaan, would you agree that
25 consumers are likely to be ambivalent about the

1 efficiency of CSP under Senate Bill 221?

2 A. I think -- strike that.

3 There's too many assumptions that would
4 have to be made for me to respond to that question.

5 Q. And can you clue me in on what those
6 assumptions would be?

7 A. Well, are we talking about the
8 perspective of consumers vis-a-vis feeling of the
9 inflationary economy and productivity in general, do
10 they want things to become more efficient which in
11 the long run would lower prices assuming we get some
12 competition in the production side of the industry,
13 which seems to be happening. Are we talking about
14 what's going to be their pocketbook in a one-year
15 time regarding electric rates. There's a lot of
16 assumptions there.

17 Q. In general would you agree with me that
18 under Senate Bill 221 that the value of efficiency is
19 not necessarily passed back to customers as opposed
20 to a traditional cost based rate approach?

21 A. Your question is right -- is a perfect
22 illustration of the problem we have in this
23 giraffapotomus of a regulated free market entity that
24 is providing service under something akin to
25 regulation called a standard service offer which is

1 in competition with the market and in a sense with
2 itself, with the company itself that can have a
3 nonregulated offer as well.

4 Now, if there were some productivity
5 improvement such that all of the promises that I grew
6 up with in terms of Reddy Kilowatt being too cheap to
7 meter would actually come halfway true so that the
8 American Electric Power Company, the nonregulated
9 parts of it would be producing electricity at 2 mils
10 a kilowatt-hour without any pollution, et cetera,
11 et cetera, et cetera, I think this would benefit
12 everybody and they would -- and the consumer would
13 benefit too.

14 There is a market out there, so looking
15 at it from the market perspective, productivity
16 improvements are a wonderful thing to happen.
17 Looking at it from a regulatory perspective, we are
18 not in Senate Bill 221, the Commission is not passing
19 through productivity improvements on the nonregulated
20 side back into the regulated side.

21 So which perspective, the giraffe
22 perspective or the hippopotamus perspective, which
23 part of the animal are we looking at when we make
24 these comments regarding productivity improvements
25 and how their effect will be.

1 Q. But everybody likes to go to the zoo to
2 see different animals, don't they?

3 A. Yes.

4 Q. Let me withdraw that. I'm sorry.

5 A. And I haven't even begun to discuss what
6 part of the anatomy we're looking at.

7 Q. Now, in that same paragraph, and we're
8 talking about 17, page 17, lines 12 and 13, you're
9 talking about an asymmetrical risk there and I know
10 there was a bit of cross this morning on that and so
11 I will try to be -- not try to replicate that cross.

12 You characterize the SEET test as
13 creating an asymmetrical risk; is that right?

14 A. That is right.

15 Q. Are you essentially saying that since
16 SEET contains an asymmetric risk, that a higher
17 threshold return on equity should be used in the SEET
18 calculation?

19 A. I am saying that because -- strike that.

20 The existence of a symmetrical risk
21 argues for a greater leeway in terms of the
22 threshold; point number one. The amount of
23 asymmetrical risk that I identified two years ago was
24 a certain amount based upon the possibility of being
25 able to treat the companies together, about

1 averaging, all these various things that could reduce
2 the asymmetrical risk from where it has turned out to
3 be because these things have not come about. So in
4 that context I think my answer's yes.

5 Q. Now, this follows up on what you were
6 saying, you said that -- or you tie your
7 recommendation in the last case, the 200 to 400 basis
8 point adder, to the fact that you considered factors
9 with that and the two factors that you mention in
10 your testimony are that you were looking at applying
11 the test on a multiyear basis and you were
12 considering the earnings of the operating utilities
13 jointly; is that right?

14 A. Yeah. There may have been another or a
15 couple others in my previous analysis, I'm not sure.

16 Q. Can you check that? Would you check that
17 for me, please? Don't want to mischaracterize your
18 former testimony.

19 A. No. I guess I was thinking with all the
20 words that I used there must have been more reasons.
21 There are just those two.

22 Q. Thanks.

23 And when you were talking in your
24 testimony in 08-917 about averaging -- or applying
25 the test on a multiyear basis, what number of years

1 were you considering when you were -- when that
2 testimony was drafted?

3 A. No specific number.

4 Q. Do you recall if you did any analysis at
5 that point to look at what would happen if you
6 applied the test on a multiyear basis instead of a
7 yearly basis?

8 A. No.

9 Q. Do you understand that Dr. Makjija in
10 that proceeding was suggesting a multiyear basis for
11 his test?

12 A. I don't remember.

13 Q. For purposes of this proceeding did you
14 look at the average common equity return on equity
15 earned by CSP over a period of time?

16 A. I am aware of it, yes. I did look at the
17 historical earnings.

18 Q. And did you look at a -- over what period
19 would you have looked at the historical earnings of
20 CSP?

21 A. Well, what I did was to look at the
22 earnings of CSP for the whole period from 2000 to
23 2009.

24 Q. And in your analysis did you make any
25 conclusions about how many years the return on equity

1 calculated was above 20 percent during the past ten
2 years?

3 A. It's not a question of conclusions, it's
4 a matter of fact in terms of the reported earnings of
5 the company at least as to the FERC 1, so there
6 was -- I don't want to characterize this as analysis
7 is what I'm saying.

8 Q. Understood. And as a matter of fact, did
9 you find that the return, the average common equity
10 return on equity earned by CSP over the last ten
11 years to be above 20 percent?

12 A. The average over the last ten years?

13 Q. Yes.

14 A. I didn't do a -- conduct an average but
15 looking at the numbers I --

16 Q. Let me --

17 A. I'm not sure what the average would be.
18 It would be around 20 but whether it would be above
19 20 or not, I don't know. I did not do an average of
20 these things.

21 Q. Over the past five years would you agree
22 that the return on equity earned by CSP was above
23 20 percent?

24 MR. CONWAY: Objection.

25 EXAMINER SEE: Basis?

1 MR. CONWAY: Relevance. There's a
2 specific formula that the Commission promulgated in
3 its June 30th order about how you go about
4 calculating a return on equity for purposes of SEET.
5 There's been no foundation laid that the values he's
6 being asked to average are calculated in accordance
7 with the formula that the Commission requires for
8 purposes of the SEET calculation.

9 MS. GRADY: For clarification I'm not
10 asking him to average, I'm asking him what the
11 average common equity return on equity that was
12 earned during the last ten years.

13 MR. CONWAY: I don't quite understand how
14 that's responsive but it sounds like she is asking
15 for an average over the last ten years and my
16 relevance objection stands.

17 EXAMINER SEE: I'm going to sustain the
18 objection.

19 Q. (By Ms. Grady) Dr. Cahaan, would you
20 agree with me that when the ESP plan was adopted in
21 08-917, that the asymmetric SEET test was mitigated
22 by factors or measures that were features of the ESP
23 plan?

24 A. Without clearer specification of what
25 you're referring to I don't think I can answer.

1 Q. Let's turn to your testimony submitted in
2 08-917 beginning on page 24, and I believe there
3 you're testifying as to specific consideration that
4 should guide the Commission. Do you see that
5 reference?

6 A. Yes.

7 Q. And there you say -- you speak to, for
8 instance, riders, deferrals, unavoidable charges.
9 Those were all features of the ESP that were
10 approved; is that right?

11 A. I believe so.

12 Q. And the riders, is it your understanding
13 that there's an economic development rider in place
14 currently?

15 A. Since I haven't been at the Commission
16 for a while, I cannot speak from that perspective,
17 but I have seen documents at this hearing that have
18 talked about an economic development rider.

19 Q. And you would assume that there's other
20 riders just from being at the hearing and hearing the
21 testimony of the witnesses, the various witnesses; is
22 that right?

23 A. Yes. I assume there's a number of riders
24 that exist.

25 Q. Is it your understanding also that the

1 ESP would have included a fuel adjustment clause?

2 A. Well, I understand that there's deferrals
3 regarding the fuel being composed, so I would expect
4 there's a fuel adjustment clause lurking in the
5 background there.

6 Q. Fair enough.

7 If you know, are there deferrals that
8 have been approved in the ESP plan that would
9 stabilize the earnings of CSP?

10 A. Once again, since we are discussing
11 deferrals today with respect to what goes in and out
12 of the calculations for SEET purposes, I assume that
13 deferrals exist and they would -- well, they would
14 tend to augment, I don't know whether they would tend
15 to stabilize, the earnings of CSP.

16 Q. And there's also unavoidable charges such
17 as POLR charges under the ESP plan --

18 A. Yes.

19 Q. -- if you know?

20 Now, Dr. Cahaan, you testified in
21 response to questions by I believe Mr. Randazzo that
22 you had familiarity with 4928.142 and 4928.143, the
23 SEET provisions of 221, essentially.

24 A. Well --

25 MR. CONWAY: I'm sorry, could I have that

1 question reread.

2 (Record read.)

3 MS. GRADY: Let me take out -- 142 was
4 not one of them.

5 Q. Let me rephrase.

6 A. Let me point out I don't know the numbers
7 very well on these things.

8 Q. You essentially are familiar with the,
9 for instance, you're familiar with the annual SEET
10 review process that we're in right now.

11 A. Yes.

12 Q. Is that safe?

13 A. I have a piece of paper with a section of
14 SB 221 that doesn't have what number part of the law
15 it came from that has the words that sat in front of
16 me for a while and I became very familiar with it.

17 Q. Okay. That's fair enough. Now,
18 Dr. Cahaan, do you understand that associated with
19 the annual review process that we're involved in,
20 that the companies have a -- they have the ability to
21 terminate the plan if the Commission finds that there
22 are significantly excessive earnings and orders a
23 refund?

24 A. Yes. I was a little confused as to how
25 the sequence of things occurs, but yes, if the

1 Commission orders a refund, the company can terminate
2 the plan.

3 Q. And is it your understanding that in that
4 event they could immediately file an application to
5 implement an alternative plan?

6 A. An MR --

7 MR. CONWAY: O.

8 A. -- O I think is what it says.

9 Q. Is it even beyond an MRO, if you know?

10 A. Not sure.

11 Q. Okay. Would you agree with me that to
12 the extent that the companies have the ability to
13 terminate the plan if there's a SEET finding, that
14 that is a mitigating factor that mitigates the
15 asymmetric risk of SEET to a certain extent?

16 A. Let me see if I understand this right.
17 The company would have to refund money but then could
18 terminate the plan. In my way of looking at it the
19 asymmetric risk still exists. The question is
20 whether they would have to continue under the
21 conditions separate from the existence of it.

22 Certainly, if we were setting up a
23 question of how much is too much and the company was
24 bound by this no matter what, which would be sort of,
25 once again as I have indicated, the regulatory

1 perspective, the company is regulated and stays
2 regulated, that would argue that we should have a
3 very high threshold compared to a situation where
4 they can say "No, enough's enough. I'm out of here."

5 So making that comparison would argue for
6 a lower threshold, but I think that the level of
7 asymmetric risk that exists is consistent with what I
8 feel a 50 percent adder would cover.

9 Q. When you developed your 50 percent adder,
10 did you consider the fact that the company had this
11 ability to terminate upon a finding of significantly
12 excessive earnings?

13 A. I did not explicitly make that a
14 consideration in either direction. I was aware that
15 they could terminate.

16 Q. Now, when you speak on lines 13 of page
17 17 of your testimony of the fair implementation of
18 SEET and the asymmetric risk, do you mean to say --

19 A. Could I get the reference again?

20 Q. I'm sorry, I tend to speak too quickly.
21 When you speak on lines 13 of page 17 --

22 A. Page 17, line 13. Okay, I'm finally
23 there with you.

24 Q. And there your sentence is "Asymmetrical
25 risk is a real problem in a fair implementation of

1 SEET." Do you see that?

2 A. I see that.

3 Q. Do you mean to say that the Commission
4 should act to counterbalance the asymmetry of the
5 annual SEET?

6 A. I'm not sure what "counterbalance" means
7 in this situation. I am suggesting that the nature
8 of asymmetrical risk argues for more room of earnings
9 above some benchmark because of its existence. Now,
10 if that's counterbalancing, perhaps -- I'm not sure
11 what you mean by that word.

12 Q. That the Commission should take a
13 conservative approach to defining the threshold
14 because of the asymmetric nature of the test.

15 A. Conservative from whose perspective?

16 Q. From the customer's perspective.

17 A. Because of asymmetrical risk? I'm
18 arguing the opposite.

19 Q. Now, in the company's last case, and I'm
20 referencing you to page 20 of your testimony
21 submitted in 08-917, you argue that there are major
22 problems with using the peer group analysis in a
23 statistical analysis when you deviate from
24 mechanically taking the EDU's return on equity from
25 its reported earnings. And I'm specifically

1 directing your attention to page 20, the question and
2 answer on line 30.

3 A. Let me take a look at this a second.

4 MR. CONWAY: On line 7?

5 MS. GRADY: Thank you, Mr. Conway, it
6 begins on line 7 through lines 15 on page 20.

7 A. I've read this now. I was referring to
8 items such as extraordinary gains and losses that
9 appear and how you would, if you were downloading
10 from a data source, might not take these into account
11 but they should balance out as a matter of a mean,
12 but on the other hand would it tend to increase
13 variance? So I would have some degree of discomfort
14 in terms of the statistical approach to the word
15 "significantly."

16 Does that clarify?

17 Q. I guess my question is when you're
18 talking about mechanically taking the -- when you
19 deviate from -- let me strike that.

20 Is it your understanding in this case
21 that the companies have taken the EDU's ROE and
22 deviated from that by recommending adjustments to
23 that for deferrals and off-system sales?

24 A. First of all, the adjustments that the
25 company is proposing for SEET purposes have

1 absolutely nothing to do with the question and answer
2 on line 30 on this --

3 Q. And that's where I was trying to go to.
4 If that's your explanation, I certainly can accept
5 that.

6 A. This is a different topic.

7 Q. Thank you.

8 Now, one last area, Dr. Cahaan, on the
9 very end of your testimony, and I think that's page
10 22, and this sentence has been pointed out by
11 Mr. Randazzo, you say "It is indeed confusing and
12 there is a need to be aware of arguments that
13 effectively are attempting to get the better of cost
14 (regulation) or market at all times." Do you see
15 that reference?

16 A. I do.

17 Q. And you indicated in response to
18 Mr. Randazzo's questions that you had seen consumers
19 groups making such arguments in the past; is that
20 right?

21 A. Yeah, I don't remember the specific
22 arguments, I just remember being in rooms when I've
23 heard this sort of thing.

24 Q. Now, is it your understanding that the
25 consumer groups in this case are making those kind of

1 arguments where they're arguing for the best of both
2 worlds?

3 A. I haven't been able to nail any
4 particular argument that fits that category. I'm not
5 surprised that people tend to argue for their
6 interests and I certainly can accept that, but there
7 is this continual confusion between looking at things
8 from a cost and regulation basis versus looking at
9 things from a market basis, and there is a tendency
10 to choose the perspective based upon the outcome
11 desired.

12 Q. Let's talk about off-system sales for a
13 moment.

14 A. Sure.

15 Q. Is it your understanding that in the ESP
16 case, that CSP argued that off-system sales not be
17 used as a -- to bring down the cost of fuel,
18 essentially, in the ESP case? That we should not use
19 the profits from off-system sales to reduce the fuel
20 costs being charged to customers; would that be your
21 understanding?

22 THE WITNESS: I'm sorry, could I have
23 that read.

24 (Record read.)

25 A. You mean in the case two years ago?

1 Q. Yeah.

2 A. I don't remember.

3 Q. Okay. Would you accept, subject to
4 check, that CSP made those arguments in the ESP case?

5 MR. McNAMEE: Objection.

6 EXAMINER SEE: On what basis,
7 Mr. McNamee?

8 MR. McNAMEE: Your Honor, the arguments
9 were whatever they were. They are reflected in the
10 record of that case. Mr. Cahaan's recollection or
11 failure to recollect whatever those arguments were in
12 that other case have no consequence here.

13 EXAMINER SEE: Objection is sustained.

14 Q. Dr. Cahaan, can you assume -- let me
15 strike that.

16 MS. GRADY: That's all the questions I
17 have this morning -- this afternoon. Thank you,
18 Dr. Cahaan.

19 THE WITNESS: Thank you.

20 EXAMINER SEE: Thank you. Ms. Mooney, do
21 you have --

22 MS. MOONEY: No, I don't have any
23 questions.

24 EXAMINER SEE: Thank you. Mr. Kurtz.

25 MR. KURTZ: Is it possible to take a

1 lunch break now, because I assume Mr. Conway's going
2 to have a fair amount?

3 EXAMINER SEE: Let's go off the record.

4 (Discussion off the record.)

5 EXAMINER SEE: Let's go back on the
6 record.

7 - - -

8 CROSS-EXAMINATION

9 By Mr. Kurtz:

10 Q. Good afternoon, Mr. Cahaan.

11 A. Good afternoon.

12 Q. I'd like to ask you about your
13 worksheets. Can you go to Exhibit 2, please?

14 A. Bear with me. Yes.

15 Q. This is the first of your worksheets
16 where you are adjusting the denominator for the
17 off-system sales adjustment?

18 A. Yes.

19 Q. Okay. As I understand it, what you did
20 is you looked at, in the FERC Form 1, the intangible
21 plant, production plant, transmission plant,
22 distribution, general plant, got a total beginning
23 year/end of year, and then did a calculation as to
24 what the average production plant to total production
25 plant was for 2009; is that correct?

1 A. Yes. It's the average -- it's the
2 averages of the -- it's the average production plant
3 compared to the average total plant for that year.

4 Q. Why did you only use production plant?

5 A. What I'm trying to do is to take out --
6 the equity on the right-hand side of the balance
7 sheet is associated with the income that is being
8 taken out in the company's proposal. So there is
9 implicit assumptions here that it is basically caused
10 by generation, that off-system sales are a function
11 of generation. I am assuming implicitly that
12 transmission is costed out in the sales; that sales
13 are made, the transmission charges of them are not in
14 the net margins, they're taken out before you get to
15 net margins.

16 And I am implicitly assuming that the
17 intangibles and the distribution and the general
18 plant, which are kind of minuscule, that these have
19 nothing to do with off-system sales.

20 Q. I understand that. And with respect to
21 intangible distribution and general.

22 Now, if your assumption about
23 transmission plant was wrong and that should be
24 included in the calculation, that would have the
25 effect of changing your number in a sense that it

1 would help the consumers and hurt the company if
2 you're looking at the pure dollar effect of it.

3 A. If my assumption about transmission is
4 wrong and if a way of plugging in a value for the
5 transmission that should be associated with the
6 off-system sales were found, then it could be
7 recalculated and the recalculation would result in a
8 higher percentage allocator of plant which would
9 result in a greater amount of common equity being
10 taken out and associated with the off-system sales
11 which would result in, everything else being equal, a
12 greater calculated number for the ROE for the SEET
13 test.

14 Q. Therefore, helping consumers all else
15 equal as we work through the process.

16 A. Right. Well, I'm just telling you the
17 arithmetic and you can draw the conclusion.

18 Q. Okay. That's fine.

19 Now, and you used production plant
20 because, in your mind, off-system sales is related
21 only to generation.

22 A. Right.

23 Q. Okay. Let's turn to --

24 A. In terms of the causation regarding the
25 dollars.

1 Q. Okay. Exhibit 3, then, please. At the
2 top where you do the adjustment, as I understand you
3 took the average equity, average common equity for
4 the year of 1.302 billion --

5 A. Yes.

6 Q. -- correct? Okay, for 2009. Here's
7 where you used your 51.5 percent generation
8 allocator. You said how much of this equity is
9 related to production plant or generation, so you
10 multiplied the total by 51.5 percent --

11 A. Yes.

12 Q. -- to get 671 million?

13 A. Yes.

14 Q. Okay. Then you said well, how much of
15 that equity related to generation should be assigned
16 to off-system sales, right?

17 A. Yes.

18 Q. And you multiplied the 671, 671 million,
19 times 13.9 percent.

20 A. Yes.

21 Q. Okay. And then you went through your
22 math.

23 Now, the 13.9 percent is a number you've
24 calculated?

25 A. Yes.

1 Q. And that's back on Exhibit 2; is that
2 correct?

3 A. Yes. It's the ratio of sales for resale
4 to total sales.

5 Q. Now, you got both of these numbers from
6 the FERC Form 1.

7 A. Yes.

8 Q. And I verified them, but let me just ask
9 you if this is true, the total sales to ultimate
10 customers are sales to CSP's jurisdictional
11 ratepayers, correct?

12 A. Yes.

13 Q. In Ohio. And that number, that
14 1.739 billion number total sales to CSP ratepayers
15 includes generation, transmission, and distribution
16 revenue from those customers; doesn't it?

17 A. Yes, it does.

18 Q. Okay. Now, if you were to make your
19 calculation just on the generation component of the
20 CSP retail rates, you would get a much bigger number
21 than 13.9 percent, wouldn't you?

22 A. Mathematically, yeah. Yes.

23 Q. So if we were trying to match generation,
24 you took out generation because off-system sales are
25 only related to generation, if we compared the

1 off-system sales generation revenue to retail
2 generation revenue, we would get a different result
3 than what you have here.

4 MR. CONWAY: Could I have the question.

5 A. The earnings on --

6 EXAMINER SEE: I'm sorry. Wait just a
7 second.

8 MR. CONWAY: Could you please read the
9 question back.

10 Q. I'll restate it. You see where I'm going
11 with this.

12 A. Well, I thought --

13 EXAMINER SEE: I thought you were going
14 to restate the question.

15 Q. If you were to look at Columbus &
16 Southern's unbundled generation revenue, all the
17 components are unbundled here, and compare that to
18 the off-system sales generation revenue, we would get
19 a much different number than 13.9 percent changing
20 the calculation and you understand which way it would
21 go.

22 A. But the problem here is that I'm trying
23 to balance out off-system sales out of \$271
24 million of total earnings, that they're taking out.
25 So I'm working with \$271 million of total earnings

1 which includes earnings from distribution, from
2 generation to jurisdictional customers, it includes
3 all these things as well as forfeited fees and all
4 the various stuff that's on that income statement.

5 So yes, I'd get a bigger allocator, but
6 the question then is what am I allocating in the
7 first place? Because I'm not going after the equity
8 associated with the off-system sales to offset, to
9 pull it out of the total 271 income, it would have to
10 be pulled out of something else, something that is
11 the generation-only income, and I don't have that.

12 Q. Had you considered this before today,
13 this process that we're talking about?

14 A. No, but my first reaction is I bet
15 mathematically it makes no change. If I took out the
16 things that don't belong out of the 271, and then
17 allocated only on a generation basis for generation
18 revenues, because I've already got a percentage of
19 the total revenues, I'm not sure it would change --
20 I've got a sneaking suspicion that you would be back
21 to where you started from in the first place.

22 Q. It would depend on the relative
23 profitability of the various aspects of CSP's
24 business, distribution, transmission, generation,
25 wouldn't it?

1 A. Well, let me just simply say that I'm
2 saying it's a hunch we would end up where we were.
3 Right now there's nothing productive I can say about
4 how that would work. But I do -- can say that it
5 would not be applied to the 271 of total revenue.

6 Q. Of total margins.

7 A. No; total revenue.

8 Q. You said 271 of net income.

9 A. Total earnings, I should say, not
10 revenue.

11 Q. Right. Right.

12 A. So it's a different mathematical problem
13 entirely. So if you're doing what you suggest --
14 well, I'll leave it there, it's different.

15 Q. Okay. All right. Let me ask you a
16 couple more questions. You have determined that the
17 comparable earnings should be 9.7 percent, correct?
18 Excuse me, 10.7 percent.

19 A. Oh, thank you.

20 Q. Right?

21 MR. CONWAY: Objection.

22 A. That's more in line with my recollection.

23 MR. CONWAY: I object to the
24 characterization that the comparable earnings are
25 10.7 percent. I don't think that's --

1 THE WITNESS: I understand that as the
2 benchmark.

3 MR. CONWAY: Okay. I'll withdraw the
4 objection.

5 Q. Okay, the 10.7 percent throughout your
6 testimony is --

7 A. Is the benchmark ROE for purposes of the
8 SEET test in my recommendation.

9 Q. That's the first starting point. That's
10 the earnings of the comparable companies? ROE of the
11 comparable companies.

12 A. It's the -- we're in fuzzyland in terms
13 of characterizing it.

14 Q. I didn't think this one was very fuzzy.

15 A. Why don't we just call it the benchmark
16 ROE that's based upon analysis of the ROEs of various
17 companies that are considered to be comparable in
18 different ways.

19 Q. Okay. So your benchmark ROE is
20 10.7 percent?

21 A. Yes.

22 Q. Now, if the Commission adopted that, then
23 the safe harbor would be 200 basis points above that
24 or 12.7 percent?

25 A. As I understand, the safe harbor is a

1 200 percent difference and it would be, yes, 12.7.

2 Q. Okay. And then applying -- what you did
3 is you said the upper end is too much, would be 1.5
4 times 10.7 or 16.05 percent.

5 A. Yes.

6 Q. Okay. If Ohio did not have the Senate
7 Bill 221 giraffapotomus shopping option that you
8 talked about, then under the Hope and the Bluefield
9 and the comparable earnings, the way we would have
10 set traditional returns on equity for fully regulated
11 utilities, then they would only be entitled to,
12 roughly speaking, the 10.7 percent comparable
13 earnings approach.

14 MR. CONWAY: Objection. First of all, it
15 calls for a legal conclusion. Secondly, it's --
16 actually it calls for a legal conclusion which is
17 incorrect. The legal test is what earnings
18 opportunity is a utility entitled to have.

19 MR. KURTZ: Your Honor, can he quit
20 interrupting my questions? I think this witness has
21 testified all over the board on all of these type of
22 topics. This is the heart of the case.

23 MR. CONWAY: Well, excuse me, your Honor,
24 but my objection stands. He's calling for a legal
25 conclusion from the witness.

1 MR. KURTZ: I do not want a legal
2 conclusion from Mr. Cahaan.

3 MR. CONWAY: Then I would request you
4 instruct the witness not to answer the question.
5 Strike it.

6 EXAMINER SEE: Just a minute, gentlemen.

7 MR. KURTZ: Your Honor, I could rephrase
8 the question if that would help.

9 EXAMINER SEE: The objection is
10 sustained.

11 MR. KURTZ: Okay.

12 Q. (By Mr. Kurtz) Let me ask you, did you
13 look at Mr. Kollen's testimony?

14 A. I've read it.

15 Q. Did you see the portion where he
16 testified as to what the 39 state public utility
17 commission decisions in 2009 were in terms of
18 authorized return on equity for those 39 utilities in
19 2009?

20 A. I read that section, I don't remember
21 what he said specifically.

22 Q. Okay. Let me refresh your memory.
23 10.48 percent. So if we assume that 10 --

24 A. Let me make sure I understand. The
25 10.48 percent is the authorized return of regulatory

1 commissions with respect to regulated utility
2 companies, is that --

3 Q. In 2009.

4 A. In 2009.

5 Q. Across the United States --

6 A. Okay.

7 Q. -- including, as we heard yesterday, Ohio
8 Edison, Toledo Edison, it included all the rate case
9 decisions.

10 A. Yeah, these are rate case decisions.

11 Q. Right.

12 A. Right.

13 Q. My point only is that 10.48, 10.7, if
14 Ohio didn't have full shopping rights, if we were
15 back to pre-Senate Bill 3, if we were fully
16 regulated, the returns would be in that range; would
17 you agree?

18 A. If we could put the toothpaste back in
19 the tube and not only repeal Senate Bill 3 but get
20 the assets and say that they are now fully regulated
21 and give them the traditional regulatory treatment of
22 full cost recovery for everything guaranteed so that
23 their entire status was different and their entire
24 economic and risk profile were different, and if I
25 were in a rate case that had to recommend a rate of

1 return for the new old Columbus Southern Power, yes,
2 I would probably be in the area of 10 or something
3 like that for a cost-based fully regulated utility.

4 Q. Now, the 50 percent adder for the how
5 much is too much under the significantly excessive
6 earnings test is, in part, in large part, to
7 compensate the utility for the added risk that
8 it's -- that customers in Ohio can shop; is that
9 true?

10 A. Well, once again we're at a place which
11 has cost-based mentality and market mentality coming
12 into conflict. From a regulatory perspective where
13 every revenue is justified by some cost, the
14 50 percent adder is to compensate them for risk, to
15 have them justified in terms of -- well, just leave
16 it there are risks of millions of kinds from a
17 regulatory perspective.

18 From a market perspective, well, they can
19 pretty much charge and keep the money and all the
20 rest of that and so why would they give, you know, be
21 required to take anything back at all from a pure
22 market perspective, it is what it is. If we had a
23 perfect market, then why would you go after any
24 excess earnings in the first place.

25 Of course, if we had a perfect market, we

1 wouldn't have standard service offers in the first
2 place. So from a market perspective the adder should
3 be infinite. Keep it. From a regulatory perspective
4 justify it in terms of every little risk element and
5 cost it out how much an insurance policy would be to
6 protect against it.

7 Well, which perspective do you have? I
8 believe that you have to end up saying the company
9 has a valid case because it's a nonregulated company
10 in many of its respects, it has the right -- excuse
11 me, strike "right."

12 There's something -- I don't want to get
13 into legal questions but there's something going on
14 where the company ought to be able to keep money that
15 it works hard to get. On the other hand, too much is
16 too much and they shouldn't be able to keep so much
17 that it's ripping off the customer. It's a judgment
18 call of fairness. I can't get more than that as far
19 as any objectivity because all the so-called
20 objectivity things would have to send me back to a
21 purely regulatory perspective and this is the
22 giraffapotomus again.

23 Q. I don't want to belabor the point. Let
24 me just ask you a couple of just fact questions. You
25 have come up with I guess at the very end of your

1 testimony, page 21, line 3, the calculated return on
2 equity for CSP adjusting out off-system sales,
3 numerator and denominator the way you've done it; is
4 that correct?

5 A. Yes.

6 Q. Okay. And if we subtract your how much
7 is too much threshold of 16.05 percent, we get
8 3.68 percent of excess earnings?

9 A. I'll assume that your calculation is
10 correct. I'm not able to -- do you want me to do it
11 right now?

12 Q. No. 19.73 minus 16.05 equals
13 3.68 percent.

14 A. Okay.

15 Q. Okay. No one's disputed this number.
16 Have you looked at Mr. Kollen's where he's calculated
17 1 percent return on equity equals how much of a
18 refund?

19 A. I believe it's 20.39 or 039.

20 Q. 20.039 million.

21 A. Right.

22 Q. So if under your calculated 19.73 percent
23 minus 16.05 equals 3.68 percent excess --

24 MR. CONWAY: Objection. He has not
25 testified to any amount of excess earnings either as

1 a percentage -- on a percentage basis or on an
2 earnings basis. To throw that into the question like
3 that and try to get an answer from this witness that
4 he'll then say represents this witness's opinion that
5 there were excess earnings of 3.6 percent is
6 misleading.

7 MR. KURTZ: 3.68 percent.

8 MR. CONWAY: 3.68 percent is misleading.

9 MR. KURTZ: I don't know whose testimony
10 Mr. Conway read, I read Mr. Cahaan's testimony,
11 19.73 percent, page 21, line 3, the 16.05 percent
12 threshold equals 3.68 percent differential. That's
13 the math.

14 MR. CONWAY: And where is the deferrals?
15 Where is the deferrals piece of this?

16 MR. KURTZ: You can ask this question --
17 your Honor.

18 EXAMINER SEE: Okay. Hold on a minute.
19 Maybe we all need a five-minute break. Recess, five
20 minutes.

21 (Recess taken.)

22 EXAMINER SEE: Back on the record. Prior
23 to taking a brief break there was an objection to the
24 question posed by Mr. Kurtz. The objection is
25 sustained. If the parties want to address the math

1 that would be the result of the question posed, you
2 can make that leap or put that example in your brief.

3 Go on to your next question, Mr. Kurtz.

4 Q. (By Mr. Kurtz) I'd like to ask you a
5 hypothetical question, Mr. Cahaan.

6 A. Yes.

7 Q. Hypothetically assume the Commission
8 accepted the 19.73 percent adjusted actual return on
9 equity as stated on page 21, line 3 of your
10 testimony, for just off-system sales.

11 A. Off-system sales only.

12 Q. Off-system sales only. And assume
13 hypothetically the Commission adopted the, quote,
14 threshold ROE of 16.05 percent as stated on page 17,
15 line 3 of your testimony, would you agree
16 hypothetically we would get 3.68 percent
17 differential?

18 A. I would agree, not hypothetically, I
19 would agree that 3.68 is the difference between 16.05
20 and 19.73.

21 Q. Would you agree with this math, either
22 hypothetically or actually, that 3.68 percent times
23 20 million 039 -- 20,039,000 is \$73,740,000?

24 EXAMINER SEE: Do not answer that
25 question. I just indicated that if you wanted to go

1 down that path, you could put the math in your brief.

2 Move on, Mr. Kurtz.

3 Q. Let me ask about, you made a second
4 adjustment to the company's actual return with
5 respect to deferrals?

6 A. Yes.

7 Q. Okay. What you did is you took your
8 starting point, well, you took your starting point of
9 what the return on equity would be if you did the
10 off-system sales adjustment correctly, in your mind,
11 and you get 19.73 percent?

12 A. What I did was to recalculate the two
13 adjustments that the company had proposed. I
14 recalculated them independently and then I put them
15 together. So you'll have to tell me which one you're
16 referring to; the calculation that's independent of
17 the off-system sales or the one that's done with them
18 together.

19 Q. Thank you. The one that's done together.

20 A. Okay.

21 Q. The 17.44 percent on line 17, page 21 of
22 your testimony.

23 A. That's the one that is the adjustment for
24 both off-system sales and deferral exclusions
25 together, yes.

1 Q. Yes. And would you agree mathematically
2 that 17.44 percent minus your recommended threshold
3 ROE of 16.05 percent equals 1.39 percent?

4 A. 1.39 percent, yes.

5 Q. Okay.

6 MR. KURTZ: Thank you, your Honor. Those
7 are all my questions.

8 EXAMINER SEE: Okay. Let's go off the
9 record.

10 (Discussion off the record.)

11 EXAMINER SEE: Let's go back on the
12 record. As I had just informed the parties, the plan
13 is to finish with Mr. Cahaan's cross-examination
14 today and that rebuttal will begin tomorrow morning.
15 At that point, Mr. Randazzo indicated that he had an
16 objection to that schedule. Go ahead.

17 MR. RANDAZZO: Yes, your Honor. I think
18 that that schedule is unreasonable. We got the
19 testimony late yesterday, we've been preparing for
20 hearing ever since. I'm still trying to read the
21 testimony let alone participate in this hearing.
22 It's unfair, it's prejudicial and I object.

23 EXAMINER SEE: Noted.

24 Ms. Grady.

25 MS. GRADY: Yes, your Honor, I would join

1 in that objection. Additionally, your Honor, I would
2 note that we have a notice of deposition out that
3 would cover the presentation of this company or
4 presentation of the rebuttal testimony that was filed
5 in the docket at the Commission on September 29th,
6 2010, category 4 where we indicated we were going to
7 take deposition upon all persons called by CSP to
8 present testimony including direct, rebuttal, and
9 surrebuttal, and any other form of testimony filed in
10 this proceeding, and that the depositions would take
11 place on the relevant topics within their testimony.

12 EXAMINER SEE: And you said that was
13 September 29th?

14 MS. GRADY: That's correct, your Honor.

15 And in addition, your Honor, we conducted
16 the deposition, for instance, of Dr. Makjija on
17 October 21st, at that deposition we asked repeated
18 questions of Dr. Makjija, what his analysis and
19 his -- what his analysis of Dr. Woolridge showed and
20 Dr. Makjija could not respond. He had the testimony
21 12 days, couldn't respond to our questions. So we
22 tried to do the deposition all at once, couldn't be
23 done because the witness, for whatever reason, didn't
24 read Mr. Woolridge's testimony and so now we're
25 forced into at the last minute responding.

1 And we believe that that was an
2 unfortunate series of events, perhaps orchestrated,
3 but for whatever reason it was we did not get our
4 opportunity to depose Dr. Makjija as well as
5 Mr. Hamrock on the testimony -- on the rebuttal
6 testimony. We believe we have that right, it is one
7 of the rights protected under 4903.082 of the Revised
8 Code which provides parties shall be granted ample
9 discovery rights in the proceeding. Additionally,
10 your Honor, there was no motion to quash made of that
11 notice to take deposition.

12 MR. KURTZ: Just for the record, OEG
13 supports IEU and OCC.

14 MR. NOURSE: Your Honor, may I respond?

15 EXAMINER SEE: Just a minute.

16 Ms. Yost.

17 MS. YOST: Yes.

18 EXAMINER SEE: Are you not with OCC?

19 MS. YOST: Well, it was specific to the
20 deposition transcript that I took of Mr. Hamrock
21 where I specifically asked him whether he began
22 drafting any supplemental rebuttal testimony. He
23 indicated no, and that date was October 21st.
24 Thereafter I asked him if he knew if he would be
25 filing any additional testimony. At that time he did

1 indicate initially "I don't know," then there was an
2 objection by counsel and then counsel ultimately
3 instructed him not to respond to my question. So,
4 your Honor, there was an attempt to find out if there
5 was any rebuttal and what that would be.

6 MR. NOURSE: May I respond now, your
7 Honor?

8 EXAMINER SEE: Mr. Nourse.

9 MR. NOURSE: Yeah, first of all, when we
10 got into the trial strategy during the deposition, I
11 did instruct the witness not to answer, but the fact
12 is we drafted our rebuttal testimony over the weekend
13 after the depositions were completed.

14 But in any event, that's neither here nor
15 there. Dr. Makjija did make extensive comments on
16 Dr. Woolridge's approach during deposition, there's
17 no question about that, and I don't see what that has
18 to do with our rebuttal.

19 You know, it's highly unusual, I'll say,
20 and perhaps unprecedented to even talk about
21 depositions for rebuttal testimony during a hearing.
22 It certainly doesn't typically occur. The discovery
23 in this case was over, you know, our rebuttal is
24 pretty straightforward. I haven't heard anything
25 stated about exactly why discovery or additional

1 depositions need to be conducted regarding our
2 rebuttal. So the company's certainly supportive of
3 keeping the case moving and will be available
4 tomorrow morning without objection.

5 EXAMINER SEE: I'll take all that under
6 consideration and the Bench will give you a decision
7 after lunch.

8 Let's reconvene at a quarter to 3.

9 (At 1:28 p.m., a lunch recess was taken
10 until 2:45 p.m.)

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1 Wednesday Afternoon Session,
2 October 27, 2010.

3 - - -

4 EXAMINER SEE: Let's go back on the
5 record. After some discussion with counsel for the
6 various parties, we'll resume for rebuttal on Monday,
7 November 1st, at 9:30. There's also been some
8 proposals about the briefing schedule. Assuming that
9 we conclude things on Monday, November 1st, briefing
10 schedule, initial briefs will be due Friday,
11 November 19th, reply briefs November 30th.

12 MR. McNAMEE: Shall we serve these
13 electronically?

14 EXAMINER SEE: Electronically on
15 everyone.

16 Let's resume cross-examination of
17 Mr. Cahaan.

18 MR. RANDAZZO: Your Honors.

19 EXAMINER SEE: Yes.

20 MR. RANDAZZO: I'm very reluctant to do
21 this but I think I'm ethically obligated to do it.

22 EXAMINER SEE: Really?

23 MR. RANDAZZO: During the off-the-record
24 discussion there was a discussion about the briefing
25 schedule and I asked the question about the timing of

1 the briefing schedule because it appeared to me that
2 we were moving along very aggressively on the
3 briefing schedule, and in response to my question,
4 the response came from the Bench, there was an
5 indication that we needed to move along based upon a
6 view regarding how the merits in this case would be
7 resolved.

8 I believe that's improper, and to the
9 extent, even if I would favor the result that was
10 suggested in the description of how -- where we
11 needed to move this along, I think it is improper for
12 who is to judge the issues in this case to have a
13 preconception about how the issue should be resolved.

14 EXAMINER SEE: You're finished,
15 Mr. Randazzo?

16 MR. RANDAZZO: Yes, I am, thank you.

17 EXAMINER SEE: Mr. McNamee.

18 MR. McNAMEE: I was here for that
19 discussion as well, and I do not recall any
20 indication of any prejudgment on the part of the
21 Bench.

22 MR. RANDAZZO: Well, I was reluctant to
23 say this, but the statement that was made was that we
24 needed to move the briefing schedule along because
25 there is a view that we're holding up a refund for

1 customers.

2 EXAMINER SEE: No.

3 EXAMINER JONES: Mr. Randazzo, are you
4 telling us that 18 days to file your initial brief is
5 not sufficient?

6 MR. RANDAZZO: No, your Honor, I'm
7 telling you that it's improper for anybody that's
8 judging this case to have a predisposition of how the
9 merits should be resolved.

10 EXAMINER JONES: And so you are accusing
11 the Bench of predisposing this case?

12 MR. RANDAZZO: I didn't accuse the Bench
13 of that, I took the Bench's comments as communicating
14 information that the Bench received.

15 EXAMINER JONES: Well, unless my
16 co-Attorney Examiner here disagrees with me, I
17 believe the briefing schedule has been set
18 November 19th and November 30th and that is what the
19 briefing schedule will be. Thank you.

20 EXAMINER SEE: Let's continue with
21 Mr. Cahaan's cross-examination.

22 Mr. Conway.

23 MR. CONWAY: Thank you, your Honor.

24 - - -

25

CROSS-EXAMINATION

1
2 By Mr. Conway:

3 Q. Mr. Cahaan, I have a few questions,
4 hopefully not more than a few, regarding your
5 testimony in this case and your views of the various
6 methodologies that you propose for establishing the
7 benchmark and the threshold.

8 First point is in reference to your
9 testimony on page 3, it's a small point, I think,
10 but -- or at least a short point. You mention at
11 lines 21 and 22 that the second step in the method
12 that Dr. Woolridge has proposed yields an additional
13 30 nonutility companies to the 15 companies that are
14 presented in the proxy group in the first step to
15 provide a combined set of 45 companies. Do you see
16 that?

17 A. I do.

18 Q. And my point is, my question is after I
19 looked at Dr. Woolridge's group of 45 companies on
20 his Exhibit JRW-4, it didn't appear to me that all 30
21 of the additional firms were nonutility firms. In
22 fact, it looked to me like there were only a few that
23 were nonutility, but the question I have for you is
24 are you sure that all 30 of them are nonutility
25 firms?

1 A. No, I'm not. I'd be -- if you want me to
2 correct it by showing me the page you're referring to
3 in Dr. Woolridge's, could do it, but it's very
4 possible I just looked at it and said, oh, there's 30
5 there and 15 there and made an assumption as I was
6 banging this out on the keyboard.

7 Q. So sitting here today you're not sure how
8 many of the additional 30 firms in Dr. Woolridge's
9 comparable public companies group are nonutility
10 firms.

11 A. Well, you've raised doubt in my mind that
12 they're all nonutility firms, certainly.

13 Q. Okay. Turning to page 4 of your
14 testimony, at lines 5 through 8, you indicate that --
15 or you ask the question "Are there different
16 selection criteria that should be used and even if
17 the selection criteria are appropriate, are there
18 firms in the sample which should be excluded for
19 other reasons?" Do you see that? Lines 5 -- the
20 sentence that starts on line 5 and continues on to
21 line 8.

22 A. Yes, I see it.

23 Q. And I took it when I read that that you
24 have some acquiescence in or you have some affinity
25 for the manner in which Dr. Woolridge selected the

1 companies that ultimately ended up in his comparable
2 group of public companies?

3 A. I'm not sure I understand what the
4 question is asking me. At this point in the
5 testimony I'm discussing properties of a methodology
6 and I have not discussed the particular results of
7 Dr. Woolridge utilizing his methodology.

8 Q. In Dr. Woolridge's approach, would you
9 agree that his method of selecting the comparable
10 risk firms allows the analyst to get to the result
11 that he thinks he should get to from the outset?

12 MS. GRADY: Can I have that question
13 reread, please?

14 EXAMINER SEE: Sure.

15 (Record read.)

16 A. I think I made it clear in discussing the
17 various approaches that Dr. Makjija claims that his
18 approach is objective and by that I would assume he
19 means this is something that could not be manipulated
20 in order to reach some prejudged conclusion. And I
21 believe I indicated that that property was a good
22 property.

23 Conversely, this property of having to
24 make discrete decisions as to specific criteria can
25 be misused to allow a prejudged outcome to be

1 achieved. On the other hand, the transparency of the
2 process allows such finagling to be detected and
3 argued about. I think that is an advantage of the
4 methodology.

5 So there's pros and cons in allowing the
6 analyst to have discretion and use judgment in
7 deciding what is relevant for the consideration. But
8 by the same token there is the issue that other
9 analysts can look at these decisions to see if they
10 seem to be biased in any particular direction.

11 Q. And so in that manner if there is some
12 bias that's inappropriate, using the approach that,
13 say, Dr. Woolridge has advocated, someone like
14 yourself would be able to detect the bias and
15 eliminate it from the methodology's results.

16 A. If we're doing this kind of a system
17 whereby everybody comes in with their own preferred
18 model, then actually it would be a lot of work but it
19 certainly could be done that other analysts could
20 look at somebody's method, make what they believe to
21 be the appropriate tweaks, show that with the
22 appropriate tweaks you get very different answers,
23 show also that the sensitivity and the range of this
24 indicates that the robustness of the tweaks is really
25 what's indicated, and so yes, you could look at

1 someone else's results and show why they are skewed.

2 I'm also, frankly, pushing a system that
3 maybe enables some more efficiency where everybody
4 starts at the same place so that everybody isn't
5 looking at everybody else's work but actually has a
6 basis for comparison.

7 But the -- let me stop there, I think I
8 answered the question. If not, you'll --

9 Q. I think what I got from your answer, at
10 least in part, was that you would agree that
11 Dr. Makjija's approach does not try to prejudge which
12 firms ought to make it into the comparable risk
13 collection of firms.

14 A. Yes. I do agree that Dr. Makjija's
15 approach, if you say in advance you're going to
16 divide stuff up into quintiles and do the little
17 boxes and then specify the database so that, you
18 know, take out the database discretion, take out the
19 slice-and-dice method discretion, then you end up
20 with two criteria that you've announced in advance.
21 You've announced the leverage and you've announced
22 the unlevered beta. And unless something is strange
23 about that, I mean, these are standard terms so
24 there's no discretion in the system.

25 Q. And that's in the selection of the

1 comparable risk firms, there's not much discretion in
2 that approach if you were to follow the methodology
3 of the type that Dr. Makjija recommends.

4 A. Yes. My disagreement is with the
5 methodology in terms of what it does, but in terms of
6 how it operates, it operates very mechanically.

7 Q. My understanding, my understanding is
8 that as far as the result of the collection of
9 comparable risk firms and the mean ROE that that
10 generates, that that's not really your -- that's not
11 where your concern originates or is focused.

12 A. My concern is, first of all, what the --
13 the words "comparable risk" here, the comparable risk
14 firms in Dr. Makjija's method are comparable in risk
15 to the investor, not comparable in risk to the firm
16 CSP, and as such the focus of this comparable risk is
17 not what the legislation says should be the
18 comparison.

19 Dr. Makjija very clearly states that he
20 is looking for firms which are of comparable risk,
21 and let me say what he's really talking about is the
22 stock of the firm of comparable risk to the investor.
23 This is not the same as the firm itself faces
24 comparable risk as the utility.

25 Now, there can be a transpondence of

1 this, but at the immediate stage it is not the risk
2 to -- it is not risks that are comparable to the
3 utility, but risks that are comparable to the
4 investor who owns stock in that utility.

5 Q. You used the word "transpondence."

6 A. Maybe I better think it through.

7 Q. No; that's okay. The point of it,
8 though, just the meaning as you were using it is that
9 you might end up at the same place?

10 A. One can look at Dr. Makjija's method as
11 saying, in effect, that he is using a screening -- a
12 screening criteria that is a two-variable screening
13 criteria as opposed to a screening criteria that
14 contains seven or six or eight or other numbers of
15 different screens. So you could use this as a
16 screening criteria without saying -- that's on the
17 same conceptual level as the screening criteria as
18 used in other models. There's a catch though, that
19 you have to drop the assumption that you're employing
20 the CAPM model.

21 And so the various statements that have
22 been made, for instance, by Mr. Hamrock that
23 Dr. Makjija's method captures all of the
24 considerations, what's the word here, the business
25 and financial risk that Mr. Hamrock listed in his --

1 Q. JH-1, right?

2 A. JH-1. A large number of times in his
3 testimony and deposition he said that Dr. Makjija's
4 analysis captures them. Well, Dr. Makjija's analysis
5 captures them only to the extent that it takes them
6 and throws them under the rug because he makes the
7 assumption that all companies' specific business
8 risks that are not diversifiable -- excuse me, that
9 are diversifiable are diversified out in a portfolio.
10 So all those various companies' specific risks are
11 captured in the sense that they're bundled up with
12 all sorts of other companies and gone away at the
13 investor level.

14 But at the company level for CSP, they're
15 not captured at all, therefore, the analysis
16 Dr. Makjija does does not specifically utilize
17 these -- any of these as screening factors, but it's
18 conceptually at the same level, same kind of
19 analysis. You can call it the same kind of analysis
20 as done by Dr. Vilbert and Dr. Woolridge.

21 Q. Just let me interject just for a moment
22 here, Mr. Cahaan. Are you aware of whether
23 Dr. Makjija also uses asset turnover as a business
24 risk measure and bond ratings as a financial risk --

25 A. I'm --

1 Q. -- excuse me, indicator in his selection
2 process also in a confirmatory way?

3 A. In a confirmatory way, but his basic
4 model is one which utilizes only the two factors, and
5 what I want to particularly point out is that it is
6 claiming to capture all of the company-specific risks
7 that are identified in other testimony.

8 The key thing is that there is a
9 difference between the risks to the investor and the
10 risks to the company.

11 Q. In any event would you agree that --
12 well, is it your position that the approach that
13 Dr. Makjija has developed can produce or may produce
14 an unbiased mean ROE?

15 A. Yes. It can produce an unbiased
16 estimate, I think, of the ROE.

17 Q. And that's, I think, at page 7, lines 5
18 through 7, when you say that.

19 EXAMINER JONES: Mr. Conway, you'll have
20 to start speaking louder. You're starting to trail
21 off again. My hearing's not as good as it used to
22 be.

23 A. Yes.

24 Q. And, Mr. Cahaan, my understanding of your
25 primary concern with Dr. Makjija's methodology is

1 that -- is your concern that it will result in a
2 variance that's too large.

3 A. His selection criteria, which contains --
4 it contains only two factors. Now, what this would
5 mean to me is that there's a high probability that
6 the resulting group may have the same -- let me back
7 up a second.

8 I don't have a problem with the measure
9 of financial risk, that's fine. So we're talking
10 only about business risk. And there are many, many
11 types of business risk, so I'm perfectly willing to
12 assume, I don't have a firm basis for this, but it's
13 not too unreasonable that between the unlevered beta
14 and other things he has the same level of business
15 risk possible in his approach in the comparable
16 group.

17 If you could somehow get an index of
18 business risk that if CSP is 17.6, then the firms in
19 the comparable group you could have a single measure
20 of business risk --

21 Q. So something other than beta?

22 A. No. I'm saying if you took -- oh, gosh,
23 yes, something other than beta.

24 Q. Okay.

25 A. Because beta captures only the

1 nondiversifiable business risk.

2 But if you somehow could get the whole
3 thing looked at, then the other companies may be
4 fairly close, but it's very likely it's a very
5 heterogeneous group, so the fact of the matter is if
6 you have a group of companies that have the expected
7 value of their earnings, in some percentage term, of
8 course, and the same expected variation around that
9 expected value, so they really do belong together a
10 priori, looking forward, ex-post whatever happens
11 happens, and if they're a very heterogenous group of
12 companies, then you would expect that what happens is
13 going to put them individually all over the place and
14 you would have a large variance.

15 Q. Thank you. So the problem with the
16 Makjija approach is that it leads to variances that
17 are too big, right?

18 A. That's a problem, in addition to the
19 issue of you cannot see what's going on in terms of
20 what the logic is there. Because it still has that,
21 it still has that all the business risks are swept
22 under the rug aspect to it by the assumption that
23 these are combined by the investor.

24 Q. Well, how he uses the beta measure is not
25 a mystery. I mean, he explains how he does it,

1 correct?

2 A. How he does it, yes.

3 Q. Yes. And you don't have any issues with
4 the arithmetic of what he did, do you?

5 A. No.

6 Q. And you don't have any issue with the
7 equity ratios that he used, arithmetically or
8 accurately.

9 A. No.

10 Q. And what I'm getting to is it seemed to
11 me that your primary concern comes down to the size
12 of the adder, and what I wanted to do is ask you,
13 based on this various approach that Dr. Makjija
14 recommends, and I just wanted to ask you kind of to
15 tie this up that, as I understand it, your concern is
16 how large the standard deviation statistic, how large
17 of a value it produces from his methodology; isn't
18 that accurate?

19 A. How his methodology will tend to produce
20 a large standard deviation because the firms are
21 really quite heterogeneous.

22 Q. As opposed to homogeneous which is closer
23 to a description of, say, Woolridge's approach,
24 right?

25 A. Well, it did surprise me that Woolridge's

1 standard deviation was as high as it was.

2 Q. You've just gotten to my next question.

3 A. I thought you'd get there.

4 Q. Okay. Thank you very much.

5 A. Trying to save you time.

6 Q. Thank you. We have other commitments we
7 all need to make.

8 But the standard deviation statistic that
9 Dr. Makjija's approach produces in this case is
10 5.85 percent, right? Would you accept that, subject
11 to check?

12 A. I'll accept it, yes.

13 Q. Were you here yesterday when I was
14 cross-examining Dr. Woolridge and he indicated that,
15 he stated that the standard deviation statistic for
16 his group was somewhere in the range of 5.6 to 5.7?

17 A. Yes, I was.

18 Q. And that's pretty close to the
19 5.85 percent that Dr. Makjija's group produced,
20 right?

21 A. That's right.

22 Q. And you would agree that those are
23 similar in magnitude, if not the same in magnitude.

24 A. They're disturbingly similar, yes.

25 Q. And the recommendation that you've

1 sponsored in this case ultimately is 10.7 percent ROE
2 baseline and a 50 percent adder which ends up being
3 5.35 percent, right?

4 A. Yes.

5 Q. And the total threshold ROE, then, is
6 16.05 percent, right?

7 A. Yes.

8 Q. Would you agree with me that the adder
9 that your approach produces in this case, the
10 5.35 percent, is the same magnitude, it's very
11 similar to the one standard deviation that each of
12 the other two methods produces, Woolridge and
13 Makjija?

14 A. Well, if it is similar -- I know the
15 numbers that we've just talked about, and the
16 conclusion that the 5.35 is close to the other two
17 numbers is what it is. They have a certain
18 relationship. Since I didn't get to the 50 percent
19 or the 5.35 by any method of standard deviations, I
20 don't want to characterize this as a standard
21 deviation of .96 or 1.02, or anything else like that.

22 Q. I understand that. I really am not
23 trying to characterize your adder as a multiple of
24 some standard deviation statistic, but I was just
25 confirming with you that as it turns out, the

1 magnitude of the adder that you would recommend in
2 this case is the same as the magnitude of the
3 adder -- one standard deviation that each of the
4 other two methodologies produces.

5 A. It turns out that way, yes.

6 Q. And so would it be fair to say that your
7 reservations about Dr. Makjija's proposal are not so
8 much about his mean ROE or the use of a
9 variance-based adder like the standard deviation, but
10 is, rather, primarily an objection to the number of
11 standard deviations that he's recommending?

12 A. Absolutely not. That does not at all
13 represent what I think. Quite the contrary. I don't
14 think that I want to tie a definition of fairness and
15 of what is a meaningful allowance for an earned
16 return above the mean to a dispersion, a dispersion
17 that is based, so-called, on a company not being
18 where it is by random fluctuations, by chance.

19 I'm not so sure that it matters whether a
20 company is there by random fluctuations or by chance,
21 and I don't think the approach of defining whether a
22 company is there, or whatever it earns, is by random
23 fluctuations or by chance is an appropriate way of
24 making a determination as to whether a company is
25 earning what it is because of random fluctuations or

1 chance.

2 If, for instance, Columbus & Southern
3 were to have a wonderful year of sales off system and
4 earn huge revenues and profits from off-system sales
5 that drove the earnings to a level that is extremely
6 high by the SEET test, and then the question is are
7 they within the fluctuations, no, they're way out of
8 it. But why use statistical inference when you can
9 just look at what's going on and use direct
10 observation and see, well, what drove that. Is it
11 normal variation and chance or is it not. Is it
12 something that's endemic that's tied to the
13 non-chance part of it.

14 Why use statistical methods to -- use
15 statistical inference to infer something that can be
16 observed or investigated. That's why just because it
17 happens to be one standard deviation is not a concern
18 or a reason why I think a statistical approach should
19 be used.

20 Q. So to sum it up, I didn't mean to
21 mischaracterize what your position was, I thought
22 that your primary concern was ultimately how many --
23 what the multiple is that was being used with regard
24 to these variance-based approaches that was causing
25 you the most concern. You've explained yourself.

1 And so would it be accurate to say that you would not
2 support, then, a one standard deviation approach to
3 the statistical methodology, that is baseline ROE,
4 mean ROE plus one standard deviation?

5 A. Correct.

6 Q. Okay. A few questions about your
7 baseline mean -- actually it's not a mean ROE, I
8 guess. It's your baseline ROE. You had mentioned I
9 think in conversation with several of the other
10 lawyers that you had looked at the mean ROEs that
11 each of the Woolridge and Makjija methods had
12 produced along with a mean ROE that you had developed
13 using the Vilbert approach. Do you recall those
14 conversations that you had with the other lawyers
15 about that?

16 A. I think that was in my testimony. I'm
17 not sure if --

18 Q. Yes.

19 A. -- conversations.

20 Q. Right. It's also in your testimony,
21 that's right.

22 A. I'd rather refer to my testimony than
23 conversations.

24 Q. Okay. Well, the questions that I had in
25 mind to ask you simply were also, like some of the

1 other questions, about the manner in which the
2 10.7 percent value that you recommend developed. And
3 that was the subject of a discussion with the other
4 lawyers, I believe.

5 A. I don't think I can add more than I've
6 said at length or under lengthy questioning already.

7 Q. I'll take that as a suggestion that I
8 move on. You don't have anything more to say.

9 A. It would be more efficient for you to
10 move on, yes.

11 Q. Okay. Mr. Cahaan, are you familiar with
12 the aspect of the SEET provision which indicates that
13 only the adjustments that are included in the ESP
14 that result in excessive earnings are subject to
15 potentially being returned to customers?

16 A. I am aware of the language, although I
17 don't have specific recall in detail of the language,
18 of the legislation. I'm also aware that there seems
19 to be a really big controversy as to how to interpret
20 that language. I myself have neither certainly a
21 legal opinion or even an economic opinion as to how
22 that language should be interpreted.

23 There have been many statements that I
24 have heard that people have made and, frankly, I'm
25 totally confused about the matter.

1 Q. Would you agree that -- or is it your
2 understanding that Columbus Southern Power's
3 off-system sales margins aren't the result of some
4 adjustment that was included in the ESP?

5 A. Well, I cannot state as a matter of fact
6 that that is the case. Offhand I would expect that
7 to be the case from the nature of off-system sales,
8 but I can't attest that, indeed, is true.

9 Q. Okay. Thank you.

10 Are you familiar with the gridSMART rider
11 and the enhanced vegetation management rider?

12 A. Actually, no.

13 Q. Do you even recognize the reference?

14 A. I've seen pages which -- of exhibits
15 which have at the top of them gridSMART rider and
16 vegetation rider, and they have, you know, been
17 introduced in this case. The whole gridSMART thing
18 and the vegetation rider either came about after I
19 left here or else when it was happening, I wasn't
20 aware -- paying attention to it. So I really don't
21 know about the gridSMART and enhanced vegetation
22 riders.

23 Q. Is it your understanding, Mr. Cahaan,
24 that the Commission, when it approves an ESP for an
25 electric distribution utility, does so after

1 concluding that the ESP is more beneficial in the
2 aggregate than an MRO would be for the customers?

3 MR. McNAMEE: Objection.

4 EXAMINER SEE: What grounds, Mr. McNamee?

5 MR. McNAMEE: Relevance. I don't know
6 how this relates at all to the question of whether
7 Columbus Southern Power has significantly excessive
8 earnings within the meaning of the statute.

9 MS. GRADY: Your Honor, I also enter an
10 objection because I believe that during the
11 cross-examination Witness Cahaan indicated that he
12 had no knowledge of the SB 221 and the symmetry and
13 asymmetry of that and that would actually be a
14 provision outside SEET. So I don't think he has the
15 knowledge and expertise. It's a legal question.

16 MR. CONWAY: Your Honors, if I might, if
17 he doesn't know, that's fine. I certainly don't want
18 him to give a legal conclusion as part of his
19 testimony. I would point out that there was earlier
20 cross-examination over the same point that another
21 lawyer or other lawyers inquired of this witness as
22 to whether or not an MRO might be more beneficial to
23 customers than the ESP.

24 EXAMINER SEE: The objection is
25 sustained.

1 Q. (By Mr. Conway) Just a couple more
2 questions, Mr. Cahaan. In your testimony you perform
3 a thought experiment, a sanity check on Dr. Makjija's
4 proposed adder and you do that by, instead of looking
5 at what the adder produces on the high side when
6 actually added to the mean ROE, look at it from the
7 low side to see what kind of a significantly
8 deficient earnings threshold it would provide when
9 subtracted from the mean ROE?

10 A. That's correct.

11 Q. Do you recall that part of your
12 testimony?

13 A. Yes.

14 Q. And if you subtract the adder that, in
15 this case that you're proposing, which is
16 5.35 percent, from the ROE that you propose as a
17 baseline of 10.7, of course, the result is also
18 5.35 percent, correct?

19 A. Yes.

20 Q. And are you aware of whether -- well,
21 strike that.

22 So if you applied the thought experiment,
23 the sanity check to your own proposal, as I
24 understand it ROEs below 5.35 percent would be
25 significantly deficient in your thought experiment.

1 Is that right?

2 A. By the criteria of my thought experiment,
3 yes, they would be reasonably characterized as
4 significantly deficient. The -- let me stop there.
5 Certainly the answer is yes.

6 Q. And do you know whether there are any
7 examples that are in front of us today in Ohio of
8 utilities whose ROEs for 2009 would have been less
9 than the significantly deficient earnings threshold
10 that the thought experiments -- a thought experiment
11 produces?

12 MS. GRADY: Objection.

13 EXAMINER SEE: I thought that what his --
14 Ms. Grady, did you --

15 MS. GRADY: I don't think we have a
16 proposed. I think it's a mischaracterization of his
17 testimony. We don't have a significantly deficient
18 threshold being proposed. It is, pursuant to
19 Mr. Cahaan's testimony, this is an asymmetric test
20 that is not part of the SEET in Ohio.

21 MR. CONWAY: Your Honor, if you'd like me
22 to rephrase the question, I would be happy to do that
23 and try again.

24 EXAMINER SEE: Go ahead.

25 Q. (By Mr. Conway) Mr. Cahaan, are you aware

1 of any EDU ROEs that have been reported in Ohio for
2 2009 which would have fallen below the significantly
3 deficient earnings threshold that your thought
4 experiment would have produced for your
5 recommendation?

6 MS. GRADY: Objection.

7 Q. Based on your recommendation.

8 MS. GRADY: Sorry. Relevance.

9 EXAMINER SEE: The objection is
10 sustained.

11 Q. (By Mr. Conway) Mr. Cahaan, are you aware
12 of -- have you read Mr. Kollen's testimony in this
13 proceeding?

14 A. Yes, I have.

15 Q. And in Mr. Kollen's testimony he reported
16 that and relied upon ROEs reported by the FirstEnergy
17 utilities two out of three of which were below
18 5.35 percent. Do you recall that, or did you read
19 that?

20 A. Yes, I do.

21 Q. Okay.

22 MR. CONWAY: No further questions, your
23 Honor.

24 EXAMINER SEE: Redirect, Mr. McNamee? Do
25 you want a few minutes?

1 MR. McNAMEE: Yeah, if I could have a few
2 minutes to chat.

3 EXAMINER SEE: Yes. 4 o'clock.

4 (Recess taken.)

5 EXAMINER SEE: Mr. McNamee.

6 MR. McNAMEE: Thank you, your Honor. We
7 have no redirect for Mr. Cahaan. I would at this
8 time ask to move the admission of Staff Exhibit 1.

9 EXAMINER SEE: Are there any objections
10 to the admission of Staff Exhibit 1?

11 MR. RANDAZZO: My usual objections, your
12 Honor.

13 EXAMINER SEE: Of definition, okay.
14 Mr. McNamee, Mr. Randazzo's standing
15 objection.

16 MR. McNAMEE: Standing response.

17 MR. RANDAZZO: And now we're all sitting.

18 EXAMINER SEE: If there are no other
19 objections to the admission of Staff Exhibit 1, it's
20 admitted into the record.

21 (EXHIBIT ADMITTED INTO EVIDENCE.)

22 EXAMINER SEE: We'll reconvene Monday,
23 November 1st, at 9:30. We're adjourned.

24 (The hearing was adjourned at 3:56 p.m.)

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CERTIFICATE

I do hereby certify that the foregoing is a true and correct transcript of the proceedings taken by me in this matter on Wednesday, October 27, 2010, and carefully compared with my original stenographic notes.

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

My commission expires June 19, 2011.

(MDJ-3638)

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in

Case No(s). 10-1261-EL-UNC

Summary: Transcript Transcript of Columbus Southern Power Company hearing held on 10/27/10. electronically filed by Mrs. Jennifer Duffer on behalf of Armstrong & Okey, Inc. and Jones, Maria DiPaolo Mrs.