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**BEFORE THE**
**PUBLIC UTILITIES COMMISSION OF OHIO**

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| **In the Matter of the Application of Columbus Southern Power Company and Ohio Power Company for Authority to Establish a Standard Service Offer Pursuant to §4928.143, Ohio Rev. Code, In the form of an Electric Security Plan.** | ) ) ) ) ) ) | **Case No. 11-346-EL-SSO**<br>**Case No. 11-348-EL-SSO** |
| **In the Matter of the Application of Columbus Southern Power Company and Ohio Power Company for Approval of Certain Accounting Authority.** | ) ) ) ) | **Case No. 11-349-EL-AAM**<br>**Case No. 11-350-EL-AAM** |

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**COLUMBUS SOUTHERN POWER COMPANY AND OHIO POWER COMPANY'S NOTICE OF FILING DEPOSITION TRANSCRIPT**

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Columbus Southern Power Company and Ohio Power Company, pursuant to Rule 4901-1-21(N) of the Ohio Administrative Code, hereby provide notice to all parties of the filing of the deposition transcript of Roy J. Shanker.

Respectfully Submitted,

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## CERTIFICATE OF SERVICE

The undersigned hereby certifies that a true and correct copy of the foregoing *Columbus Southern Power Company's and Ohio Power Company's Notice of Filing Deposition Transcript* has been served upon the below-named counsel and Attorney Examiners via electronic mail this 6th day of September, 2011.

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COLUMBUS/1600008v.1

BEFORE THE PUBLIC UTILITIES COMMISSION OF OHIO

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In the Matter of the Application of Columbus Southern Power Company and Ohio Power Company for Authority to Establish a Standard Service Offer Pursuant to §4928.143, Ohio Rev. Code, in the Form of an Electric Security Plan. : Case No. 11-346-EL-SSO
Case No. 11-348-EL-SSO

In the Matter of the Application of Columbus Southern Power Company and Ohio Power Company for Approval of Certain Accounting Authority. : Case No. 11-349-EL-AAM
Case No. 11-350-EL-AAM

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TELEPHONE DEPOSITION

of Roy J. Shanker, taken before me, Rosemary F. Anderson, a Notary Public in and for the State of Ohio, at the offices of Porter, Wright, Morris & Arthur, LLP, 41 South High Street, Columbus, Ohio, on Wednesday, August 10, 2011 at 2:00 p.m.

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On behalf of the Staff of the Public Utilities Commission.

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ROY J. SHANKER,
deposes and says as follows:

EXAMINATION

By Mr. Nourse:
Q. Mr. Shanker, are you here and ready to go?
A. Yes, I am.
Q. We will get started. My name is Steve Nourse, and I am representing Columbus Southern Power and Ohio Power Company in these proceedings, which I may refer to as the ESP or ESP2 cases, which is shorthand for Electric Security Plan. You are familiar with those terms?
A. Yes.
Q. And you are familiar with AEP generally; is that my understanding? Correct?
A. Yes.
Q. And if I refer to AEP or AEP Ohio, I'm really referring to Columbus Southern Power and Ohio Power Company. Do you understand that?
A. Yes.
Q. And, Mr. Shanker, I gather you have been deposed once or twice before.
A. Yes, I have.



Q. Okay. Since you're not here and you're doing the deposition telephonically, I guess we will be clear you have to give verbal responses or we won't be able to tell what you're intending. Is that clear?
A. I'm nodding now, but yes.
Q. Yes, that's what I thought.
If you don't understand any of my questions, please let me know and I will try to rephrase or clarify. If you do provide an answer, then it's assumed you understood it, correct?
A. Yes. I understand what you're saying.
Q. Okay. So let me first discuss with you the FRR as a general matter, and by "FRR," referring to the Fixed Resource Requirement option under the PJM tariff. Do you know what I'm referring to when I say FRR?
A. Yes. Specifically the -- well, yes, I do. I know in general what you're referring to.
Q. Okay. Now, do you agree, in general, that the FRR is an alternative to the RPM, which is the Reliability Pricing Model?
A. Yes. Load-serving entities can choose between -- eligible load-serving entities can choose



On behalf of Exelon Business Services.

between those options.
Q. Okay. And under the FRR, the entity matches their generation resources to their retail load; is that correct?
A. I think by general intent, yes, but specifically, no. PJM will establish a requirement that reflects their load obligations, but there are some adjustments that go further than just that.
Q. Okay, good. And what did you mean when you said eligible entities can choose the FRR option?
A. The FRR, if we would go through the document, there is a definition of who is eligible to be under the FRR.
Q. And what is your understanding of that restriction or whether it operates as a restriction?
A. I can give you as a general statement -- I always when I am asked this, I defer to the exact language of the agreement because it's a little complicated, but it basically would be an entity like as we defined AEP Ohio, and I believe there are provisions for municipals and cooperatives and some conditioning with respect to appropriate metering, but I'd really have to read the definition to be specific with you.



Q. Okay. Do you agree that the general purpose and the effect of the FRR option is to avoid RPM pricing?
A. You said the general effect or intent? I'm sorry.
Q. The purpose and general effect of the FRR is to avoid RPM prices.
A. I'm having trouble with the way you're phrasing the question. I think I understand vaguely what you're trying to get to, but as phrased -- the FRR is to create, one, reliable adequacy structure for the entity; and, two, as a result of choosing that option to be out of RPM, they are not participating in RPM and they are not priced against it.
Q. Okay. And you said reliable adequacy structure; is that the first part?
A. Yes.
Q. One second. Now, is it your understanding, Mr. Shanker, that the FRR load obligation, you mentioned that it was established by PJM and not necessarily by the entity; is that correct?
A. Yes.



Q. And that load obligation under the FRR option includes switching or shopping load in the FRR entity's footprint?
A. I think I can't answer that as posed. You have to give me a time frame.
Q. Well, as a general matter, under the FRR option, does the load obligation for the FRR entity include shopping or switching load?
A. It can, yes.
Q. And what would cause it not to be the case?
A. I'm sorry, I think we overlapped there. Would you repeat?
Q. What would cause it not to be the case when you say "it can"?
A. The plan as initially proposed is for 100 percent of load, and that would include any potential switching load. There are provisions that allow for -- maybe we need to be precise in nomenclature.
You said FRR entity, and the FRR entity can have some of its obligations displaced with proper notice, in this case, a rolling three-year structure by LSEs within the footprint of the FRR



entity, but as an initial matter, it does include all load. Subsequently it can be modified. The FRR entity's obligation can be modified, not the plan in total. That doesn't always include everything.
Q. All right. And the option you just referenced I believe is the same thing you're talking about in your testimony on page 7, in footnote 6; is that correct?
A. Hold on. Let me turn to that, please.
Yes.
Q. Okay. Can we call that the self-supply option, and we will be talking about the same thing?
A. Well, I'm a little uncomfortable with that, only because it creates some ambiguity. I think if we designate -- take the time to do a sentence with that, I'd be a little more comfortable. Sometimes to me self-supply can imply other alternatives.
Q. Okay. But if I talk about a CRES provider in Ohio, C-R-E-S, Competitive Retail Electric Service provider, referred to as CRES providers, are you familiar with that terminology?
A. Yes.
Q. Okay. And if a CRES provider does opt to

provide its own capacity, and I think in the terms you use in your testimony, establish its own FRR plan, that's the self-supply option I was describing. Is that --
A. Yes; as long as we -- I'm only concerned -- I don't disagree with what you're saying. I'm only concerned that "self-supply" gets used in so many different ways, but I do understand what you are referring to, yes.
Q. Okay. So on page 6 of your testimony you really make the statement I was looking for earlier where I asked you if the FRR was an alternative to RPM pricing, and you effectively say that on line 13, correct?
A. Yes.
Q. Okay. So under the FRR option, the FRR entity avoids paying RPM, and their load is taken out of the RPM auction, correct?
A. Yes. It is an adequacy alternative to participating in the RPM auction. They do not pay for capacity at the RPM price, but they maintain that capacity obligation.
Q. Would you agree that the generation resources of an FRR entity don't influence or affect



RPM auction clearing prices?
A. I don't -- I think we need some more clarification. I don't think I can answer it as posed.
Q. Okay. Well, the generation resources of an FRR entity are taken out of the auction, the RPM auction, correct?
A. Well, that's where we may be not being precise enough.
Q. Okay. Help me out.
A. Their resources are dedicated to the FRR plan.
Q. All right. And so therefore they're not part of the resources that impact or influence RPM auction clearing prices since they're not part of the auction process at all, correct?
A. Well, yes. But be clear, I said "some of them." You said "all of them," is the way you posed the question.
Q. And go ahead and explain that distinction then.
A. Well, the FRR entity may own more resources than are necessary for its plan.
Q. Right. Okay. What about those other



resources that aren't used to support the FRR plan specifically, can those be used in the RPM process; is that what you're saying?
A. Within certain limits, yes.
Q. Okay. And do you know the limits, the applicable limits, for AEP in that regard?
A. I believe there's a debt band, referred to as the threshold quantity, and I would have to look up the amount, and that's the lower end, and then there's an upper end that caps the sales at 1,300 megawatts, is I believe the current value.
Q. Okay. And what's your understanding of the purpose of that, you know, if you want to call it an exception or restriction?
A. My hesitation here is that those provisions were established as part of a settlement process at the Commission, and I'm not sure what part of my understanding comes from settlement, which may be may confidential, and which may be apparent someplace else that I just can't remember in terms of tariff statements or filings. So in terms of the settlement statements, I'm struggling with what potentially may be confidential information.
Q. Okay. Would it be fair -- regardless of



what settlement discussions you may have been in, would it be fair to characterize that as a way to true-up or as a cushion, if you will, for the process involved in the FRR of trying to match load and generation resources so that they're balanced in the end?
A. No. I don't think I would agree with that, no.
Q. Is there a percentage associated WITH the 1,300, or is it stated as a 1,300-megawatt limitation?
A. I think it's -- I'd have to look, but I think it says it's either 2 or 3 percent, not to exceed 1,300, but, you know, the RAA provision is available to us and we can look it up. I'm not sure if I remember the exact language.
Q. Okay. So it's a couple percentage. It's a small fraction of the FRR entity's load, that much you recall, correct?
A. The amount that can be sold, that is correct, yes, that can be sold by the FRR entity from its resources in excess of its requirement into the RPM auction is capped, that is correct. And it is a small percentage. I believe two percent, but I'm not

exactly sure. I have to look at the RAA.

Q. Okay. And if that were not permitted, then what would happen to that, you know, extra capacity where the load turns out to be less than projected as far as the dedicated resources?

A. I think you're mixing two concepts here. The, quote, excess is not necessarily a function of a deviation in the load forecast. It is somebody just may own more than what the requirement is.

Q. Right. Well, that's fair. But, again, isn't the idea of the FRR to match the resources that are dedicated to the load in advance?

A. Yes. That part is true. Where we're disconnecting is the property you've asked me about regarding, in AEP's case, as we were discussing, the up to 1,300 megawatts. You're meshing those two things together, and I think they shouldn't be combined in the way you're asking the question.

Q. Well, I understood your answer. That's why I was going back and breaking it down. So, yes, again, if the FRR is intended to match the dedicated resources to the load -- and you agree with that, right?

A. Yes.



Q. And if there weren't an exception or an allowance for some capacity to be used or cleared in the RPM, then couldn't the FRR entity get stuck with having extra capacity that couldn't be used that was already dedicated?

A. That could occur independent of whether it had a surplus. I think you're saying if their load forecast declines, would they have extra and could that be used, and I believe the answer to that question is yes. That's independent of the, quote, excess that we were talking about of that 1,300.

Q. Okay. Okay.

A. Those are separate concepts, at least to me they are.

Q. Now, on page 6 of your testimony you make the statement down on line 19 that "LSEs in AEP Ohio no longer have any opportunity for self-supply." Do you see that?

A. Yes.

Q. And that's, as you say on line 18, that's within the term of the current ESP -- or the proposed ESP, rather, that extends to the middle of 2014?

A. Yes. Yes. They have a limitation that really is driven by the RPM RAA requirement and that



limitation extends beyond the term of the ESP.

Q. So it's your understanding that it's too late under the PJM rules and the established process to do that, and it's just not possible at this point. That's what you're saying, right?

MR. ALEXANDER: Objection as to form, no time frame is specified.

Now you can go ahead and answer if you know.

A. Sure. Within the window, the three-year window that we were talking about, I do not believe that the LSE at its discretion can do that. And as I said, I was moving off the previous answer, but that's a good clarification. It's within the window.

I think the footnote we discussed earlier on the following page, footnote 6, explains that subsequent to that period, they do have the opportunity, and I believe I do discuss that in the testimony.

Q. Okay. And assuming those time restrictions are followed under the tariff, as you've cited it, do you agree that it is the CRES suppliers' choice to self-supply?

A. Okay. You mean subsequent to the end of



the time period as provided for in the provision identified in footnote 6, yes, that's their determination.

Q. Right. So it's accurate to say that CRES suppliers have decided not to elect the self-supply option during the term of the proposed ESP, correct?

A. You're saying as a factual matter did any of them elect a self-supply option during the ESP period. The answer to that is no, as far as I know.

Q. But it's based on their own decision not to pursue the self-supply option; is that accurate?

A. Well, only partially, and I think I discuss that in the testimony.

Q. Explain what you mean.

A. Well, certainly the ultimate actions of providing a self-supply plan or not, as the way we are now using the term "self-supply" and the way we've now defined it here, that ultimate action to submit one is there.

Your notion of responsibility is contextual, at least to me, or decision-wise is contextual, because the roles and the positions by AEP and the way that they have chosen to proceed made it unnecessary for -- as well as what has been

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subsequently confirmed by the Ohio Commission -- made it unnecessary and actually possibly disruptive for them to engage in what we are now calling self-supply.

Q. Well, your comments refer to the AEP Section 205 filing; is that what you're talking about?

A. No. What I'm talking about is that at the point of time during which a CRES supplier operating as an LSE within PJM could have made such election that would have applied for the ESP period, there was no need, and, in fact, it would have, I think, been inappropriate for them to make that -- or not inappropriate, but it would have been potentially disruptive to the market for them to have made such elections at that time.

Q. Would it have been economic for them to make that decision at that time?

A. Under the facts as known at that time, no, it would not have been, and under the procedures and the process by which transfer pricing -- and I use that term, and we may need to define it -- but the transfer pricing or charge for capacity between the FRR entity and the CRES, it would not have been

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economic for them to do so nor rational.

Q. So if we look at the current situation and projecting out three years, and again following the PJM RAA rule about doing this three years in advance, is that something that CRES providors today should look at from an economic standpoint?

A. Yes, it is. And I think I describe the consequences of them doing so in a context where the transfer price is set inappropriately.

Q. Okay. But is it your understanding that CRES suppliers today are interested in doing self-supply out into the future?

A. That's a different question. In terms of anybody's specific business plans, I don't know anything.

Q. Well, as a witness in this proceeding, and you're representing FirstEnergy Solutions, is that something FES has looked at and should be interested in doing?

MR. ALEXANDER: Objection.

Roy, you can go ahead and answer if you know.

A. Yes. There's two things. First, rationally would someone want to think about this and

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have I heard parties say, "Is that an option that should be considered?" The answer is yes, I've heard that.

In terms of the economic self-interest -- now speaking generically, not with respect to any knowledge of their decision process -- it may, depending on the results of this proceeding, be in their economic self-interest to do so. And I think, however, I've explained that if that became the case, there would be some very perverse implications for the market as a whole because that incentive would only exist if the underlying transfer price had been established inappropriately in this proceeding.

I guess actually maybe I shouldn't say "this proceeding." This and, I guess, 10-2929. I don't know how the final determination would be made by the Ohio Commission.

Q. Right. When a CRES provider would be reviewing that option of self-supply, would there -- what would their criteria, their primary criteria, be in reviewing that? Is it limited to or mainly the delta between costs and RPM market -- their own costs and RPM market projections?

A. No.

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Q. I think you answered the second question. You didn't answer the first. But do you recall the first question?

A. Well, I think you had asked me what they would look at and said would it be limited to the difference between their own costs and RPM, and I think my answer was no, it would not be limited to that.

Q. So what would be the other factors?

A. The principal factor would be the opportunity costs, which would reflect potential revenues in RPM versus the transfer charge from AEP to a CRES supplier, and, as I've said before and I've repeatedly discussed in my testimony, the undesirable results of that transfer price being other than the RPM RTO price.

Q. Well, again, my question is not what you think the undesirable effects are. I'm asking what the CRES provider would consider in reviewing whether they should exercise that self-supply option.

A. I'm sorry.

Q. So you've mentioned opportunity costs versus transfer charge. What other factors would they consider?

A. Well, they do need to consider the undesirable consequences if those prices diverge because the decision is being made outside of the horizon -- if we are talking about a decision today, it's being made with uncertainty regarding the transfer price structure, and there are significant negative consequences associated with self-supply in an environment where that transfer is set improperly.

Q. Okay. So uncertainty and negative consequences is another category. What else would they consider?

MR. ALEXANDER: Objection.

Go ahead.

A. Well, obviously they would have to look at their own anticipations with respect to -- well, first, I guess have to take a step back. I've been answering this, and I think you've put this in the context where I was thinking that we're talking about potential suppliers who are also participants in PJM markets and whose resources are in the PJM markets, because you referred to FirstEnergy.

In answering this question going forward, is that the predicate of the type of supplier we are talking about?



Q. I actually was going to ask you about that. If you're assuming that all the CRES providers you have in mind have capacity resources in RPM, that's fine, you can predicate your answer that way.

A. Well, we can split it. But the answer I was about to give was with respect to that, and I think there probably would be a balancing of potential obligations in the other markets. It's linked to the opportunity cost concept, but there may be other business arrangements that could extend even within PJM or outside of PJM that would influence that decision.

Q. So the extent to which they have capacity tied up in RPM and the consequences associated with that on the self-supply decision, that's another factor?

A. Or tied up in any other fashion in a business arrangement that may impinge on their flexibility to utilize that capacity.

Q. Okay. Are there other things that come to mind?

A. I'm sorry, I'm thinking. If it wasn't clear, this is linked up to what I consider and have referred to as a perverse result, and so if that's



already in one of the boxes that you've created, then we don't need to add that, but I would add that is something I see as a divisible issue.

Q. I think you're referring to your hypothetical that's page 17 through 19 of your testimony where you kind of lay that out. We will get to that.

A. I'm just looking to see if I agree with the pages.

Q. Okay. Go ahead.

A. Yes. There is a discussion, as you sort of described, that begins on page 17, that's correct.

Q. Okay. Now, one of the things you mentioned was as a factor -- first of all, are there any others that come to mind?

A. Not immediately, but I don't know that I've, you know, worked it through the way I normally do if I trying to make a decision or help a client with a decision like that.

Q. Are there any, I'll say, negative or obligatory aspects of the FRR self-supply option that would be part of the calculus in that kind of decision?

A. I hope we had established beforehand that



we were talking about the three-year window; is that correct?

Q. Correct.

A. That was what I thought was an ongoing predicate to this line of questions. That would be the first item.

Certainly the second would be that there are other conditions that apply in general that I wasn't thinking about because you were talking about their decision process, but there are -- I mean, the resources have to be unit specific. They have to be capacity resources, CR, within PJM and recognized by PJM and meet that definition. So they have to have the eligible resources or obtain eligible resources to start this whole process.

Q. So as part of that, obtaining those resources and then dedicating them as far as the FRR, they have to be obtained, as in either owned or contractually obtained, and they're otherwise uncommitted in the context of the FRR; that's what you're saying?

A. Well, again, we're talking outside of the three-year window, so they would not be a part of the FRR, nor would they be at that time committed to PJM.

They would be capacity resources that are eligible that the party has the ability to control or direct. But at that stage, other than the general obligations that would accrue as time passed, depending on their disposition that they are not committed.

Q. Okay. So putting that kind of resource into the FRR plan for a self-supply option, that would tie up or commit that resource for the period of the FRR, the planning year that is affected, correct?

A. If a CRES supplier wearing the hat as actually an LSE within PJM elected to designate eligible resources in the period beyond the existing plan and they met all the other requirements, they would then become part of the FRR plan for the -- I think we used the term FRR zone as opposed to area. That would be the area over which the FRR applies.

Q. Okay. So that resource would be tied up undertaking that commitment.

A. Yes.

Q. Okay. And what's the term that it would be tied up for?

A. The individual LSE designation appears to be a subset within the plan that would be updated



every three -- every year on a three-year forward basis. So I don't believe this is discussed explicitly, but as I understand the rule, it would then become a one-year obligation. It's in the context of the rolling obligation of the entire FRR plan.

Q. Are you saying it's your understanding that a CRES supplier could decide to establish a one-year self-supply option and then move all those same resources back out to RPM the following year?

A. I'm not 100 percent sure of that. I would have to check the exact wording. I don't believe it's written to make that affirmatively or not. I have to look at the language.

Q. You're not aware of a notice period or minimum stay period for an FRR entity?

A. For an FRR entity there is, yes.

Q. And wouldn't a CRES provider be considered an FRR entity under this example?

A. I am not sure that's the way the tariff reads, so I would defer that to be a legal question of the interpretation of the tariff, and right now I don't know if on my own I've attempted to decide that.



Q. Okay. Now, is it fair to say you're a consultant that represents generation owners in the PJM stakeholder process?

A. Yeah; among other parties. Yes, that's correct.

Q. Okay. And did you or your clients, the parties you represent, did you agree with the FRR when it was established?

MR. ALEXANDER: Objection.

Go ahead and answer if you know.

A. Well, let me put it this way. I publicly stated -- so we are now outside of the settlement process, which is what my concern is.

Q. Okay.

A. That I publicly expressed the fact that I did not believe there should be an FRR alternative.

Q. Okay. Do you still hold that belief today?

A. Yes. I believe the market would function better in the absence of an FRR alternative.

Q. Okay. Now, under the RAA -- and that's an acronym I'm not sure we spelled out for the reporter yet, but that's the Reliability Assurance Agreement, that's basically another name for the



tariff that deals with the -- includes the FRR provisions; is that correct?

A. The provisions that are relevant to the FRR selection are identified in the RAA, yes.

Q. Okay. Now, do you agree that the RAA allows an FRR entity at any time to make a filing under Section 205, the Power Act, to change the basis for compensation for capacity?

A. I need to read the exact provision just to make sure, the additional statement.

Actually, it depends on how you read the language, is what I'm going back to. I don't think I've actually thought about your question as to whether there were limits on the 205, and if you read the tariff language, it could be read that that would be conditional only in the absence of a state mechanism.

Q. Okay. And that's the subject of a pending FERC proceeding, is it not?

MR. NOURSE: Did someone just join the call?

MR. ARAGONA: Yes, this is Arin Aragona representing Exxon.

Q. So, Mr. Shanker, is it your understanding that you said it depends how you read that RAA provision we were discussing, and I asked you whether that dispute or difference of how you read the tariff is the subject of a pending FERC proceeding.

A. Let me answer in two pieces. I know there are two open FERC proceedings, a 205 and a 206 filing by AEP that they are involved with. Whether the conditional language that says "in the absence of a state compensation mechanism" is conditioning the availability of the 205 option, I'm actually not sure if that is a specific item of the appeal or request for rehearing.

Q. Okay.

A. So I don't know.

Q. That's fine. So just taking a couple examples of the FERC case we just mentioned, the 10-2929 docket you had mentioned earlier -- and there may be other venues where AEP Ohio's wholesale capacity charge could be changed -- would you agree that it's not presently known that the RPM rate will apply to CRES providers relying on AEP's capacity during the term of the proposed 2012 to 2014 ESP?

MR. ALEXANDER: Could I have that question read back, please.



(Record read.)

MR. ALEXANDER: Objection as to form. You can go ahead and answer.

A. I guess the answer is there is uncertainty as to whether the status quo, which is that charge, would continue. I think I agree with that, if that's the point of the question.

Q. Okay. Now, is there anything in the RAA tariff language -- by the way, when we talk about that tariff language, we're referring to Schedule 8.1, Section D.8, I believe, that you cite in part on page 11 of your testimony. That's the RAA tariff that we're talking about, correct?

A. That's the section there, that's cited there, I believe, that's correct.

Q. Okay. And this language that you have on page 11 is not the entire section, is it?

A. No, it's not.

Q. Okay. But in that part of the tariff, and part of which you quote in your testimony, do you know if there's anything that requires an FRR entity to provide capacity to CRES suppliers based on RPM auction clearing prices?

A. I believe the section that we just cited



reads that, "In the absence of a state compensation mechanism, the applicable alternative retail LSE shall compensate the FRR Entity," that is the retail LSE's CRES supplier, and then I put in brackets in "at [rest-of-pool or 'RTO' RPM clearing prices]."

Q. Again, your understanding only if a state compensation mechanism exists --

A. I'm sorry, what is the question?

Q. Well, I was not finished.

A. Okay. I'm sorry.

Q. You're saying only if a state compensation mechanism exists, that's the only condition under which an FRR entity would collect something different than RPM prices?

MR. ALEXANDER: Objection.

Go ahead.

A. Not necessarily, no, I'm not saying that.

Q. Okay. What are the other scenarios or conditions that would cause variance from collecting the RPM clearing prices?

A. Well, there is the provision to allow in the absence of that state mechanism, presumably in any circumstances under Section 206, the FRR entity to put forward an alternative price. That's



distinguished from which should be the property or the character of that price, and I think the testimony says that -- I think the best -- when you figure out what is it that is most consistent with the overall market design, the best answer would be the RTO RPM price, but I think I also state within the testimony that there may be other means to attempt to estimate the appropriate transfer price that matches the characteristics that are held by the RTO RPM price and that those might be other alternatives.

I tried to characterize the use of the RTO RPM price as the best alternative, and I believe specifically it is. But if you were trying to estimate a market price, understanding that market price within the FRR area is the correct transfer price, then I could envision -- and I state so in the testimony -- that somebody might estimate such a transfer price and get something slightly different than the RTO price and RPM.

Q. Now, when we are talking about this RAA tariff language, you had mentioned earlier the uncertainty as to the meaning of the language about making a 205 filing with FERC. Do you recall that?

A. Well, I stated that there is an -- the sentence reads -- you said "in general," or I thought or understood the question was "always," and the sentence in which that is contained says, "In the absence of a state compensation mechanism."

Q. Well, the language I quoted from the tariff says "at any time." But with that --

A. I'm sorry, not to argue with you, but the whole sentence says, quote, "In the absence of a state compensation mechanism."

Q. Yeah, I understand. I understand what you're saying. We both have language we can rely on and argue, and I'm not intending to do that either. What I'm asking you is a background question leading up to my next question.

So you recall that, as we just illustrated, there's a difference in opinion of how you interpret that language about the 205 filing, correct?

A. Well, with respect to -- I said there may be, and I said that I wasn't sure if that specific element was part of the ongoing disputes at FERC or not.

Q. Okay. So do you recall language in this



same section of the RAA tariff that also allows CRES providers and other market participants to file 206 complaints as well?

A. I don't know if I remember anything explicitly that states that. I'm not aware of any limitation on that either.

Q. Do you have the tariff handy where you can look at that entire section, not just the part you quoted on page 11 of your testimony?

A. I have page 11. Are you talking about the entire RAA?

Q. Well, this section of the RAA.

A. The last sentence -- I'm sorry, I do have a version of it available.

Q. Okay. Can you read the last sentence out loud?

A. Yes. I'm trying. It's a long sentence.

MR. ALEXANDER: Just for clarification, are you talking about the last sentence of Schedule 8.1 Section D.8, Mr. Nourse?

MR. NOURSE: Well, he's the one that referred to it. He can clarify. I believe so.

A. Unfortunately, I believe that the version I have of the RAA is dated, so --



Q. Well, we're a bit handicapped because we are not here in the room to be able to --

A. I think I can maybe get to your point, even with the dated version, in that there is conditioning provision that says a retail LSE -- this is the June 1, 2007 date. This is the version that I seem to have here.

"A retail LSE" -- which, again, in the context of this discussion is the CRES provider -- "at any time may exercise its rights under Section 206 of the Federal Power Act." I think that's what you're referring to.

Q. Yes. So what does that mean to you?

A. It means that -- I think it means exactly what it says, but I think that's always the case, is that any party with appropriate standing has the right to file a complaint and exercise its rights under Section 206 of the Federal Power Act. That would include, obviously, all CRES providers, and I think you asked as well as the FRR entity, I'm not sure, in your original question.

Q. Okay. So if there is a state mechanism under this section of the RAA tariff, can a CRES provider file a Section 206 complaint at the FERC



attacking or challenging that state mechanism?

A. I think you're taking a step that goes beyond -- that introduces potential legal issues that really are -- that are a legal judgment that I could see being argued in both ways, and I'm not sure that -- I mean, I could probably tell you what the alternatives might be, but I don't know that I can answer dispositively whether that conditional statement assumes that or not. I doubt that it does.

Q. You doubt it does what I asked in my question?

A. That I doubt it limits their ability to file a 206.

Q. Even at FERC concerning a state compensation mechanism?

A. Yes. Boy, we're going down a lot of branches of conditional statements with respect to when and what and under what conditions someone can exercise certain legal rights, and --

Q. Yeah. Mr. Shanker, I'm not asking you for any kind of legal conclusion. You are an expert, and you're holding yourself out as an expert under not only the RAA but the PJM in general and the RPM market and all those related matters.

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This particular provision is a key provision in this whole discussion in these cases. So I'm asking you, you know, a simple question, under that provision, and that is, if there's a state mechanism, like you're maintaining there is in Ohio, does this sentence mean to you that a CRES supplier can file a complaint at FERC if they want to challenge or contest the state mechanism?

MR. ALEXANDER: Objection.

Go ahead.

A. Well, the language speaks for itself. The issue I'm having is that I'm not sure that even if there were language to the contrary here, that it would ban -- that's what's creating the problem here for me, because I can see circumstances where a complaint would be available no matter what. But certainly it does say that a retail LSE may at any time exercise its rights under Section 206, and it is subject to that same -- at least in the version I have -- in the absence of a state mechanism. But my opinion would be that the 206 rights would persist no matter what.

Q. Would it be fair to read those two sentences in the same manner?

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MR. ALEXANDER: Objection.

Go ahead.

A. Actually, no, I don't believe so, and that's where I think the difference may lie.

Q. Well, that's what I figured, but I just wanted to ask you and confirm.

Okay. So let's talk a little bit more about the self-supply option that you've referred to here so far just to drill down a little bit more factually here. What was the most recent PJM planning year for which CRES suppliers could supply their own capacity under that self-supply option?

A. The year would have been -- counting on my fingers, hold on. 2014-2015 planning year.

Q. 2014-2015?

A. Correct.

Q. Okay. And when would the election for that period have been made?

A. I'd have to go back and read specifically, but a few months in advance of the auction.

Q. It would have been the spring of this year?

A. Yes.

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Q. Okay. And you may have stated this in one of your prior answers, but did FES, or any other Ohio CRES provider that you're aware of, elect to pursue the self-supply option?

A. Not that I am aware of.

Q. Okay. I'm trying to skip through some questions we've already talked about here. Would you agree as a general matter, Mr. Shanker, that the theory of regulation is to replace competitive markets and competition? That's the justification for economic regulation of utilities.

A. To replace competition?

Q. To fill the void where there is no effective competition.

A. I don't think I would say it that way. No, I don't think I agree with that characterization.

Q. So historically when utilities had monopolies over certain things and there was no competition, you don't agree that was the basis for, the justification for economic price regulation?

A. I think the -- now, depending on how far back we're going in time, but I think if we're talking about the traditional regulation of vertical companies, you know, going back over a century, there

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were considerations about what constituted a, quote, natural monopoly where competition would lead to inefficient results, and that regulation was put in place to avoid that and, to some extent depending on the nuances of how it was actually implemented, to replicate what might have been a competitive result and certainly to, I think most traditionally, have engaged in a cost-based regulation.

Q. Okay. And would the reverse --

A. The term "replace" doesn't strike me as being either of those.

Q. That's fine. You can describe it as you want to. I think you just did. So would the converse also be true, that in a competitive market where competitive markets control the price, there's no need for regulatory price controls? Is that true?

A. No. Well, this is somewhat tautological if by competitive you mean the conditions that an economist might say surround the presence of perfect competition, then that would be -- I would agree with the statement.

If we're talking about the markets where there are -- like PJM, where there are competitive market-like elements in establishing the pricing, I would not agree that there's no need for regulation.

Q. Right. So you would agree that the PJM market and the RPM market, in particular, they're not purely competitive markets?

A. They are not really competitive markets. They are market mechanisms that do not match all the conditions for perfect competition and have associated regulatory protection.

Q. So it's a hybrid or a blend of market mechanisms and regulatory pricing restrictions; is the accurate?

A. It is a hybrid. I don't know that it would be just those two elements, but it is a hybrid of market-like mechanisms and other associated rules, yes.

Q. But it is a market -- it's a hybrid of market and regulation, isn't it?

A. Yes. There is -- there are both market type mechanisms and regulatory conditions that apply to the operation of those markets, yes.

Q. So would it be fair to say that in that context of a hybrid, as we've called it, some regulatory rules may apply and others may not, while some market principles may apply and others would



not?

A. If you're trying -- I'm struggling between -- now, you're talking any market? Are you talking PJM? Are you talking actual implementation, or are you talking intent?

Q. Let's just focus on the RPM market for purposes of this discussion, and I think you agreed that it's a hybrid in the sense that it has some components of market and some components of regulation, correct?

A. Well, this is -- the answer is --

MR. NOURSE: I think that Mr. Weston has joined. Bruce Weston just signed on for OCC.

MR. WESTON: Thank you. I'm not entering an appearance. Thank you for that.

Q. Do you recall the question, Mr. Shanker?

A. I think so. What I'm trying to distinguish and to make clear that there are regulatory elements in this hybrid, but the intent of those regulatory elements is to try and conform the market-like mechanism for the conditions that would be expected under competition.

The way you're asking the question you're suggesting they're at odds with each other, and I



think that intent is, while nothing is perfect, the intent is to try and use the regulatory conditions to complement the accomplishment of a market mechanism that looks like it's operating under fully competitive conditions.

Q. Correct. And that's where I started with my initial question, Mr. Shanker, that that is what justifies regulation. But my point now -- you may be reading negative implications into it -- but the point of my question is simply to ask you whether you agree that in this hybrid, as we've described it, some regulatory principles apply and others would not; while some market principles or theories would apply and others would not. Do you agree with that?

MR. ALEXANDER: Objection, asked and answered.

Go ahead.

A. No. I think that changes what I just answered what your question was. When you talk about regulatory principles, if you were to define them as I did, which were actions that were under regulatory authority to attempt to make the market function as closely as possible to a competitive regime, then I would think we would agree.



But you're using the term "regulatory principles" in a very open-ended way, and I have no idea what you are implying with that.

Q. Okay. Is it your opinion that the RPM -- and we've confined our discussion here to the RPM, this series of questions. So does what you just said apply to the RPM, that the regulatory controls emulate a market or a more pure market mechanism that is a result of the way the RPM is designed?

A. The intent of the regulatory overlay is to accomplish that, yes.

Q. Okay. By the way, when we are talking about this capacity rate, this wholesale capacity rate that CRES suppliers pay for capacity that they're relying on or using from AEP Ohio, you would agree that is a wholesale charge, wouldn't you?

A. The value established is coming out of the wholesale market. The conditions of it being established within Ohio as to whether that constitutes wholesale or retail I think is in dispute, and I'm not sure that at this stage that's material to my conclusions --

Q. Well, we can leave to others what is material.

A. -- in terms of the wholesale market. And I can see how it could be under different conditions what is under a retail structure could be both either federal or state, so I don't really have an opinion on that for here.

I think it is -- I think actually AEP has argued that it's a state rate and then it's federal, and it's gone up and back. The answer is that I don't have a final conclusion on that myself.

Q. Okay. Well, I appreciate all your thoughts on all those various issues, but what I'm asking you is whether the charge that's paid by CRES suppliers through the RPM market to cover the capacity we're relying on of AEP Ohio, is that a wholesale charge in your opinion?

A. If the payment were to purchase capacity from PJM, it would be a wholesale charge. As a payment to AEP at the transfer rate as part of the retail structure, it might be a retail rate. And I don't think I know enough about the specific conditions, nor do I really need to know, for a conclusion on that.

Q. Well, that may be your opinion, sir, but I'm asking you because I think it's material and



relevant. Are you saying that this charge that's paid through the RPM process and through PJM involves retail customers directly when it's paid?

A. The RPM rates in general do not. The retail structure in Ohio I think is a point of dispute, and, as I said, I don't think I know the answer.

Q. What makes you say it's a point of dispute?

A. Well, my understanding has been there's been some argument about what constitutes wholesale and retail jurisdictions here.

Q. And I'm not asking you about jurisdiction. I'm asking you as an expert in PJM matters and RPM matters, how does this charge get levied and what parties are involved, and I'd like to know if there's a retail customer involved. With the focus on that, can you answer that question?

A. If we are talking about the capacity payment provided by the CRES, the issue is whether by the CRES providor or through the CRES provider, that that would be, if it's for their purchase of capacity that is then resold to their customers, it is a wholesale charge.



Q. Is that your understanding of how it is charged?

A. I believe so, but I'm not 100 percent positive.

Q. Okay.

A. What I'm trying to get to is if there's a transfer price and a retail, then it would be a retail charge, and it would pass from the customer of AEP as opposed to the CRES entity repurchasing.

Q. Are you aware of other state compensation mechanisms as that term is used in the RAA tariff?

A. I'm sorry, I don't think I understand the question.

Q. Are there any other states that have adopted state compensation mechanisms, as that term is used under the RAA tariff?

A. Now we're talking specifically in the context of the FRR, I'm not aware of any.

Q. So the December 8, 2010 entry in the 10-2929 case here in Ohio, that was the first state commission you're aware of that established a state compensation mechanism under the RAA tariff?

A. Under the FRR terms, that's the only one I'm aware of, yes.



Q. Okay. Let's shift to a new topic and talk about the RPM market and how it functions and its effectiveness. Okay?

A. Yes.

Q. Do you think the FRR market is effective and functions well?

A. Boy, that's a complicated question. In terms of meeting reliability requirements, I think it is effective and functions well. In terms of setting pricing, I believe there are a number of deficiencies.

Q. Can you list your major criticisms or deficiencies when it comes to pricing under the RPM?

A. Well, there's a couple things. There are -- some of the demand is withheld from the base residual auction, which is one criticism. There are a number of backstops that interfere with some of what I would call the market-like mechanisms. There is the potential for the exercise of buyer market power, and it may or may not be occurring. I think those are the principal concerns I have.

Q. Okay. I heard three. I'd like to circle back and talk about those a little bit and maybe talk about some others. The first one is that demand is withheld from the base residual auction is that what you said?

A. A portion of the demand is not represented in the base residual auction, correct.

Q. Okay. Can you explain that a little bit more?

A. PJM -- well, the specifics are that the forecasted load is reduced by 2.5 percent in the base residual auction with the stated intent that that would be incrementally procured in the incremental auction based on -- well, several factors were suggested as to why it occurred. But, again I think this comes out of the settlement process.

Q. And that holdback definitely lowers the clearing price in the auction, correct?

A. Yes.

Q. And would it be accurate to say it artificially reduces the RPM price that clears the auction?

A. I always get concerned, and I do it myself, with the term "artificial," but it is an inappropriate reduction, from my perspective.

Q. Okay. And then the second one you mentioned, the number of backstops that interfere



with the market pricing mechanism of the RPM, can you summarize those briefly?

A. Well, the principal ones are -- I can't remember the number of megawatts, but that if there is an anticipated shortfall or if the market is short of its targets for a specified -- I can't really remember the number of years. It may be two or three years in a row -- PJM may then undertake additional out-of-market procurement.

Q. And how would that, in that scenario, how would the additional out-of-market procurement work? Is that spelled out? Do you understand how it would work?

A. I think it is spelled out. I haven't looked at it in a while. I think my summary is that PJM would procure it, is probably the best I could do right now without going through and reading the exact language.

Q. Would it be based on price regulation and embedded cost?

A. I don't know if backstops is like that. I'm not sure. I think they would just enter into an agreement. I'm not sure that there's anything that prevents that from being an auction-like mechanism or



other. But I would literally have to go back and read the tariff with respect to that.

Q. Okay. Any other backstops you had in mind when you made that statement?

A. Depending on the deviation in the forecast, there are some incremental procurements that could take place in the incremental auctions, and those constitute a form of backstop.

Q. Okay. Any others?

A. That's all that I'm thinking about now.

Q. Okay. Then you mentioned a third major flaw, that buyers can potentially exercise market power under the structure of the RPM. Can you explain that a little bit further?

A. Yeah. I mean, the market works with a demand curve, and it's a relatively steep demand curve, so there may be an incentive to a party that has market power, that can exercise market power, to bring uneconomic new entry into the market, and that would suppress prices.

Q. Are you aware of other criticisms that may have been raised by stakeholders or the market monitor or state commissions that you don't necessarily hold true to your belief but that are out



there being debated?

A. Yes.

Q. And what are those?

A. Some of them relate to a belief that the forecast overstates demand, the forecast and some of the drivers of the forecast, and that as a result, prices are too high.

Others relate to the reliability planning criteria for local deliverability areas, LDAs, that the local deliverability criteria, which is what drives the capacity emergency transfer objectives of the market, are too stringent and that results in an overstatement of pricing.

Q. That was local delivery areas?

A. Yes; and the capacity emergency transfer objective, that the associated criteria for those are too stringent and leads to excessive pricing.

Q. Any others that you're aware of?

A. In thinking about this deposition, I haven't organized my thoughts that way, but there are literally probably several dozen criticisms on both sides of the ledger, and you'll probably see a summary of those shortly. And there has been near chaos from the Brattle Group, who has been asked to

assess the market.
Q. Now, are you aware of actions undertaken by states, such as Maryland and New Jersey, that have been undertaken in order to address or work around some of the RPM flaws?
A. Well, they have taken actions that impact on RPM. I don't know if you want to say which specific flaws or what actions, then we can talk about it. But generally the states are engaged in capacity-related activities, both of them.
Q. And what capacity-related activities are they undertaking?
A. Well, Maryland has a pending -- actually, I don't think it's a pending RFP. They have a pending proceeding. They've issued a draft RFP for procurement. As of now, I think that process is pending, which would be to look at buying new-only generation located within Maryland.
New Jersey has what they refer to as the LCAPP. I'll get the initials wrong, but for now, LCAPP. That's Capacity Acquisition Pilot Program. I'm blanking with respect to what the L is. And that passed last year and has pending procurements of approximately 2,000 megawatts from three new



facilities. And both states are obviously actively involved in the PJM stakeholder process.
Q. Okay. Would you agree that the RPM clearing prices have been volatile since it's inception?
A. Boy. They have changed from year to year, and in some cases significantly. I would agree with that, yes.
Q. Okay. So significant changes in prices from year to year, is that not volatility in your mind?
A. Well, boy, I guess -- in a very general term, as you and I might just be talking, I think the term "volatile" would be fine. If you are implying some sort of variance that is structural in the terms of the way the prices are determined, I'm not sure that I would agree with that. So that's the distinction that I'm trying to come to.
There are certain structural things that take place within the market that would lead to some of these changes. Some are exogenous. Like the recession certainly has changed demand, and to the extent that moves prices, I think that would fall within traditional volatility.



To the extent that there are changes in transfer capability that are an outgrowth of the transmission planning process, those are more expected deviations between supply in separate regions, and I don't know that that would fall under the typical notion of what I would consider volatility. I mean, that's supposed to happen.
But that's why I'm trying to condition it as yes, there have been changes in the price, and I think conversationally people may use the term "volatility." I think you have to partition what is going on into several pieces.
Q. Okay. And if you were to compare the RPM prices to a cost-based rate, would the cost-based rate -- on a relative basis, would the cost-based price be more stable than the RPM price and less volatile?
A. Over what period of time?
Q. Let's use the same period of time, 2007 through the present.
A. If we're talking about -- I guess a cost-based rate, if you are talking about just the recovery of a capital asset under cost-based rates, is that what you're referring to?



Q. A cost-based rate for capacity, yeah.
A. If we are talking about sort of abstract positional cost-based rate-making that's independent of a market mechanism, you would expect that to be less variable over time, yes, within the time window we were discussing. So if you had a dollar in capital in a cost-based return structure over that same period, the charges would not look as variable as RPM prices.
Q. Okay. Now, you are aware of the RPM auction clearing price for the 2012-2013 planning year. Is that approximately $16 a megawatt-day?
A. Yes. Well, yes. I'm just looking them up, but, yeah, $16.46. Yes.
Q. Okay. And do you expect that to hold in the future in the next few years at that kind of low level?
A. No. And there would be several things contributing to the changes, but no, I don't.
Q. And why do you estimate that -- are you saying you estimate it will rise, continue to rise in the subsequent years?
A. No. Let's talk -- I think it's easier to say what influences it than where I expect the prices

to go. I rarely, if ever, offer forecasts of where I think prices will go.

Those results were low, and several factors influenced that. In particular, actually, probably one of the largest factors was congestion in terms of the ability to deliver into the eastern part of PJM, which would drive up prices in that area and reduce prices because -- it's almost like they're constrained-on resources in the East, and those are accounted for in terms of the total resource supply for the pool as a whole.

And so as we build out transmission capability, which is one of the structurally anticipated sources of variation, you would expect that differential, that split, that east-to-west split, to decline, and, indeed, that's actually what we saw in the last auction.

Q. So but you're saying the $16 auction clearing price was in part caused by the congestion factor and the East Coast prices going up and the Midwest prices going down; is that what you're saying?

A. Well, part of the -- the fact that the East Coast prices, eastern PJM prices, went up



reflected limited transfer capability or getting close to the limit on transfer capability, and what that does is effectively constrain on generation.

When you look at the RTO price as a whole, it is actually done simultaneously when they did the calculation, but you can think of it sequentially. They had to get extra in the East, might be a way of looking at it, and, of course, as you got incremental additional supplies in the East, they were more expensive.

But then when you look at the requirements for the RTO as a whole, having been forced to have those additional resources, the demand for the rest of the RTO resources is lowered because you've constrained on some in the East.

And that was a material factor in the auction. There was also just differences in supply, too. I mean, there's a couple things going on. That was one of the factors.

Q. Would you agree the $16 price, that the RPM is bottoming out and is likely to go up?

A. Well, it has gone up. Like I said, I don't like to give price forecasts one way or another.



Q. Okay. Let's talk about the influences that you mentioned that you expect to impact in the future years. Can you explain?

A. Well, a lot of it is due or would be a result of various issues that we were talking about. Like if the 2.5 percent holdback was removed, that would tend to send prices higher. If the CETO criteria were reduced, then that would tend to send prices lower.

If the recession gets deeper, prices would get lower. If the economy accelerates, it would get higher. If demand response -- unlimited demand response becomes more viable with some of the FERC order 745 changes, those are in the energy market, but those would likely reduce or incent capacity function on demand response, and that would tend to lower prices.

If new transmission is built, it would tend, at least some of the things that were planned, would tend to lower prices in the East and raise prices in the West.

EPA changes for environmental controls on generation would to some extent either raise costs or potentially -- for individual units, or potentially



force them into retirement, that would tend to raise costs.

Maryland or New Jersey-type activities that would comply, let's say, with the appropriate restrictions that wind up adding additional supply would tend to lower costs.

The renewable portfolio standards, which are exempt from any kind of market mitigation, I think PJM is looking at scenarios over the next blank years of 42,000 megawatts of interconnection -- some of that is obviously derated for capacity purposes -- but that would tend to significantly reduce prices.

So I'm not sure. As I said, I don't do forecasts and I don't know how you amalgamate a trend out of that unless you actually attempted to do a forecast.

Q. Okay. Now, you're familiar with the energy and ancillary service offset to CONE, cost of new entrance, CONE?

A. New entry, yes.

Q. New entry, I'm sorry.

A. That's fine.

Q. That's based on an historical calculation that may have no relevance to current or future

market prices, correct?
A. Well, let's break that into a few pieces. Is it based on historical prices? Yes. You said "may" have no relationship, so I guess the answer is potentially it may not be related.
Over time the intention was for that to catch both up and down over time, and so it's a process as opposed to any individual year would be expected to have a relationship to prices.
Q. Over a long period of time.
A. Over a number of years, yes. The whole design was to look at sort of a business cycle type approach to the pricing.
Q. So is that one of your criticisms of RPM, or just other voices?
A. I'm sorry, is what?
Q. The offset.
A. The use of the historic offset is not something that I have specifically criticized. There are things in the calculation of energy and ancillary services that I think should be different.
Q. Okay. Now, do you agree that the RPM model is designed to attract peaking generation?
A. You mean exclusively?



Q. Well, that's the focus of how the administrative demand curve is calculated?
A. Well, there's a difference between how you establish the demand curve and what type of generation will be responsive to the attempt, so you have to clarify your question for me.
Q. Would you say the RPM is designed to attract investment in baseload capacity?
MR. ALEXANDER: Was that "attract"?
MR. NOURSE: Attract, I think, yes.
A. Boy, you say "designed to." I'm having trouble with that as well. If it was done the way I would have designed it exactly, the anticipation would be that it would be neutral, other than changes in exogenous factors, like low growth and load shape between the choice of technology, you know, assuming equilibrium-type conditions.
Q. Neutral relative to baseload, combined cycle, peaking, is that what you're saying, neutral?
A. It should have been. I think as implemented, there may be a bias towards less capital-intensive alternatives, likes peakers. But there's a difference between the design intent and, I think, the empirical fallout, and that's the



distinction I'm trying to make.
Q. That's fine. That was my next question if you couldn't agree to the design.
Now, generators are capped at offers, in many cases, below cost due to the parameters of the PJM rules and the market monitor's interpretations. Could you agree?
A. You have to define "cost" in that sentence.
Q. That's true. They're below their embedded costs, certainly, to start with, right?
A. Your embedded capital costs only, with no adjustments for energy and ancillary services?
Q. Let's start there.
A. I'm trying to be precise because these are things we are arguing about.
They are capped at their -- I think it is easier to say affirmatively what the cap is, which is the avoided-cost rate, which is defined in the testimony in terms of the components and in the tariff.
As a general matter, could that be at a value including offsets of less than the strict embedded cost of a traditional capital-only



accounting? The answer could be yes. Empirically it may turn out different than that for a highly depreciated asset.
Q. Okay. And that's really what I was asking. Is it -- does that happen, not that it -- so there are various parameters that would affect the answer, but it does happen.
A. It could happen either way. But when it's empirical, it's two different metrics of cost so it would be different.
Q. And there's a constraint of 150 percent of net CONE, correct?
A. For a new entry offer and under certain conditions, but the offers actually can exceed that under certain conditions. They may not clear, but they can exceed that.
Q. Yeah. I was focused on clearing prices.
A. Yes. The offers themselves, there are conditions where existing offers' caps can be much higher than that.
Q. Right. And there are conditions where the unconstrained RPM price might be higher or lower than a cost-based charge, regardless of which definition of cost you use; isn't that true?

A. What do you mean by "unconstrained RPM price?"
Q. Well, I think you used that same term in your testimony.
A. If you could point it to me and we could use it in the same context, that's fine. I don't remember that right now.
Q. Well, let's just say auction-clearing RPM prices.
A. It's a clearing price, okay. What's the question again, now that we're talking about the clearing price?
Q. There are circumstances where the clearing price for RPM would be lower or higher than a cost-based charge.
A. If we define the cost-based charge the way we were talking about before, the answer is yes, embedded costs.
Q. And are you limiting it to embedded costs, the answer to that question? If it included offsets or --
A. It could be higher or lower if you included offsets as well.
Q. Okay. Under the theory of the RPM and



design, what is the expected result of clearing prices over time?
A. Just for RPM, the expected -- the design result should be the net cost of a new peaker. The present value of the expected results would be the net cost of the peaker, and I'm saying net, net of energy and ancillary services offset over time.
Q. Okay. Now, what happens to RPM clearing prices in the long run if new capacity is not built or if existing capacity is retired?
A. Freezing everything else?
Q. All else equal.
A. You're assuming low growth?
Q. We don't need to complicate it that way.
A. I mean, if you reduce supply and everything else stays the same, the price would increase.
Q. Right. And that's true under the retirement example as well as just the fact that capacity is not built; would you agree?
A. Well, the capacity not built now gets into issues about transmission and low growth and things likes that. If you remove existing supply and everything else stays the same, then definitely, you



know, prices would go up. If you're assuming -- you got to tell me more about not built.
Q. Yeah. Yeah, I understand your point.
Now, do you agree that CRES providers -- I'm using this example, you know, here in Ohio where, as you stated earlier, none of the CRES providers have done self-supply or their own FRR, so they're relying on AEP's capacity. You agree they should pay the RPM in years when it is much higher than a cost-based capacity rate would be?
A. I think the better statement of what I've presented here is that the transfer price should be -- that is, that the effective cost that they pay, say we kept the status quo where AEP is providing all of the supply, that that transfer price should be the RPM RTO price, regardless of its relationship to AEP's, quote, embedded costs. If it's higher, it should be higher. If it's lower, it should be lower.
Q. Okay. Now, you mentioned a couple of different times your hypothetical example that starts on page 17 of your testimony, producing what you call perverse and uneconomic results.
A. Yes.
Q. Now, are you saying that CRES self-supply



capacity under the PJM RAA tariff has perverse and uneconomic results?
A. If the transfer price is not established at the RTO value, then yes. That's the linchpin in making all the pieces fit together. Once you do that, then presumably there's no reason to self-supply. The system would be indifferent, potentially indifferent, but we wouldn't get a bad result, or as bad a result, as you would when you change the transfer price to be higher than the market price.
Q. Is it fair to say that CRES suppliers don't have any need for or motivation to obtain their own capacity under this system?
A. If the transfer price is correct, only if the transfer price is correct. It's the distortion of the transfer price to not reflect market, and in this case to be significantly above market, that distorts the behavior and creates the bad results I discuss.
Q. So if the transfer price is correct and based on the RPM, in your opinion then CRES providers don't have any need or motivation to obtain their own capacity.

A. They should be indifferent, but for some of the rules, but in general there would be no need for them to do it, because you become indifferent if the transfer price is set at market.
Q. What do you mean by that?
A. Just what I tried to describe. Obviously, I didn't do a good enough job. If the value you get for selling into RPM is the same as the value you get in terms of transferring it to provide retail load in the FRR entity's zone, then you're indifferent, and it doesn't distort the allocation of the resources between one application and the other.
Where you have a nonmarket price that is significantly higher, then you create perverse incentives for people to withdraw capacity from PJM and dedicate it to use in the market where it's not -- where they're being charged more but where its value is actually not as high as the charge, which would be the AEP FRR entity zone.
Q. So if the capacity pricing for this -- for the CRES retail load to support that remains at RPM, you're saying that the CRES suppliers' permanent business model would be to buy capacity from AEP?
MR. ALEXANDER: Objection.



Go ahead.
A. If all other things equal, they should be indifferent between self-supply and doing just that.
Q. So there are no obligations or potential detriments associated with being a self-supply entity, other than the RPM pricing you're focused on?
MR. ALEXANDER: Objection as to form. Go ahead.
A. I'm not sure I understand the question. You're saying -- maybe you can just reask it. I'm not sure I understood it.
Q. You're saying the key, and really the single criteria, or when you say they're indifferent in your answer, is that the RPM price -- that the capacity remains at the RPM price?
A. In terms of getting the right behavior, yes, in terms of the incentives. Would they potentially as you enter into a bilateral agreement to lock in prices based on their own business expectations over time separately? They might do that. They might do that as a financial hedge.
But in terms of removing capacity from the market and distorting the spot market by effectively creating an incentive to send capacity



out of PJM, that goes away.
It doesn't mean -- I guess this means -- I may have oversimplified my answer before when I said they become indifferent. They become indifferent to the response to distort where they allocate their own resources.
In terms of a business strategy, they may engage in other sorts of hedges that would go beyond, certainly, to spot your price signal. But they should be doing that anyway, just based on their own decisions regarding future anticipations.
Q. Okay. On the bottom of page 17 in your example here, you say, "Once a CRES provider makes its own FRR election, the CRES provider will withdraw its capacity from PJM auctions." Do you see that?
A. Yes.
Q. Okay. So does that assume that all these CRES suppliers, providers, they have generation assets out there that are already tied up in the RPM; is that the assumption?
A. Going forward if they have the choice between deploying marginal resources within RPM or to -- they're CRES self-suppliers, we call them, in Ohio. They would have a false incentive, an



inappropriate incentive to push the resources into the FRR plan in AEP.
But this was in the context of people who were otherwise participating in the PJM market. Not necessarily all the resources would have to be RPM resources.
Q. But your statement here that they would withdraw capacity from PJM auctions, does that go beyond RPM, referring to something else?
A. No. If I'm sitting here and I'm making a decision as a CRES provider, and I have a resource that otherwise would have been offered into RPM say at $100, or whatever my guess is for the three or four years out -- and they would make their own business decisions, but, in general, it would seem they would be lower than the three or four times higher prices we are seeing suggested for cost.
But if they're making that decision as to, Do I offer it into RPM and get hypothetically $100, or do I use it to serve my own retail load in AEP and get effectively $350 of value, the choice would be to direct it into the AEP FRR plan as self-supply for that CRES supplier.
Q. Okay. Well, you know, you say what you

say in your testimony, so we don't need to go through the whole example each time I ask you a question about it.

I was asking you with respect to that sentence I directed you to, that you're assuming, are you not, in this statement, that CRES providers will withdraw capacity from RPM, which means they already have that capacity tied up in RPM. Doesn't that fairly state your assumption?

A. Yeah, and maybe -- the answer is that's what the words say, and maybe it's not explanatory enough, because, remember, the whole discussion takes place at the horizon before the next auction, you know, at the end of the existing FRR plan. That may be where we are talking by each other.

Q. No, that's fine. So you state next at the top of page 18 that that withdrawal we were just talking about will cause RPM prices to rise.

A. Right. All other things equal, you reduce the supply, the price goes up.

Q. Right. Okay. Now, does that statement assume that there's not uncommitted capacity that could fill that gap or that the current auction situation is not already oversubscribed?



A. In the way it's presented, no, I don't think that that matters. I mean, the notion is where would you direct the resource, and you would direct it to the highest value market. If there was sufficient surplus, you know, then you would think that the PJM price would be very low and so there may be more available, and so even more would get directed over.

Q. Yeah. But when you say in line 2 and 3 on page 18, that "due to the decreased supply of capacity," doesn't that assume that this withdrawal that you're talking about will be a reduction of the critical supply; that it will drive the price --

A. It would have to be supplies that otherwise would have cleared, and maybe that's -- that may be the clarification that is missing.

Q. And if there were oversubscription currently, or if there were other uncommitted generation assets out there, would that -- this statement wouldn't necessarily be true under those circumstances, would it?

A. If the -- that's an empirical point, and now I understand what you're saying. If there were sufficient surplus to displace all of AEP's FRR



requirement at a price that was -- that did not clear an RPM, at a price lower than the proposed AEP capacity price, then that would be the case.

But as long as the need in AEP in total is greater than the surplus of anybody's individual resources, they would have an incentive to offer as much as they can into AEP under these circumstances.

Q. Okay. But this example that you're talking about where you're assuming CRES providers will withdraw capacity, the capacity I thought you were talking about was withdrawing capacity from the RPM in a quantity or an amount that would cover their own capacity needs for retail customers to self-supply.

A. They might do that, but given the incentives, they should do as much as they can with whatever is reasonable because they're technically going to get paid, either displace the charge from AEP or presumably, as suggested, if they had extra resources put in, they would raise the question of what AEP would pay them if AEP was lined up with more load than the FRR plan than they had resources.

Q. Are you saying that CRES suppliers can just nominate whatever self-supply amount of capacity



they want to without any load forecast or other checks and balances in the PJM process?

A. Actually no, I'm not saying that. What I'm saying is that they would be encouraged to be as aggressive as they could about getting load into AEP and transferring capability there, and I don't know that there are any existing processes, other than very general ones, to address what constitutes appropriate behavior there.

Q. Okay. Now, you have a couple points here that you make. You say several effects of this example, and your first two I guess start on line 12, goes down to line 18 on page 18.

The first two points are just that under your assumption AEP's capacity obligation would be decreased by a commensurate amount of whatever the CRES supplier nominates under their aggressive approach. Am I right so far?

A. As I understand it, the way it's supposed to work is that the FRR entity is supposed to adjust the plan to incorporate the nominations of the LSE, so, yes, they would reduce AEP's requirements.

Q. All right. And that reduction or decrease is what you are referring to here as an

excess of capacity for AEP Ohio?
A. Yes. If it otherwise had been dedicated to the FRR plan and was no longer needed, yes.
Q. Okay. And then you go on in your second point to say that AEP Ohio will be unable to sell that, quote, unquote, excess capacity.
A. There's limits on that sale.
Q. Limits, are you referring to the 1,300-megawatt limit that we talked about earlier?
A. It says "because these types of sales are limited." That's the 1,300 we discussed earlier.
Q. Correct, okay. So that limit might or might not come into play in any particular situation. Do you agree?
A. Yes. If it comes into play, they're stuck, and if it doesn't come into play, then they would presumably sell it for the RTO RPM price, which is what we're proposing as the transfer price.
Q. Okay. And this distortion or perverse consequence that you conclude in this example, it seems to me that there are two aspects of what you're saying here. One is that you think AEP Ohio will be stuck with excess capacity, and if they can get rid of it, it will be at RPM prices. Is that one of your



distortions that you're identifying?
A. Yes. I mean, in the abstract they could sell it into MISO or someplace else, but the spot price that would be available to them would be the RPM price.
Q. And your second distortion or perverse consequence, to use your term, is that AEP Ohio would then essentially be forced to purchase the shortfall in capacity from the same CRES provider? Is that what you're saying?
A. I think that's listed as third. If the FRR plan itself would be deficient, that the distribution of the resources and the loads would be such that AEP potentially could become short, and then we would have to figure out a transfer price from the CRES provider who had self-supplied and wound up with more resources than load to AEP.
Q. Okay. You would agree under that example AEP Ohio is not -- would not be bound to purchase that capacity from the CRES provider?
A. No. I don't know that I would agree with that at all.
Q. So you think that would be their only option?



A. I think the same constraints would apply during the pendency of the horizon as apply now.
Q. And what are you referring to?
A. Well, there are no affirmative options within the FRR horizon for the CRES supplier to displace AEP's capacity with self-supply.
Now, it may be that AEP and PJM may permit that, but it is not affirmatively provided for. Similarly, going forward in the environment where the FRR plan is set and the resources are identified and AEP's plan includes the supply from the CRES self-supply, and AEP finds itself as a retail forward supplier with more load than AEP as a sales entity of capacity has in the auction, they will have to, out of the FRR resources, procure additional capacity. The question then becomes what is the price for that?
The whole reason these questions come up because the transparent -- the obvious solution is use the transfer price. Then everybody knows what the prices are. But the moment you create these kinds of incentives between the value in the market -- the value in the market and the cost-based compensation, you wind up with questions like this.



Q. Okay. But you agree they are questions that are not definitively answered as we sit here today?
A. No. I said I didn't agree with you. I said I thought the conditions would apply that AEP would have to, you know, wearing its retail or POLR obligation, would have the potential to have to purchase capacity from the other suppliers who had put assets into the FRR plan going forward if they were short. So, no, that's currently how I read the tariff.
Q. Okay. I think we will leave this hypothetical and take it up, perhaps, during the hearing later, Mr. Shanker.
Let me ask you to turn to page 21 of your testimony. I only have a few more minutes. You don't need a break, do you?
A. No. I'm fine.
Q. Okay. Good. Let's plow through and finish up.
Page 21 of your testimony you talk about the competitive benchmark price there starting on line 7. Do you see that?
A. Yes.

Q. Okay. And then this is in the context of the MRO test, correct?
A. Yes.
Q. And by MRO test, we are talking about the Market Rate Offer test that applies to a proposed ESP; is that your understanding?
A. Well, I get somewhat confused by the terminology, but I've always thought the ESP was what was being proposed and the MRO was the alternative as opposed to it was within the ESP, but yes.
Q. Yes, that's correct. And under -- in approving the ESP, the Commission is supposed to look at the effect of the proposed ESP and compare it to the expected results that otherwise would apply under an MRO. Is that your understanding?
A. Yes. With the conditional statement being that, you know, the share of the supply that is brought in under the MRO changes during the period, and it's that aggregate that's the test as opposed to just the MRO rate itself.
Q. I'm sorry, it's what?
A. It's that profile over time of the changing proportion, not just the MRO rate itself.
Q. So on the MRO side of the comparison,



you're talking about the price blend of the MRO price of the pure market-based price versus the blending of the adjusted SSO price.
A. I just wanted to keep the distinction, and actually the term "blend" is good. We'll talk about the MRO rate and then the blend for the test. That's the only difference. I wanted to make sure we were clear as to which we were talking about.
Q. Yeah. So, again, that's part of what I wanted to clarify your understanding. So it's your understanding that the proposed ESP rates during the term of the proposed ESP are compared to this price blending that occurs in the first few years of an MRO to see if the ESP is more favorable; is that your understanding?
A. Yes. Yes.
Q. So it's not just whatever capacity price is embedded in a competitive benchmark that drives the MRO test, mathematically speaking, correct?
MR. ALEXANDER: Objection, as beyond the scope.
Go ahead if you know.
A. Well, if you're blending a series of numbers, and a big hunk of the blend of each of those



numbers is the capacity price, then, of course, it impacts it. It's not the only thing.
I mean, this is more appropriate, I think, to ask Mr. Schnitzer. He actually computed both the MRO rate itself and then the blending and did the comparisons. I haven't done anything like that.
Q. Yeah, I understand. That's fine. Your statements so far have clarified what I wanted to clarify.
Just looking through some questions to see if I'm about done. Just give me a minute.
You had been involved in working for FirstEnergy Solutions in the FERC case, the Section 205 case that AEP Ohio filed where it initially proposed the cost-based capacity rate; is that correct?
A. The 205 filing correct, yes.
Q. Okay. And you had signed an affidavit in support of their protest, I believe, in that case. Do you recall that?
A. Yes.
Q. Do you recall if in that affidavit that part of the position you advanced was that the POLR



charge, Provider of Last Resort charge, that AEP Ohio had approved as part of its 2009 through 2011 ESP reflected capacity costs recovery?
A. Actually, what I said is that I believe it did because I was relying on a statement by Mr. Baker that said it did.
Q. Okay. But your position in the case was that that was one of the charges that was part of the 2009-2011 ESP that already reflected recovery of AEP Ohio's capacity costs.
A. Yes.
Q. Okay. Now, as I understand, your updated position here, reflected on page 35, you're basically saying that it doesn't -- you recognize now at this point, as you sit here today, that the POLR charges are not direct capacity revenues as you had thought they were in the 205 affidavit. Is that fair?
A. Yes. I think I explained that there was a bunch of questions that I would have as to the documentations and the type of discovery with respect to AEP's charges, and that in relying on Mr. Baker's characterization of the POLR charge being to stand ready to serve both energy and capacity needs, it was my understanding at that time it had been included.

And I think what has taken place since we got the information, that whether it was calculated right or not, the intent is relating to energy call transfers, not capacity.

MR. NOURSE: Okay. Thank you. That's all questions I have, Mr. Shanker. I appreciate your cooperation.

Unless someone chimes in on the phone here with questions, I think we're finished.

Thank you.

(The deposition concluded at 4:35 p.m.)

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State of Ohio :
: SS:
County of ________________ :

I, Roy J. Shanker, do hereby certify that I have read the foregoing transcript of my deposition given on Wednesday, August 10, 2011; that together with the correction page attached hereto noting changes in form or substance, if any, it is true and correct.

_______________________
Roy J. Shanker

*I do hereby certify that the foregoing* transcript of the deposition of Roy J. Shanker was submitted to the witness for reading and signing; that after he had stated to the undersigned Notary Public that he had read and examined his deposition, he signed the same in my presence on the ________ day of ____________________, 2011.

_______________________
Notary Public

My commission expires ________________, ________.

- - -



CERTIFICATE

State of Ohio :
: SS:
County of Franklin :

I, Rosemary F. Anderson, Notary Public in and for the State of Ohio, duly commissioned and qualified, certify that the within named Roy J. Shanker was by me duly sworn to testify to the whole truth in the cause aforesaid; that the testimony was taken down by me in stenotypy in the presence of said witness, afterwards transcribed upon a computer; that the foregoing is a true and correct transcript of the testimony given by said witness taken at the time and place in the foregoing caption specified and completed without adjournment.

I certify that I am not a relative, employee, or attorney of any of the parties hereto, or of any attorney or counsel employed by the parties, or financially interested in the action.

IN WITNESS WHEREOF, I have hereunto set my hand and affixed my seal of office at Columbus, Ohio, on this 13th day of August, 2011.

_______________________
Rosemary F. Anderson,
Registered Professional Reporter,
and Notary Public in and for the
State of Ohio.

My commission expires April 5, 2014.

(RFA-8660)

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