

BEFORE THE PUBLIC UTILITIES COMMISSION OF OHIO

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In the Matter of the :
Commission Review of the :
Capacity Charges of Ohio : Case No. 10-2929-EL-UNC
Power Company and Columbus:
Southern Power Company. :

- - -

PROCEEDINGS

before Ms. Greta See and Ms. Sarah Parrot, Attorney
Examiners, and Commissioner Andre Porter, at the
Public Utilities Commission of Ohio, 180 East Broad
Street, Room 11-A, Columbus, Ohio, called at 9:00
a.m. on Monday, April 23, 2012.

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VOLUME V

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Monday Morning Session,

April 23, 2012.

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EXAMINER PARROT: Let's go back on the record. Before we get started with our next witness let's take brief appearances of the parties. Again, names only. Beginning with the company.

MR. NOURSE: Thank you, your Honor. Steven T. Nourse, Matthew J. Satterwhite, Daniel R. Conway, Christen Moore, Yazen Alami.

MS. KALEPS-CLARK: Thank you. Lija Kaleps-Clark and M. Howard Petricoff on behalf of RESA Constellation, Direct Energy, and Exelon.

MR. HAYDEN: Good morning, your Honors. On behalf of FES, Mark Hayden, Jim Lang, and David Kutik.

MS. KINGERY: Good morning, your Honors. On behalf of Duke Energy Retail Sales and Duke Energy Commercial Asset Management, Amy B. Spiller and Jeanne W. Kingery.

MR. RANDAZZO: Good morning, your Honors. On behalf of the Industrial Energy Users of Ohio, Sam Randazzo and Frank Darr.

MR. KURTZ: For the Ohio Energy Group, Mike Kurtz.

1 MR. YURICK: Mark Yurick and Zach Kravitz
2 on behalf of the Kroger Company.

3 MR. SUGARMAN: Roger Sugarman on behalf
4 of National Federation of Independent Businesses of
5 Ohio.

6 MR. CAMPBELL: For Interstate Gas Supply,
7 Andrew Campbell and Melissa Thompson.

8 MR. KERN: Kyle Kern and Melissa Yost on
9 behalf of the Office of the Ohio Consumers' Counsel.

10 MR. JONES: Steve Beeler and John Jones
11 on behalf of staff.

12 EXAMINER PARROT: Thank you very much.

13 Mr. Nourse or Mr. Conway.

14 MR. CONWAY: Thank you, your Honor, at
15 this time the company calls Frank Graves.

16 EXAMINER PARROT: Mr. Graves, please
17 raise your right hand.

18 (Witness sworn.)

19 EXAMINER PARROT: Please be seated.

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1 FRANK C. GRAVES

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

4 DIRECT EXAMINATION

5 By Mr. Conway:

6 Q. Mr. Graves, could you state your name.

7 A. Yes. My name is Frank C. Graves.

8 Q. And by whom are you employed?

9 A. I am a principal with the consulting firm
10 The Brattle Group in Cambridge, Massachusetts.

11 Q. And, Mr. Graves, did you prepare
12 testimony on behalf of Ohio Power Company for this
13 proceeding?

14 A. I did.

15 MR. CONWAY: Your Honors, at this time I
16 would mark as AEP Ohio Exhibit No. 105, I believe it
17 is, Mr. Graves' prefiled testimony.

18 EXAMINER PARROT: So marked.

19 (EXHIBIT MARKED FOR IDENTIFICATION.)

20 Q. Mr. Graves, was this -- again, you
21 prepared this testimony?

22 A. I did.

23 Q. Do you have any additions or corrections
24 to make to the testimony at this time?

25 A. No, sir.

1 Q. And if I were to ask you the questions
2 contained in the testimony today, would your answers
3 be the same?

4 A. Yes.

5 Q. And are those answers accurate to the
6 best of your knowledge and belief?

7 A. Yes, they are.

8 MR. CONWAY: Your Honor, at this time I
9 would offer AEP Ohio Exhibit 105 into the record, and
10 Mr. Graves is available for cross-examination.

11 EXAMINER PARROT: Thank you.

12 Mr. Kutik.

13 MR. KUTIK: Thank you, your Honor.

14 - - -

15 CROSS-EXAMINATION

16 By Mr. Kutik:

17 Q. Good morning. On page 5 of your
18 testimony, on line 14 you talk about AEP's position
19 as a compromise, correct?

20 A. Yes.

21 Q. And would it be fair to say that that
22 compromise is not part of this case?

23 A. I understand that to be true, yes.

24 Q. And essentially one of the choices that
25 the Commission will be making in this case is the

1 choice between a fully embedded cost capacity price
2 or potentially an RPM-based price, correct?

3 A. Yes.

4 Q. And RPM-based prices are essentially or
5 generally regarded as market-based prices, are they
6 not?

7 A. Generally, sure, they're determined in a
8 market process with some administrative elements.

9 Q. For example, FERC has determined that the
10 prices resulting from RPM approximate a competitive
11 market.

12 A. I'm not familiar with the specific FERC
13 opinion to that effect.

14 Q. Have you studied the FERC opinions
15 regarding RPM prices?

16 A. Somewhat. I'm aware there's been some
17 discussion of it over time.

18 MR. KUTIK: Your Honor, may I approach,
19 please?

20 EXAMINER PARROT: You may.

21 MR. KUTIK: Your Honor, I would like to
22 have marked as FES Exhibit 118 a document bearing the
23 caption "PJM Interconnection Docket Numbers
24 ER05-1410-05, and EL05-14805," an order denying
25 rehearing issued from the FERC on November 15th of

1 2007.

2 EXAMINER PARROT: So marked.

3 (EXHIBIT MARKED FOR IDENTIFICATION.)

4 Q. Mr. Graves, showing you what's been
5 marked for identification as Exhibit FES 118, do you
6 recognize this as an opinion of the Federal Energy
7 Regulatory Commission?

8 A. Yes.

9 Q. And it's an opinion that's discussing the
10 RPM process, is it not?

11 A. Yes.

12 Q. Let me direct you to page 12. Are you
13 there, sir?

14 A. I am.

15 Q. In paragraph 24 does it state "We
16 conclude that the prices in RPM will be just and
17 reasonable because mitigation measures will constrain
18 sellers to submit bids that prevent the exercise of
19 market power with the result that prices will
20 approximate those of a competitive market"? Do you
21 see that?

22 A. I do.

23 Q. And you agree with that, do you not?

24 A. Well, I certainly agree that that's
25 FERC's opinion. I have not done an independent

1 assessment of whether it's equivalent to a
2 competitive market.

3 Q. Okay. And the FERC has determined that
4 RPM prices or RPM-based prices are just and
5 reasonable, correct?

6 A. Yes.

7 Q. And RPM is based on the premise that a
8 properly designed market will produce just and
9 reasonable rates, correct?

10 A. I guess I would invert the way that
11 occurs. I think the presumption or the premise is
12 that a properly designed market does produce just and
13 reasonable rates and then there's a finding I guess
14 in FERC's view RPM satisfies that standard.

15 Q. Now, FERC, like this Commission, has an
16 obligation to review rates to make sure that they are
17 just and reasonable, correct?

18 A. Certainly. At the wholesale level.

19 Q. Pardon?

20 A. At the wholesale level.

21 Q. Yes. And that standard, that just and
22 reasonable standard, does not compel approving rates
23 that are just cost based, correct?

24 A. Correct.

25 Q. And in a competitive market for capacity

1 prices don't differ based upon whether the plant
2 producing the capacity is new or old, correct?

3 A. In a market whether it's competitive or
4 not there's one price for the product at a time
5 unless there's a significant price discrimination or
6 market segmentation. So lacking that, whether or not
7 it's competitive, there's one price.

8 Q. So the answer to my question is yes.

9 A. Yes.

10 Q. And in a competitive market for capacity
11 the price doesn't differ whether the plant that's
12 producing the capacity is efficient or inefficient,
13 correct?

14 A. Okay.

15 Q. And competitive markets can produce
16 advantages to electricity customers in comparison to
17 cost-of-service regulation.

18 A. Sure, when they are truly competitive.

19 Q. For example, a competitive market with a
20 single clearing -- a single market clearing price can
21 force sellers to be more efficient in order to obtain
22 more profits, correct?

23 A. Yes. That can also be true under
24 regulation but it's true of markets.

25 Q. And it is also true that in a competitive

1 market when sellers are working to minimize their
2 costs, the competition will keep prices as low as
3 possible, correct?

4 A. Yes, that's true, over the timeframes
5 when those changes can be reflected if, for instance,
6 if prices are reset continuously, that happens fairly
7 well. If they're set at regular intervals, there can
8 be lags.

9 Q. So a competitive market can result in
10 benefits to consumers by having more efficient
11 sellers and lower prices, correct?

12 A. Well, we have to be careful about what we
13 mean by "lower." They would be perhaps lower than
14 they might be absent competition, they might or might
15 not be lower than they would be under regulation.

16 Q. Now, all CRES providers outside of
17 AEP Ohio pay RPM-based price for capacity, correct?

18 A. That's my understanding.

19 Q. And, in fact, that would be the case for
20 all retail generation providers, whatever they may be
21 called, in other states in PJM that have retail
22 choice.

23 A. I believe that's correct.

24 Q. So but for locational pricing
25 differences, if AEP Ohio's proposal were accepted in

1 this case, the CRES providers that would operate in
2 AEP's territory would be paying on a different basis
3 than similar service providers in Ohio or the rest of
4 PJM, correct?

5 A. Yes, that's true, but of course AEP is
6 operating on a different basis than the rest of PJM
7 also.

8 Q. Well, let's talk about that. Once
9 capacity is committed, either through the RPM process
10 or an FRR plan, it's the same capacity service; is it
11 not?

12 A. I need some clarification about what you
13 mean by the "same service."

14 Q. Well, a capacity supplier, whether it's
15 under an FRR plan or participating in the RPM
16 process, is required to meet the same reliability
17 standards, correct?

18 A. I wouldn't say that.

19 Q. You think that's incorrect.

20 A. I think it's an oversimplification. The
21 capacity providers who supply power to RPM simply
22 have to make their capacity available or face
23 penalties.

24 The FRR suppliers have to supply enough
25 capacity for however much load is in their FRR

1 territory regardless of whether they are serving that
2 load or not, and they have a load obligation which
3 just being a capacity supplier does not entail.

4 Q. Let's go back to my question. My
5 question is they have to meet the same reliability
6 standards, correct?

7 A. No. The FRR supplier has to meet a
8 reserve margin for its customers and the RPM capacity
9 supplier just has to provide their capacity into the
10 market and perform.

11 Q. Let's talk about the relationship between
12 RPM-based pricing and AEP's embedded costs. Would it
13 be fair to say it's your understanding that RPM
14 clearing prices relative to Ohio, that is the rest of
15 market prices, have been below AEP's embedded costs
16 since 2007 through the present planning year?

17 A. I have not done a detailed study of prior
18 embedded costs but I suspect that's true.

19 Q. And you would expect that to be the case
20 through planning year 2014-'15.

21 A. Yes. Even more so than today.

22 Q. And you believe that would be the case
23 for planning year 2015 and '16.

24 A. It's likely, but we don't know yet.

25 Q. But it's likely, you think.

1 A. Yes.

2 Q. Okay. Now, because AEP is an FRR entity
3 and has been, and under the theory that AEP could
4 seek some alternative price other than an RPM-based
5 price, would it be fair to conclude from the fact
6 that AEP Ohio did not apply for any different price
7 for 2010 that AEP Ohio believed that the price it was
8 receiving for capacity prior to 2010 reflected fair
9 value of its capacity?

10 A. I assume you're referring to them
11 proposing an alternative CRES price.

12 Q. Yes.

13 A. I think that's inferring too much from
14 their history because energy prices were also quite
15 high or considerably higher in the past years and
16 customer shopping is a function of both capacity and
17 energy prices, so whether or not RPM prices were
18 compensatory wasn't by itself sufficient or
19 dispositive for them to worry about the adequacy of
20 that compensation.

21 Q. So any inadequacy in the compensation
22 would have been either masked by low shopping or
23 higher energy prices; is that what you're saying?

24 A. Yes.

25 Q. Now, if the Commission determines that

1 the state compensation mechanism should be RPM-based
2 price, you would agree, would you not, that there
3 would be more CRES providers serving customers in
4 AEP Ohio's territory than if the Commission adopted
5 embedded cost-based capacity prices?

6 A. I would expect that to be true.

7 Q. And if the state -- if the Commission
8 establishes an RPM pricing mechanism as the state
9 compensation mechanism, shopping customers would be
10 able to see market driven pricing for both capacity
11 and energy.

12 A. Yes. To the extent they were flowed
13 through to -- the wholesale prices were flowed
14 through to them, yes.

15 Q. In general would you agree that market
16 prices -- or, market processes produce durable and
17 efficient competition?

18 A. Can I hear the question again?

19 Q. Sure.

20 MR. KUTIK: May I have it read, your
21 Honor.

22 (Record read.)

23 Q. So in my question delete "prices," to the
24 processes.

25 A. Okay.

1 Q. It's a little bit circular in that it
2 presumes the markets themselves are competitive, but
3 subject to the presumption that the market is
4 competitive it does --

5 A. And will remain so, then those benefits
6 should be durable.

7 Q. Now, in Ohio and within AEP Ohio you're
8 not aware that there is any CRES supplier that
9 exercises market power.

10 A. No. I am not aware of any.

11 Q. And if we assume that there are over a
12 dozen CRES suppliers active in AEP, and if we assume
13 that they have roughly the same cost structure in
14 terms of the same cost components, you wouldn't
15 expect CRES providers to be receiving substantially
16 high margins, would you?

17 A. I would expect them to compete against
18 each other and drive down those margins. On the
19 other hand, I'm not sure how familiar the average AEP
20 Retail customer is with their market opportunities
21 and how sophisticated their analysis of the offers
22 that they receive might be. So I think they'll get
23 something in between their price to compare and the
24 market price.

25 Q. But certainly competition puts downward

1 pressure on margins; would you agree with that?

2 Right?

3 A. Yes.

4 Q. And you wouldn't expect a CRES provider
5 participating in an RPM-based market to recover its
6 full embedded costs.

7 A. A CRES provider may not, in fact, have
8 any embedded costs in the sense of owned assets that
9 have a fixed cost to operate. They may be entirely
10 working through financial contracts.

11 Q. Let's talk about the CRES providers,
12 then, that own generation assets. You wouldn't be
13 expecting them in an RPM-based market to be
14 recovering their full embedded costs, would you?

15 A. It would be unlikely. It's not
16 impossible, but . . .

17 Q. Now, most customers for retail generation
18 service would consider price as part of their
19 decision whether to switch; you would expect that,
20 would you not?

21 A. Sure.

22 Q. And reasonable economic behavior for a
23 customer would be to choose retail electric service
24 based upon price.

25 A. Yes, that's one factor, as we just

1 agreed.

2 Q. For example, industrial or commercial
3 firms, in looking whether to locate in the area or to
4 stay in the area, may consider their energy prices as
5 one factor. You would agree with that, right?

6 A. Sure, along with many others; labor
7 costs, taxes, lots of things, but electricity would
8 be a consideration.

9 Q. Now, as I understand your testimony, one
10 factor that you believe supports AEP's application
11 for the embedded cost recovery is that that type of
12 recovery is needed to maintain incentives for
13 investment in generation; that's one factor, correct?

14 A. It's a little oversimplified. There can
15 be incentives to invest under RPM and market
16 mechanisms as well, but ability to have fair recovery
17 of costs that were committed under a regime where
18 certain kinds of obligations prevailed is a influence
19 on whether suppliers will continue to invest.

20 If they feel the rules of the game are
21 unstable or changing adversely, that can affect their
22 willingness to invest.

23 Q. So one factor is the -- is whether AEP
24 will be incentivized to invest, correct?

25 A. In continuing with embedded rates?

1 Q. Yes.

2 A. In principle, sure.

3 Q. Okay. Now, up until this year, as I
4 think we may have agreed earlier, AEP Ohio has been
5 charging RPM-based prices, correct?

6 A. Yes, from 2007 to the present.

7 Q. And you're generally aware of what those
8 prices have been, correct?

9 A. Yes.

10 Q. And, for example, in 2007-2008 they were
11 in the mid-\$40 per megawatt day?

12 A. In the RPM zone AEP is in, correct.

13 Q. And for 2008-2009, same question, about
14 120, 130 dollars.

15 A. That's my understanding.

16 Q. 2009-2010, same range.

17 A. Roughly.

18 Q. And 2010-2011, over \$200.

19 A. Yes, just slightly over 200.

20 Q. In 2011-2013 -- excuse me, 2011-2012,
21 around 145.

22 A. I believe that's right.

23 Q. In 2012-2013 the clearing price is about
24 \$20?

25 A. Yes, and about 33 the year after that.

1 Q. And 2014-2015 about \$150.

2 A. That's my recollection.

3 Q. Now, it would be improper for AEP Ohio to
4 switch off opportunistically between the higher of
5 RPM-based prices and embedded cost prices, correct?

6 A. I agree with that as a general principle.
7 I don't believe that describes their decisions in
8 this case, but I agree that it's improper to
9 opportunistically do so.

10 Q. And currently would it be fair to say
11 that AEP Ohio is long on capacity?

12 A. Yes.

13 Q. In fact, Ohio is long on capacity.

14 A. I don't know that's true of every zone.
15 I think there are some in the Alleghenies that are
16 tight but the AEP zone is long.

17 Q. PJM, that's long as well on capacity,
18 correct?

19 A. Yes, for a few years forward.

20 Q. And, in fact, the PJM market with its
21 reliance on RPM has been functioning effectively
22 since 2007.

23 A. That's a pretty broad statement. Do you
24 mean in regard to what?

25 Q. Well, do you have your deposition, sir?

1 A. I do.

2 MR. KUTIK: Your Honors, may I approach?

3 EXAMINER PARROT: You may.

4 Q. Would you turn to page 14 of your
5 deposition, please. Are you there, sir?

6 A. Yes.

7 Q. Let me direct you to line 14, and would
8 it be correct that you testified as follows:

9 Question: "Now, would be it correct to say that you
10 believe that the PJM capacity markets have been
11 functioning effectively since 2007?"

12 Answer: "Yes, I agree with that."

13 That was your testimony, correct?

14 A. I'm sorry, just on my copy that isn't on
15 page 14. Can you give me just one minute here to
16 find that.

17 Oh, it's on the bottom. I'm sorry. Yes.

18 Q. Now --

19 MR. CONWAY: Excuse me.

20 A. Wait, I'm sorry, I'm still -- yeah, I'm
21 sorry, for me that's on 15.

22 Yes, I agree with that, still your
23 previous question that I don't believe was about PJM
24 capacity markets, I believe you said were PJM markets
25 functioning effectively.

1 MR. CONWAY: Excuse me, Mr. Kutik,
2 because I'm having a little difficulty following
3 along, could you give me a cite to the deposition
4 transcript?

5 MR. KUTIK: Sure. The deposition
6 transcript, the version I'm looking at is on page 14,
7 line 14.

8 May we go off the record, your Honor?

9 EXAMINER PARROT: Yes.

10 (Discussion off the record.)

11 EXAMINER PARROT: Let's go back on the
12 record.

13 Q. Now, these markets have been -- have
14 brought forward a large amount of new capacity
15 resources, correct?

16 A. Certainly.

17 Q. And the RPM options are designed to
18 ensure that there's an adequate supply of reserve
19 margins three years following.

20 A. Precisely.

21 Q. And in that regard they have done very
22 well.

23 A. I agree.

24 Q. PJM has more reserves committed under the
25 base residual auction than the target reserve

1 requirement.

2 A. Yes, about 4 percent right now.

3 Q. And this is true through 2014-2015.

4 A. Yes.

5 Q. Now, you're familiar with recent
6 predictions of the capacity available in the PJM
7 projections or predictions made by NERC, correct?

8 A. Yes, their long-term supply adequacy
9 study.

10 Q. And their predicted margin as a whole
11 will have a 20 to 30 percent margin over a projected
12 peak of 168 gigawatts.

13 A. Yes, I recall something about that. Can
14 you be specific about the year that is the reference
15 point? I think that's a 2015 or '16 outlook but I'm
16 not positive.

17 Q. Okay. That's about 13 gigawatts relative
18 to a 15 percent reserve, correct?

19 A. Yes, almost 13.

20 Q. And there will be 5 to 9 gigawatts of new
21 generation likely come on line at PJM over the next
22 three to four years.

23 A. I believe that's true.

24 Q. So that at least through 2015-2016 you
25 have no concern about the capacity shortfall within

1 PJM.

2 A. Yes, that's correct. There are other
3 changes that you didn't describe such as perhaps 20
4 gigs of retirement, but I think on net there still is
5 an adequate reserve margin.

6 Q. And indeed you don't expect there will
7 come a time when RPM will fail in its purpose to
8 ensure sufficient and reliable capacity.

9 A. I agree with that.

10 Q. Now, AEP, starting in 2015, the 2015-'16
11 year, will have no long-term commitment to anyone or
12 any area under AEP's current plan, correct?

13 A. You mean AEP generation or --

14 Q. AEP Ohio.

15 A. AEP Ohio. They would have no supply
16 obligations.

17 Q. And as part of the RPM process -- I'll
18 back up. You understand that AEP Ohio intends to
19 participate in the RPM process beginning with the
20 planning year 2015-2016.

21 A. I do.

22 Q. And in that regard, as a participant in
23 that process AEP Ohio's incentives will be no
24 different than any other generators within PJM.

25 A. We'll go back, I think we're confusing

1 suppliers and generators, I mean suppliers and
2 distributors. AEP Ohio won't have any supply
3 obligations so they won't be comparable to other
4 generators in PJM.

5 Q. All right. Now, your practice group was
6 retained to do an evaluation of RPM, correct?

7 A. Yes, The Brattle Group has evaluated
8 PJM's RPM model twice.

9 Q. And with respect to the most recent
10 report that was a report in 2011, correct?

11 A. Yes, August of this last year.

12 Q. And that report is attached to
13 Mr. Stoddard's testimony, correct?

14 A. I believe so.

15 Q. You did not author that report.

16 A. Correct.

17 Q. There were others at Brattle that did
18 that.

19 A. Yes.

20 Q. The report was prepared by Brattle in the
21 regular course of its business.

22 A. Of course.

23 Q. And it has been maintained by Brattle in
24 the regular course of its business.

25 A. It's available from Brattle if people

1 want it. In that sense, sure, it's maintained I
2 guess you could say.

3 Q. And you would consider that report to be
4 an authoritative source of data, analysis, and
5 conclusions about the efficacy of the PJM RPM
6 process, correct?

7 A. Yes. Absolutely.

8 Q. You've relied on that in your work, that
9 report.

10 A. Yes. Several times.

11 Q. And you would have no hesitation asking
12 the Commission to rely on that report.

13 A. Correct.

14 Q. Now, I think you mentioned earlier that
15 one of the things that would support AEP's
16 application to receive embedded cost recovery for
17 capacity was the expectation that AEP had when it
18 made certain either investment decisions or made
19 certain decisions to spend moneys to construct or
20 acquire plants; fair to say?

21 A. I don't know that I described it as AEP's
22 expectation, but -- because I don't know how to
23 describe those, not being an insider, but there are
24 obligations as an FRR provider which shaped some of
25 the needs and commitments they made.

1 Q. Well, isn't it true that you believe that
2 AEP Ohio's facilities were under a regulatory compact
3 that provides for the recovery -- that provides for
4 recovery of the cost of these assets in return for
5 the company's duty to provide service to all
6 customers?

7 A. Yes, that's generally true.

8 Q. And you believe that AEP Ohio should be
9 allowed to recover its embedded costs from CRES
10 providers because AEP Ohio built or acquired its
11 fleet under criteria that sought to minimize the
12 riskiness and cost of service over long-term horizons
13 such as decades or the life of those assets.

14 A. Yes, that's correct.

15 Q. Now, AEP voluntarily elected to be an FRR
16 entity, correct?

17 A. Yes.

18 Q. And would you agree with me that an FRR
19 entity might -- or operating to be an FRR entity
20 might make sense for a vertically integrated entity
21 within PJM?

22 A. Sure.

23 Q. And that election was made in 2007,
24 correct?

25 A. Yes.

1 Q. By AEP.

2 As an FRR entity the AEP companies were
3 not obligated to use their own generation resources
4 to fulfill their FRR capacity obligations.

5 A. That's my understanding.

6 Q. Now, as you mentioned earlier, you were
7 not a -- you're not an AEP insider.

8 A. Correct.

9 Q. Have you -- I take it, though, that you
10 have studied various filings that AEP has made in
11 which it declared what its intentions and
12 expectations have been.

13 A. No. I've discussed that question with
14 AEP staff but I don't recall reading specific
15 documents that describe those intentions or
16 expectations.

17 Q. Well, for example, statements that AEP
18 makes in its 10-K might be statements that we could
19 rely upon regarding their intention or expectations,
20 correct?

21 A. One would hope.

22 Q. Or statements that were made by AEP Ohio
23 in briefs to this Commission or to the Ohio Supreme
24 Court could be equally relied upon, correct?

25 A. Sure, taken in context.

1 Q. Sure.

2 Now, you don't know whether AEP Ohio has
3 built or acquired any generation since it became part
4 of an FRR entity, correct?

5 A. I believe they acquired some gas plants
6 in 2007 which would have been right around the time
7 of becoming an FRR entity, but I don't know if it was
8 right before or shortly after.

9 Q. Well, you were aware that in Ohio there
10 is something called SB 3?

11 A. Yes.

12 Q. And there was something called SB 221.

13 A. Yes.

14 Q. And both of those dealt with the
15 deregulation of the electric market in Ohio.

16 A. I understand that.

17 Q. And if AEP Ohio acquired certain plants
18 between those two bills, the enactment of those two
19 bills, would it be fair to say that AEP Ohio would
20 have an expectation that generation service would be
21 priced at market rates?

22 A. I think that's a little overreaching from
23 my understanding of what AEP expected or could have
24 expected.

25 Q. Okay.

1 A. I believe SB 3 indicates that the market
2 rates would apply but there are broader terms to how
3 regulatory transitions are made and I don't know that
4 that describes everything that AEP expected.

5 Q. Okay. Well, would you agree that
6 merchant plants acquired during that time would have
7 been acquired with the attendant risks that market
8 rates for generation service would produce revenue
9 below the level needed to support the investments?

10 A. Yes, that's certainly possible.

11 Q. And, in fact, isn't it true that AEP,
12 indeed, had that expectation that there could be such
13 a risk?

14 A. Again, I'm not the proper witness for
15 that.

16 MR. KUTIK: Your Honor, may I approach?

17 EXAMINER PARROT: You may.

18 MR. KUTIK: And before I do I would like
19 to have marked as FES Exhibit 119 a document from the
20 Ohio -- on the Ohio Supreme Court docket Case No.
21 09-2298, a case captioned Columbus Southern Power
22 Company versus the Public Utilities Commission, this
23 document is entitled Merit Brief and Appendix of
24 Appellant Columbus Southern Power Company.

25 EXAMINER PARROT: So marked.

1 (EXHIBIT MARKED FOR IDENTIFICATION.)

2 Q. Mr. Graves, showing you what's been
3 marked as Exhibit 118, this appears to be a brief of
4 the Columbus Southern Power Company, correct?

5 A. Yes, it does.

6 Q. And it appears to have been filed
7 March 19, 2010?

8 A. Yes.

9 Q. And I want to refer you to page 3 of the
10 brief.

11 A. Okay, I have it.

12 Q. Is it true that at page 3 of the brief
13 Columbus Southern Power Company states as follows:
14 "In the intervening years between the enactment of
15 SB 3 and SB 221, CSP acquired two generating
16 facilities, the Waterford Energy Center (Waterford)
17 was purchased on September 28th, 2005, and the
18 Darby Electric Generating Station (Darby) was
19 purchased on April 25, 2007," and then there's a
20 cite.

21 A. I see that.

22 Q. At the time Waterford and Darby were
23 purchased, CSP's expectation under the then-current
24 legal structure of regulation in Ohio was that
25 generation service would be priced at market rates

1 starting at the end of 2008 and that electric
2 utilities would continue to be permitted to freely
3 transfer generating asset units to and from the
4 distribution utility without approval of the
5 Commission.

6 In other words, CSP purchased Waterford
7 and Darby as, quote, merchant plants, end quote, and
8 undertook the attendant risks that market rates for
9 generation would produce revenue below the level
10 needed to support the investments either during a
11 given time period or overall during the remaining
12 life of the plants.

13 This situation stands in stark contrast
14 to a regulated utility's investment in the purchase
15 or construction of similar generating units where the
16 regulated utility would be guaranteed not only the
17 return of the investment but also the opportunity to
18 earn a reasonable return on that investment.

19 That's what CSP said, correct?

20 A. Yes.

21 Q. So would you agree with me that CSP
22 appears to have had the expectation that they would
23 incur the risk that revenues would be below necessary
24 to recover their investment?

25 A. That's certainly consistent with the

1 passage we just read.

2 Q. Now, as of 2007, as we've just talked,
3 Ohio had laws establishing a competitive retail
4 generation market.

5 A. Yes, I agree with that.

6 Q. And those laws envisioned that EDUs were
7 supposed to operate their generation operations
8 separately from their distribution operations.

9 A. Yes.

10 Q. And there was a transmission -- excuse
11 me, a transition mechanism established as part of the
12 process of setting up a competitive retail market.

13 A. I understand that to be true.

14 Q. And you're aware of the existence of such
15 a thing but you're not necessarily familiar with the
16 details.

17 A. That's correct.

18 Q. And you would expect that the transition
19 process would permit companies like AEP Ohio to
20 recover stranded costs.

21 A. Yes, that would be conventional.

22 Q. And stranded costs might be referred to
23 as the difference between market -- a market value of
24 the asset and the book value of an asset.

25 A. Yes, on a present-value basis over the

1 remaining useful life of the asset.

2 Q. And the book value would be based upon
3 depreciated costs.

4 A. Normally.

5 Q. And the market value could be determined
6 by the expected cash flows of revenues of sales into
7 the market.

8 A. Yes, over all the remaining future years
9 of useful life.

10 Q. And it might be a fair concept to think
11 that the appropriate way to recover stranded costs
12 would be the difference between market rates and
13 unbundled generation rates.

14 A. That's one way to do it. It's sort of a
15 lost revenue approach which would do it in realtime,
16 or as costs were incurred, it more commonly is done
17 on a present-value basis on an estimated basis.

18 Q. You're aware that, are you not, that AEP
19 in its so-called ETP case initially proposed
20 recovering its stranded costs on the method that I
21 have just described?

22 A. On a lost revenue basis?

23 Q. Yes.

24 A. Generally I understand that to be true,
25 but I'm not a historian in that process.

1 Q. And whatever your familiarity is, you
2 understand that AEP waived its right to recover those
3 stranded costs in that way; fair to say?

4 A. At the level of secondhand knowledge, I
5 agree with that.

6 Q. Now, as of 2015-2016, that planning year,
7 CRES providers in AEP Ohio will not be paying for
8 capacity based upon a long-term average cost.

9 A. Correct. They'll be paying the RPM price
10 which is a one-year price.

11 Q. Right. And the RPM price is determined
12 using something called net CONE.

13 A. That is a factor in the determination.

14 Q. And the net of net CONE is taking the
15 gross CONE and netting out the net margin of energy
16 and ancillary service sales over a three-year
17 look-back, correct?

18 A. Yes, that's the way PJM calculates that
19 CONE.

20 Q. And by three-year look-back, it's
21 basically the average or the weighted average of the
22 last three years' energy and ancillary service sales.

23 MR. CONWAY: Objection.

24 Q. Correct?

25 A. My understanding is --

1 EXAMINER PARROT: Grounds, Mr. Conway.

2 MR. CONWAY: It's a misleading question.

3 MR. KUTIK: I'm not sure that's an
4 evidentiary basis, your Honor, as an argument for
5 brief.

6 EXAMINER PARROT: The objection is
7 overruled.

8 You may answer, Mr. Graves.

9 A. I'm not sure what you meant by a
10 "weighted average," but my understanding is that PJM
11 does a look-back to three prior years based on what
12 the type of technology, that is the CONE technology,
13 would have been expected to earn as energy and
14 ancillary service revenues in the past, given the
15 prices that prevailed in PJM.

16 Q. Now, I want to go through with you some
17 of the timing of AEP's activities. We've already
18 mentioned that up until this year AEP was charging
19 CRES providers an RPM-based price, right?

20 A. Yes.

21 Q. And RPM first elected to be an FRR entity
22 in 2007.

23 A. AEP.

24 Q. AEP, excuse me.

25 A. Yes.

1 Q. And AEP Ohio, or the AEP East companies,
2 submitted a plan to be an FRR entity in 2007, that
3 plan went through May of 2012, correct?

4 A. Yes, it's initially a five-year
5 commitment.

6 Q. And in the spring of 2009 AEP East
7 companies then filed another FRR plan for the
8 planning year 2012-2013, correct?

9 A. Right. Because you have to do it three
10 years ahead, which would have then been 2009 for
11 2012-2013.

12 Q. And the spring of 2010 they submitted a
13 plan for 2013-2014, correct?

14 A. That's my understanding.

15 Q. And in November 2009 they submitted a
16 petition to the FERC to seek compensation for
17 capacity from CRES providers on a basis other than
18 RPM pricing, correct?

19 A. I think that actually occurred in 2010,
20 but --

21 Q. Excuse me. Thank you.

22 A. Otherwise I believe that's correct.

23 Q. Thank you for that correction.

24 So in November of 2010 that filing, that
25 would have been the first time that AEP had indicated

1 that it wanted to charge a price for capacity other
2 than an RPM-based price.

3 A. As far as I'm aware that would have been
4 the first time. There may have been other
5 discussions, exchanges, but I'm not aware of them.

6 Q. Now, prior to that filing by AEP in
7 late-2010 a CRES provider would have had no incentive
8 to opt out of AEP's FRR plan, correct?

9 A. A CRES provider would not have had an
10 incentive to become be an FRR provider in lieu of
11 released capacity from AEP, if that's what you mean.

12 Q. Because it's RPM-based prices, correct?

13 A. Up until then, yes.

14 Q. Now, one of the things that we might do
15 to judge the reasonableness of capacity prices that
16 should be paid by shopping customers would be to look
17 at the capacity prices that are paid by nonshopping
18 customers in AEP Ohio, correct?

19 A. They should be equivalent I believe.

20 Q. And would it be fair to say that you
21 don't know what part of the rates that nonshopping
22 customers would pay that would be designated for the
23 recovery of capacity costs?

24 A. That's true, I have not seen a specific
25 breakdown of that.

1 Q. And you don't believe that that
2 calculation would be necessarily a difficult
3 calculation for the company to do.

4 A. I think it could be done. I don't know
5 whether it would be difficult or not. It would
6 involve untangling how the ESP rate has been set over
7 time and what components of it were related to
8 capacity elements, but it could be done.

9 Q. It wouldn't be hard to back out the
10 generation component of the rates less the fuel
11 adjustment costs, correct?

12 A. That would be an approximation, that
13 would not be terribly difficult.

14 MR. KUTIK: One minute, your Honor.

15 I have no further questions. Thank you,
16 Mr. Graves.

17 EXAMINER PARROT: Thank you.

18 Ms. Kaleps-Clark.

19 MS. KALEPS-CLARK: I just have a few
20 questions.

21 - - -

22 CROSS-EXAMINATION

23 By Ms. Kaleps-Clark:

24 Q. Good morning, Mr. Graves. My name is
25 Lija Kaleps-Clark and I'm here on behalf of RESA,

1 Exelon, Constellation, and Direct Energy.

2 A. Good morning.

3 Q. Mr. Graves, have you ever worked for or
4 been employed by a retail power marketer or a
5 competitive retail electric supply provider?

6 A. Yes.

7 Q. You have. When were you employed?

8 A. In the early-2000s.

9 Q. And how long was that employment?

10 A. A few months at a time, a couple of
11 times.

12 Q. Okay. Now, have you ever served any
13 power or made sales for --

14 A. Let me clarify. I'm sorry. When I mean
15 "employed by," I was not literally an employee of
16 such firms; I've never done that.

17 Q. Okay.

18 A. But I've assisted them as a consultant.

19 Q. And my question was your clarification.
20 So have you ever been an employee of a wholesale
21 power marketer or generator?

22 A. No.

23 Q. Okay. So have you ever served any power
24 or made sales for a load-serving entity?

25 A. No.

1 Q. So do you have any direct experience in
2 selling power for suppliers?

3 A. No, just working with such parties, but
4 not direct experience.

5 Q. Okay. So do you know whether it's
6 possible for shopping customers to terminate their
7 contracts with CRES providers?

8 A. I don't know that there's a general rule
9 for that. I would think that it could be arranged as
10 a contractual matter so there could be market "out"
11 clauses going in either direction for the supplier
12 and the purchaser.

13 Q. And do you know whether customers,
14 shopping customers, may contain provisions for price
15 adjustments in their contracts with CRES providers?

16 A. Again, there's no necessity that that be
17 the case, but I would be very surprised if there
18 aren't such contracts.

19 Q. And in a competitive market would a CRES
20 provider need to be concerned about losing customers
21 to another CRES provider with, let's say, a better
22 offer?

23 A. Well, subject to having entered a
24 contract with -- in permanent relations with the
25 customer, they would have to consider that. They

1 would have the opportunity in their contract to price
2 in a premium for that if they were able to negotiate
3 one. So it could be a risk that they can price, but
4 it's a risk they might have.

5 Q. But you would agree that in order to keep
6 customers a CRES provider would be motivated to offer
7 a lower price than their competitor.

8 A. Sure.

9 Q. Okay. And would that include passing
10 through a lower capacity price?

11 A. You mean lower than the other CRES
12 provider is offering?

13 Q. Correct.

14 A. It's -- that could be part of it. I
15 wouldn't expect retail contracts to be generally
16 specific as to the sources of the cost that's being
17 offered or the price that's being offered. It would
18 reflect all sorts of managerial capabilities, risk
19 management service features, lots of things, and I
20 don't know the capacity component could be broken out
21 but I would say they would try to be as low as
22 possible without being more low than necessary.

23 Q. Okay. So to the extent that a CRES
24 provider could beat out the competition by offering a
25 lower capacity charge, would you agree that they

1 would likely do so in a competitive market?

2 A. Again, I would say yes in the qualified
3 sense that they would be offering as low a price as
4 they could which would reflect lots of components in
5 it. I don't think they would literally discount
6 capacity as well as cost to them, but they might have
7 other margins that they can eat into and try to make
8 those as lean as reasonable.

9 Q. Okay. So moving on, Mr. Graves, are you
10 familiar with the reliability assurance agreement, or
11 the RAA?

12 A. Only in general terms.

13 Q. Would you agree that the RAA governs the
14 provision of capacity under the FRR alternative?

15 A. That's my understanding.

16 Q. Okay. So would you agree that the price
17 AEP Ohio charges CRES providers for capacity supply
18 is determined by the RAA?

19 A. Subject to regulatory implementation of
20 the RAA, yes.

21 Q. Okay. Now, would you agree that your
22 testimony is based on the premise that AEP Ohio is
23 entitled under the RAA to recover for its capacity
24 and embedded costs?

25 A. That's going a little farther. I'm not

1 offering a legal opinion as to whether the RAA
2 endorses that. I'm actually more offering the
3 opinion of an economist that it would be reasonable
4 to do so. I do understand the RAA to have a
5 provision that a cost-based alternative is one of the
6 possibilities.

7 Q. But you do agree that the RAA is what
8 governs what capacity charge AEP Ohio can charge CRES
9 providers, correct?

10 A. Yes, I believe it has to fit within one
11 of three broad styles of justification.

12 Q. So, Mr. Graves, throughout your testimony
13 you state that RPM pricing is not an appropriate
14 basis to compensate AEP Ohio for capacity because
15 it's a short-term rate that does not reflect the cost
16 of serving long-term obligations AEP Ohio faces in an
17 FRR. Is that a fair characterization?

18 A. Yes, that's pretty close to what I said.

19 Q. Mr. Graves, do you know whether AEP Ohio
20 has made a commitment to PJM to participate in the
21 upcoming RPM auctions for the 2015-2016 delivery
22 year?

23 A. I understand it has.

24 Q. And do you know how long that is for, how
25 many years?

1 A. Five years, I believe.

2 Q. Now, is it also your understanding that
3 AEP Ohio has been compensated by CRES providers for
4 capacity at the RPM auction price from 2007 until
5 this year?

6 A. Yes, to the extent there's been CRES
7 providers in this time.

8 Q. But that's what they've been charged.

9 A. Yes.

10 Q. So your discussion in your testimony that
11 embedded cost is the only just and reasonable rate
12 CRES providers should pay for AEP Ohio's long-term
13 obligations in the FRR entity is really only
14 applicable for the next three years until June 1st,
15 2015?

16 A. Yes, I'm referring to the time when
17 they're an FRR provider and transitioning out of
18 that.

19 Q. Okay. Now, in your testimony you discuss
20 the importance of AEP Ohio recouping its embedded
21 cost of capacity from CRES providers, again, because
22 of AEP Ohio's long-term planning commitment as an FRR
23 entity, correct?

24 A. Yes, and more broadly the set of risks
25 and obligations that FRR entails which are not just

1 long-term but they're also different intertemporally
2 even in the short period of time than, for instance,
3 being a CRES provider.

4 Q. So do you anticipate a shortage of
5 capacity in the next three years in the PJM region
6 that's covering AEP Ohio's load?

7 A. No, I don't think this is about assuring
8 supply adequacy.

9 Q. You don't think that this just and
10 reasonable rate is about securing supply adequacy?

11 A. I don't think there's a supply adequacy
12 problem to worry about over the next few years, but
13 just and reasonable rates do affect supply adequacy
14 when supply is needed.

15 Q. Okay. Now, turning to page 15 of your
16 testimony --

17 A. Okay.

18 Q. -- at the top of page 15 you state that
19 AEP Ohio would be bearing a disincentive to develop
20 future capacity, because it would know that there are
21 future "free-riders" that are expecting to pay RPM
22 auction prices rather than the full embedded cost for
23 that capacity. It's not a direct quote but is that
24 essentially what you're saying?

25 A. Yes. When there's an issue of having to

1 develop capacity at a cost that might be bypassable,
2 that creates a disincentive.

3 Q. So based on this statement do you
4 recognize that starting in the 2015-2016 delivery
5 years AEP Ohio will be bearing a disincentive to
6 develop future capacity because it will be charging
7 CRES providers the RPM auction price?

8 A. In principle, yes. In practice, no,
9 because I don't think there's any capacity they need
10 to develop in that time frame. I'm not aware of any
11 that they've identified as essential for that purpose
12 except possibly continuing to maintain their plans
13 for FRR obligations during that time.

14 Q. So to the extent that capacity would be
15 required, do you think that there is a disincentive
16 to develop that capacity under the RPM auction
17 prices?

18 A. If capacity were required and could be
19 developed as quickly as, say, next year or something
20 like that, a very small supplementation for emergency
21 capacity, and then it was going to be priced at RPM
22 price, sure, I would think there would be a
23 disincentive to do that.

24 Q. So starting in 2015-2016 you think there
25 will continue to be a disincentive, you said within

1 the next year.

2 A. No, I was referring to the transition out
3 of FRR from 2015-'16 on the prices be set by RPM and
4 then the incentives are to develop capacity that
5 satisfies that, that's economical within that price
6 range.

7 MS. KALEPS-CLARK: No further questions,
8 thank you.

9 EXAMINER PARROT: Thank you.

10 MR. HAYDEN: Your Honor, may we get
11 Mr. Graves a mic that works, please?

12 EXAMINER PARROT: Ms. Kingery.

13 MS. KINGERY: Thank you, your Honor.

14 - - -

15 CROSS-EXAMINATION

16 By Ms. Kingery:

17 Q. My name is Jeanne Kingery and I'm here
18 representing Duke Energy Retail Sales and Duke Energy
19 Asset Management.

20 A. How do you do.

21 Q. I just have a few questions for you.

22 A. Thank you.

23 Q. A detailed description of your experience
24 is attached to your testimony, correct?

25 A. Yes.

1 Q. And although that description identifies
2 financial analysis as one of your areas of expertise,
3 in this case you are not offering any opinions as to
4 the formulas used by AEP Ohio to develop a cost-based
5 capacity rate, correct?

6 A. That's right. I have not reviewed the
7 calculations that AEP has done, I'm familiar with
8 them at a high level but I'm not sponsoring or
9 affirming them.

10 Q. So just to clarify, to the extent you are
11 comparing and contrasting AEP Ohio's retail rates
12 with its proposed capacity charge of 355 per
13 megawatt-day, that comparison is based solely on what
14 AEP Ohio has told you, correct?

15 A. Can I hear that again just to make sure
16 I'm responding to what you asked.

17 Q. Yes. To the extent that you are using
18 the figure of 355, \$355 per megawatt-day in your
19 analysis and comparing that with, for example, its
20 retail rates, you're merely relying on what they have
21 told you about the development of the 355.

22 A. Mostly relying on that, but I'm also -- I
23 also find it consistent with some of the analyses
24 done by intervenors who attempted to unpack the
25 capacity component of rates and found that on average

1 they were similar to the 355, but generally it's the
2 second -- it's other evidence that I did not
3 personally develop.

4 Q. But as to the development of the \$355,
5 for that piece of it you're relying on what AEP Ohio
6 told you, as opposed to having done an independent
7 analysis of that figure.

8 A. Certainly. I understand it to be derived
9 from Form 1 components and those are what I
10 understand to be normal cost of service components,
11 but I haven't validated those inputs.

12 Q. All right. Thank you.

13 If you'd look at page 8 of your
14 testimony.

15 A. Sure.

16 Q. Are you there?

17 A. I am.

18 Q. On line 4 you discuss AEP Ohio having a,
19 quote, longer, more binding reliability obligation as
20 an FRR utility than the CRES providers incur as
21 short-term load serving entities. Did I read that
22 correctly?

23 A. You did.

24 Q. Isn't it true that after May 31, 2015,
25 AEP Ohio will not have any long-term binding broad

1 reliability obligations?

2 A. That's correct. AEP Ohio will not except
3 insofar as they're obliged to -- no, I'm sorry,
4 that's right. They will not.

5 Q. Okay. Thank you.

6 And an FRR entity is not obligated to use
7 its own generating resources to fulfill its FRR
8 capacity obligation, correct?

9 A. That's my understanding.

10 Q. Okay. You have testified as an expert
11 witness before the FERC, correct?

12 A. Yes.

13 Q. And, in fact, your experience identifies
14 market competition as one of your areas of expertise,
15 correct?

16 A. Yes.

17 Q. So as we've discussed, AEP Ohio's status
18 as an FRR entity will end May 31, 2015, correct?

19 A. Yes, I agree that.

20 Q. And it is AEP Ohio's intention to
21 transfer its generating assets to an affiliate
22 effective January 1, 2014, correct?

23 A. That's my understanding.

24 Q. And is it your understanding that two
25 plants will be going to regulated affiliates and the

1 balance will go to a nonregulated affiliate?

2 A. Yes, Amos and Mitchell units will go to
3 APCo and Kentucky Power and the rest will go to AEP
4 Gen.

5 Q. Thank you. So between the time of that
6 transfer and the end of its FRR obligations, is it
7 your understanding that AEP Ohio intends to rely on a
8 purchased power agreement with AEP generation
9 resources?

10 A. I believe that's correct. I have not
11 studied that contractual arrangement, but I
12 understand that AEP GenCo, will sell power back to
13 AEP Ohio on a cost basis to close out its FRR
14 obligations.

15 Q. With your credentials I expect that
16 you're aware of the FERC's Edgar standards, correct?

17 A. Yes.

18 Q. And isn't it true that the Edgar
19 standards relate to the FERC's approval of purchased
20 power agreements with affiliates?

21 A. Yes, that's generally true.

22 Q. So a purchased power agreement between
23 AEP Ohio and its affiliated owner of the generating
24 assets in place after corporate separation would be
25 subject to the Edgar standards, correct?

1 A. I don't want to offer a legal opinion on
2 that but it wouldn't surprise me if that's true.

3 Q. And I'm not in these questions asking for
4 any legal opinion.

5 A. Okay.

6 Q. As a nonlawyer would you agree with me
7 that it is true that the premise of the Edgar
8 standards is to ensure that affiliate power sales
9 transactions are above suspicion such that the market
10 would not be distorted and ratepayers would be
11 protected?

12 A. You know, I don't recall the specific
13 motivational language for the Edgar standards but
14 generally they are designed to assure that there's
15 not self-dealing favoritism in intercompany transfers
16 and they are comparable to what could have taken
17 place in a market process.

18 Q. So under Edgar, as you say, then, the
19 FERC would look at whether or not there is direct
20 head-to-head competition between the affiliate and
21 nonaffiliated entities, correct?

22 MR. CONWAY: Objection. Relevance.
23 Whatever FERC process applies to whatever purchased
24 power arrangement is put in place between Genco and
25 AEP Ohio will be reviewed by FERC and it's not a

1 matter that is relevant to this proceeding.

2 MS. KINGERY: Your Honor, this goes to
3 factors that will be relevant to the cost that AEP
4 has to pay to its affiliate in order to obtain
5 capacity in that bridge period, and this is a period
6 that we have talked about at great length during this
7 hearing. So I believe that the factors that will be
8 relevant are also relevant to our discussion today.

9 MR. CONWAY: Your Honor, if I might,
10 whatever purchased power arrangement is put in place,
11 again, will be subject to the FERC's review, it won't
12 be subject to this Commission's review, and so
13 debates about what ought to be in that contract or
14 what ought not be in the contract, whether such a
15 contract, whatever its form, would comply with or not
16 comply with a standard that the FERC will apply to it
17 when it reviews it is simply not relevant to this
18 proceeding.

19 MS. KINGERY: And I'm not asking the
20 witness to talk about what might be approved, what
21 might not be approved, merely what costs may be
22 passed on under that agreement to the CRES providers
23 during the bridge period.

24 EXAMINER PARROT: The objection is
25 overruled.

1 You may answer, Mr. Graves.

2 A. Can I hear the question again?

3 (Record read.)

4 A. It's been a while since I've done an
5 Edgar matter, but my recollection is they would look
6 at whether there was competition or whether, if there
7 had been competition, it would produce a similar
8 result. And it's specific to the type of service
9 being sought, it's not just a general question of
10 whether there's a market alternative, it has to be
11 matched to the transaction in question.

12 But they would look at the intent of
13 competition or the equivalent result of competition
14 in my recollection, but it's been a while since I've
15 done that.

16 Q. Just one more question on this issue.
17 And is it your understanding they also look for
18 benchmark evidence of price, terms, and conditions of
19 sales by nonaffiliated sellers?

20 MR. CONWAY: Objection, your Honor. Same
21 objection.

22 EXAMINER PARROT: Overruled.

23 MR. CONWAY: We're not litigating the
24 FERC approval process.

25 EXAMINER PARROT: You may answer,

1 Mr. Graves.

2 A. Yes, that's my understanding as part of
3 that process of identifying whether it's equivalent
4 to a market alternative.

5 Q. Thank you.

6 Would you agree, sir, that in the near
7 term it is probable that competition will be stifled
8 in AEP Ohio's service territory under its proposal in
9 this proceeding?

10 A. I assume you're referring to retail
11 competition.

12 Q. Yes.

13 A. No. I wouldn't agree with that. I think
14 there will be less activity by CRES providers, but
15 that doesn't mean there won't be competition. There
16 could still be opportunities to be profitable even
17 under the terms that are more expensive than CRES
18 providers would like, and I don't regard the simple
19 transfer of AEP's capacity at RPM prices to be
20 fostering competition, that's just replacing
21 suppliers with another capacity.

22 Q. But you have testified, I believe -- I'm
23 looking here at page 12 of your testimony, I'll wait
24 till you get there. I'm looking at line 21. "It is
25 very likely that there would be less near-term CRES

1 activity under AEP Ohio's proposal...."

2 A. Yes, and I'm sticking with that.

3 Q. Okay.

4 A. I'm just not defining "activity" as
5 "competition."

6 Q. Okay. All distribution utilities in Ohio
7 now operate in PJM, correct?

8 A. To my knowledge.

9 Q. And no other distribution utility in Ohio
10 charges CRES providers for capacity based on cost of
11 service, correct?

12 A. I'm not aware of any. I'm not aware of
13 any other FRR distribution companies, either.

14 Q. And as of the 2015-2016 planning year, no
15 Ohio utility will be an FRR entity, correct?

16 A. Yes. That's right.

17 Q. Turning to page 15 of your testimony.

18 A. Okay, I have it.

19 Q. On line 10 you talk about CRES providers
20 appearing to be, quote, seeking a lower of cost or
21 market. Is that correct?

22 A. Yes, that is.

23 Q. Thank you. In essence you're saying it's
24 opportunistic, correct? That the CRES providers are
25 trying to be opportunistic.

1 A. Sure. I understand why but I think
2 that's fair.

3 Q. And if AEP Ohio were charging RPM-based
4 rates when their embedded costs were lower, it would
5 be similarly opportunistic? In other words, if the
6 table were turned, would it also be opportunistic?

7 A. Yes, I think if we were in a situation
8 where embedded cost rates were below RPM and AEP was
9 asking for the higher of cost or market, that would
10 be opportunistic on behalf of AEP.

11 Q. And, sir, do CRES providers at this point
12 have the ability to opt out of AEP Ohio's FRR plan
13 and self-supply?

14 A. Not for the next three years.

15 Q. And similarly, if we look at page 14 of
16 your testimony --

17 A. Okay.

18 Q. -- on line 20 you talk about CRES
19 providers having little or no incentive to contract
20 forward for FRR capacity, correct? I guess that's
21 actually line 21.

22 A. I see that.

23 Q. But, again, they would have to make that
24 decision three years in advance, correct?

25 A. Yes.

1 MS. KINGERY: I have no further
2 questions.

3 EXAMINER PARROT: Mr. Randazzo?

4 MR. RANDAZZO: Thank you.

5 - - -

6 CROSS-EXAMINATION

7 By Mr. Randazzo:

8 Q. Mr. Graves, I'm general counsel for the
9 Industrial Energy Users of Ohio.

10 A. Okay.

11 Q. And I'd like to talk to you a little bit
12 about some of your testimony, but before I begin I've
13 got a question for you on principle, I guess.

14 If the retail rates that AEP Ohio
15 collects from nonshopping customers, the level of
16 those rates for the generation supply component was
17 set based upon a benchmark against market-based
18 prices including the capacity price established by
19 RPM, would that be inconsistent with your
20 understanding of the way that AEP's prices have been
21 set?

22 MR. CONWAY: Your Honor, could I have
23 that question read back?

24 (Record read.)

25 MR. CONWAY: I'll object, form of the

1 question. I can't understand it. So that's my
2 objection. Not a good question.

3 MR. RANDAZZO: Your Honors, if I may, I
4 would like an instruction from the Bench to
5 Mr. Conway, the process requires one to state an
6 objection, there's a basis, it needs to be requested.
7 Mr. Conway has a persistent habit of trying to guide
8 the witness and argue. I have a lot of
9 cross-examination and I would ask for an instruction
10 from the Bench.

11 EXAMINER PARROT: Mr. Randazzo, do you
12 have a response to his objection?

13 MR. RANDAZZO: Yes, I do, your Honor.
14 This witness has throughout his testimony
15 stated that embedded capacity pricing is appropriate
16 because that was -- that's the way that rates were
17 set and that's what AEP expected. I'm asking him now
18 if the way that rates were actually set, to the
19 extent that those rates were set based upon
20 benchmarking against a competitive market price
21 including RPM, if that were the case, would that
22 affect his view.

23 EXAMINER PARROT: Mr. Graves, you may
24 answer the question.

25 A. Okay. I understand that the nonshopping

1 customer's rate is based on a blend of adjusted prior
2 ESP rates and competitive benchmark price which is a
3 fraction of the total factor that determines an MRO,
4 and if the ESP is less than that, then it's deemed
5 acceptable, I believe.

6 So there is some influence of competitive
7 benchmark pricing in the ESP.

8 Q. (By Mr. Randazzo) And for purposes of --
9 do you understand that for purposes of that
10 benchmarking that AEP Ohio has historically used PJM
11 RPM capacity prices to calculate the benchmark price?

12 A. I haven't reviewed the way they've done
13 it in comprehensive history, but I'm aware that
14 that's been the case in recent filings, and it
15 wouldn't surprise me.

16 Q. Now, is it your understanding that AEP
17 has taken the position that the revenues available
18 from nonshopping rates for the generation supply
19 component include a capacity charge equivalent to
20 approximately \$356 per megawatt-day?

21 A. I understand that to be the opinion of
22 witness Mr. Allen that the G component of the ESP
23 rate is approximately the same as the CRES embedded
24 rate.

25 Q. Okay. So if that were true, if the

1 rates -- the revenues produced by the generation
2 supply rate for nonshopping customers included the
3 equivalent of a 356 per megawatt-day capacity charge,
4 it is true, is it not, sir, that the rates and the
5 capacity revenue provided by those rates generated
6 substantially more revenue for AEP Ohio than would
7 have been generated had the capacity component been
8 set based upon RPM?

9 A. These are the rates for nonshopping
10 customers you're referring to?

11 Q. That's correct, sir, yes.

12 A. As a general matter that sounds right.
13 If the nonshopping rate was lower, it would have
14 generated less revenue.

15 Q. And do you have any sense of how much
16 revenue AEP Ohio collected as a result of the 355 or
17 356 per megawatt-day capacity charge that would not
18 have been collected had the capacity charge been set
19 based on RPM?

20 MR. CONWAY: Objection. Object to the
21 form of the question. There's no \$355 per
22 megawatt-day capacity charge set up in the retail
23 rates as a separate rate.

24 MR. RANDAZZO: Will you stipulate to
25 that?

1 MR. CONWAY: The retail rates do not
2 include --

3 MR. RANDAZZO: Will you stipulate to what
4 you just said?

5 MR. CONWAY: I said what I said.

6 MR. RANDAZZO: Will you stipulate to
7 that?

8 EXAMINER PARROT: The objection is
9 overruled.

10 You may answer, Mr. Graves. Do you need
11 the question reread?

12 A. Yes, I would.

13 (Record read.)

14 Q. And, again, we're talking about from
15 nonshopping customers.

16 A. Right. I'm not aware of a calculation to
17 that. I think it would require specifying a lot of
18 things, what timeframe you're talking about, what
19 else would have changed in the rates, whether energy
20 prices would have been different if the capacity
21 prices had been different, so it would take a lot of
22 specification that we haven't considered.

23 Q. Okay. And you talked with Mr. Kutik a
24 little bit about some of the history. In Ohio's
25 transition plan are you aware, and I'm talking about

1 the transition plan associated with the
2 implementation of the electric -- Mr. Kutik called it
3 deregulation, I call it restructuring, but the
4 legislation that implemented Ohio's customer choice
5 law, are you aware of how the collection of stranded
6 costs or transitioned revenues was constructed?

7 A. I believe generally there was an
8 opportunity to have a generation transition charge of
9 some kind and there I believe were hearings about
10 whether there were stranded costs and whether such
11 amounts should be amortized through, I forget, 2005
12 or something like that.

13 Q. Right.

14 A. Beyond that kind of general level of
15 detail I don't know the specifics.

16 Q. Okay. And can I -- I'd like to explore
17 one other aspect of this with you to test your
18 understanding of this if a claim for transition
19 revenue was granted by the Commission, do you have
20 any understanding as to whether or not the collection
21 of the transition costs occurred from both shopping
22 and nonshopping customers?

23 A. I don't know the specifics of the Ohio
24 policy in that regard. As a general rule transition
25 charges are collected as nonbypassable charges so

1 they're borne by both shopping and nonshopping
2 customers.

3 Q. Okay. And it wouldn't surprise you if
4 that were the case in Ohio I take it.

5 A. Right.

6 Q. Okay.

7 A. The rates are distorted if that's not the
8 case so it would not be consistent with trying to
9 induce effective retail competition.

10 Q. Now, from your -- by the way, I have to
11 tell you, it's not often that I run into a witness
12 who has credentials that exceed the length of his
13 testimony. Very impressive.

14 A. Sorry about that.

15 Q. Very impressive.

16 A. It's a long résumé.

17 Q. But I assure you I read them.

18 In Ohio are you aware that there is
19 competition between municipal electric utilities and
20 investor-owned electric utilities?

21 A. Can you be more specific as to what type
22 of competition you're talking about?

23 Q. Retail.

24 A. I do not know the extent to which
25 municipal utilities are protected from or allowed to

1 participate in retail competition in Ohio.

2 Q. Will you accept, subject to check, that
3 the City of Columbus has a municipal electric
4 utility?

5 A. Sure.

6 Q. How about the City of Westerville, Ohio?

7 A. Westerville?

8 Q. Yes.

9 A. I believe they do.

10 Q. Will you accept, subject to check, that
11 both of those communities are located within the
12 footprint of AEP Ohio?

13 A. Sure.

14 Q. Does AEP Ohio's -- does the FRR election
15 that you understand that AEP Ohio made extend to load
16 within municipal utilities?

17 A. Can I hear the question again?

18 (Record read.)

19 A. That's a question better directed at AEP
20 witnesses. I don't know for sure whether they're
21 considered part of the FRR obligation or not.

22 Q. Okay. So if municipal utilities,
23 electric utilities, serving retail customers in AEP's
24 service territory are not subject to the FRR election
25 that you understand AEP Ohio made, then the municipal

1 utilities would be free to secure capacity from the
2 RPM market, right?

3 A. Under those conditions, that sounds
4 right.

5 Q. Right. And if they are subject to AEP,
6 what you understand was AEP Ohio's election, they
7 would be obligated to secure capacity from AEP,
8 right?

9 A. To the extent they hadn't opted to cover
10 themselves and in effect become their own FRRs or --

11 Q. Well, they'd have to, if they're going to
12 do their own FRR, they would have had to have made
13 that election before -- within a certain period of
14 time, correct?

15 MR. CONWAY: Objection. I don't think
16 the witness was finished with his answer before
17 Mr. Randazzo interjected.

18 Q. I apologize. Please continue.

19 A. Yes, they would have had to have made
20 that election three years in advance or so of the
21 time they wanted to begin doing it.

22 Q. So, let's see, if it's appropriate, in
23 your judgment, based upon your just and reasonable
24 standard, that CRES suppliers pay an embedded
25 capacity charge when they are serving retail

1 customers that were formerly served by AEP Ohio,
2 would the same logic extend in the circumstance where
3 a municipal electric utility is serving a retail
4 customer that was formerly served by AEP Ohio?

5 A. So this municipal utility has a retail
6 arm that is in effect a CRES provider itself?

7 Q. No, the municipal utility serves retail
8 customers and customers that the -- the customers
9 have the ability to either elect service from
10 AEP Ohio or the municipal electric utility. The
11 municipal electric utility service retail customers.

12 In that circumstance, based upon your
13 notion of just and reasonable, would it be necessary
14 to charge the municipal electric utility a capacity
15 charge in circumstances where the retail customer
16 moved from AEP Ohio to the municipal utility and that
17 capacity charge is specified at an embedded cost
18 rate? Is that the logical implication of your view?

19 A. It's a pretty rich hypothetical so let me
20 just make sure I can reconstruct it a little bit
21 here. We have a customer who is a nonshopping AEP
22 customer who decides to become a customer of a
23 municipality and is apparently able to elect to do
24 so, or at least we're assuming that that's the case,
25 and pay whatever the municipal electric charge is for

1 its capacity.

2 Q. Right.

3 A. And so then the question is should the
4 municipal electric company have to pay AEP the same
5 rate as the CRES providers?

6 Q. Yes.

7 A. It seems to me to be a much richer
8 problem and it's very hard for me to give you an
9 answer because --

10 Q. I noticed.

11 A. -- under the rest of the terms of the
12 contract between the AEP and the municipality and
13 what other assumptions are being made about the
14 municipality covering specific capacity costs of AEP,
15 maybe they have a contract that's five years old, ten
16 years old, maybe unit specific.

17 Q. Okay.

18 A. I don't know the terms and I wouldn't
19 want to suggest that those contracts should be
20 overridden because of this switching here but, so I
21 can't offer a categorical conclusion on that.

22 Q. So in that circumstance there would be a
23 lot of things that you'd want to take a look at
24 before concluding that an embedded cost capacity
25 charge exit fee should be imposed either on the

1 departing retail customer or the municipality. You
2 would need to look at a lot more things, right?

3 A. Sure. I wouldn't presume it's per se
4 unreasonable or inequitable to do so but there may be
5 other considerations that have already precluded
6 that.

7 Q. And those other considerations may cause
8 it to be unreasonable in that circumstance.

9 A. Or infeasible. Whether it's unreasonable
10 or not.

11 Q. Right. But there are other circumstances
12 that may cause it to be unreasonable. You answered
13 "infeasible." I asked "unreasonable."

14 A. I could conceive of circumstances where
15 it would be. For instance, if there had already been
16 prepayment for some sort of indemnification against
17 some kinds of changes in cost and there was already
18 agreement that customer migration of that kind could
19 occur and was compensated through some a priori
20 mechanism, then switching to a new embedded cost
21 basis might be unreasonable.

22 Q. So if AEP received stranded cost
23 compensation prior to this retail customer moving
24 from AEP to the municipal utility, that might affect
25 your judgment as to whether or not it was appropriate

1 to impose an embedded cost exit fee on the departing
2 customer or the municipality, right?

3 A. Yes, that's an example of a possible
4 condition that would override the equivalent pricing.

5 Q. And if AEP Ohio had committed that it
6 would not charge shopping customers a lost revenue
7 exit fee of the type that I've described, that would
8 be another consideration that might override your
9 judgment about the justness and reasonableness of
10 using an embedded cost capacity charge, right?

11 A. Yes, I guess that's fair enough. It
12 would depend on context and it's conceivable that,
13 you know, prior contractual arrangements had already
14 addressed that concern and made arrangements and then
15 changing that would be unreasonable. But it depends
16 on how the contract was entered, whether it was arm's
17 length, whether it was a settlement or a mandate or
18 what determined it.

19 Q. Now, as you understand what AEP Ohio is
20 proposing in this case -- let me back up.

21 Do you have your testimony in front of
22 you?

23 A. Yes.

24 Q. Do you know what a case caption is?

25 A. Not really.

1 Q. Okay. You see on your testimony below
2 the front page where it says "Before the Public
3 Utilities Commission of Ohio," and then it's got some
4 words on the left and then a case number on the
5 right?

6 A. Sure.

7 Q. All right. Is it your understanding that
8 this case is to review the capacity charges of Ohio
9 Power Company and Columbus Southern Power Company?

10 A. Yes.

11 Q. And do you use -- do you mention Columbus
12 Southern at all in your testimony?

13 A. You know, I don't appear to, but I think
14 it's just an oversight, except on what must be the
15 case caption here.

16 Q. That's all right. It wasn't a trick.
17 Now, do you agree that despite likely
18 coal plant retirements over the next few years due to
19 low gas prices and environmental retrofit
20 obligations, it does not appear that there is any
21 reason to fear a supply adequacy problem?

22 A. Yes, I think that's generally true.

23 Q. And do you agree that PJM has more than
24 target reserves at present and likely retirements are
25 partly offset by announced new entry of generating

1 resources?

2 A. Sure.

3 Q. And, furthermore, that the RPM auctions
4 occur far enough in advance that even if a pending
5 shortfall appeared likely, there would be sufficient
6 time for new resources to be deployed.

7 A. Yes, I agree with that.

8 Q. Okay. And would you accept, subject to
9 check, that I am reading from the testimony that you
10 filed in the ESP 2 as modified case on March 30th,
11 2012, at the top of page 3, that testimony was filed
12 seven days after the testimony you filed in this
13 case? Would you agree that I was reading from that
14 testimony, subject to check.

15 A. It certainly sounds familiar.

16 Q. All right. Now, what was the scope of
17 your responsibility as you were selected by, and I'll
18 just call them AEP Ohio for purposes of preparing
19 your testimony in this case?

20 A. I think it's pretty well described in my
21 report. I was asked to comment on the reasonableness
22 of using embedded cost prices versus RPM prices.

23 Q. Did you look at any alternatives? Beyond
24 the way you framed the analysis, did you look at
25 alternatives beyond RPM or embedded costs as part of

1 your assignment?

2 A. No, other than being generally aware of
3 AEP's consideration of a transition out of the FRR
4 process to future RPM-based supply plan.

5 Q. So you constrained your analysis to
6 either embedded cost as you accepted AEP's rendition
7 of it or RPM, right?

8 A. I guess so. That was the scope of my
9 requested services.

10 Q. Right. And from the credentials in your
11 testimony I understand that you've done a fair amount
12 of modeling to address trade-offs and optimize
13 benefits associated with difficult issues; is that
14 fair?

15 A. Sure, I guess so. I'm often involved in
16 planning studies and regulatory approvals for
17 utilities in which there's complex trade-offs and
18 risk analysis pricing controversies, that sort of
19 thing.

20 Q. Did AEP ask you to limit your analysis to
21 either embedded costs or RPM?

22 A. It wasn't posed explicitly as a hard
23 constraint, but that was the effective nature of the
24 request, that I address the trade-offs between those
25 two and they were -- and that I not take

1 responsibility for any other strategy development for
2 them or any validation of their other -- their
3 estimation of those parameters.

4 Q. Okay. So the binary structure was a
5 given as you proceeded to render your opinions; is
6 that correct?

7 A. I think that's fair.

8 Q. All right. Now, by the way, going
9 through your credentials, lengthy credentials
10 attached to your testimony, do the words "embedded
11 cost" appear anywhere? Will you accept, subject to
12 check, that they do not?

13 A. I would be happy to accept that.

14 Q. Do the words "marginal cost analysis"
15 appear frequently in your credentials?

16 A. Probably.

17 Q. What's the difference between "marginal
18 cost" and "embedded cost"?

19 A. Well, marginal cost is a short run or
20 long run avoidable cost of future service. Embedded
21 cost is the average cost of the -- recovering the
22 investment and operating costs of historically
23 acquired assets.

24 Q. Have you ever constructed a model that
25 relies exclusively on embedded costs for purposes of

1 trying to identify an economic efficient result?

2 A. Not exclusively, but I've certainly used
3 embedded cost analyses in analyses of what would be
4 efficient.

5 Q. But you would not design a model of the
6 type that I described earlier only to consider
7 embedded costs, right? If you were trying -- if you
8 were trying to reach economic efficiency. Is that
9 correct?

10 A. Well, efficiency is a broad topic,
11 there's short-run efficiency and long-run efficiency,
12 there's question about dynamic efficiency and
13 fairness, and the longer term ones do require
14 consideration of embedded costs and continuity of
15 rulemaking and so on. So they enter into it but
16 they're not sufficient by themselves to resolve that
17 question.

18 Q. Right. So I appreciate the length of
19 your answer and the qualifications, but am I correct,
20 sir, that you would not believe it would be
21 reasonable to rely upon an economic model that
22 utilized exclusively embedded costs to identify an
23 economically efficient outcome? Is that correct?

24 A. I certainly have not done so and I would
25 say that generally I would not expect to.

1 Q. And based upon your experience it would
2 be unreasonable to do so; would it not?

3 A. Sure, if efficiency is your only
4 consideration, then you can't solve that by just
5 looking at embedded costs.

6 Q. Is The Brattle Group engaged by AEP or
7 any subsidiary of AEP for purposes other than your
8 testimony?

9 A. I believe we have been from time to time.

10 Q. And can you describe the range of
11 services that you provide to AEP through The Brattle
12 Group.

13 A. I don't know that I can give you a
14 comprehensive list. It's not very extensive, but I
15 believe we've been involved in some assisting in some
16 assessments of the design of their advance meter
17 infrastructure and demand response programs, I think
18 we may have reviewed some of their efficiency
19 programs, I think we're involved in some transmission
20 line risk analysis and investment analysis.

21 Q. Okay.

22 A. I am not involved in those, but our firm
23 is.

24 Q. And one of the main aspects of your
25 training and experience involves finance; is that

1 correct?

2 A. Yes, it certainly does.

3 Q. Can you help me to understand your view
4 of what falls under the heading of "finance"? What
5 is the discipline of finance about?

6 A. Well, at a very broad level finance is
7 about --

8 Q. Please.

9 A. -- intertemporal economics of how markets
10 equilibrate over time as opposed to
11 cross-sectionally. Conventional microeconomics is
12 about cross-sectional behavior, pricing, and
13 competitive activity, and finance is about how
14 payoffs to decisions that occur over time are priced
15 and how markets that provide intertemporal allocation
16 and capital reallocation work.

17 Q. Okay. And when you say "intertemporal,"
18 you're talking about things that occur in different
19 time periods, correct?

20 A. Yes.

21 Q. Okay. So in finance looking at the
22 present value of various options would be part of --
23 routine part of financial analysis, correct?

24 A. Yes, that's an important component.

25 Q. Right. And things like, tools like

1 discounted cash flow would be another way to come to
2 a present value observation about different
3 opportunities, correct?

4 A. Yes, that's one of the tools. There are
5 others, but of course that's an important one.

6 Q. And I also gather from your experience
7 that you have been involved in the issuance of
8 securities; is that correct?

9 A. Not directly. Not as an issuer or as a
10 dealer, but I've been involved in assessing what the
11 value of securities might be and whether they were
12 fairly disclosed, priced, that sort of thing.

13 Q. Right. And from your credentials I also
14 gather that you've also been an expert witness in
15 litigation in circumstances where there have been
16 allegations that misrepresentations or fraud had
17 occurred in conjunction with the issuance of
18 securities, correct?

19 A. Yes. Generally less so with regard to
20 issuance of securities than with regard to management
21 representation about the going-forward value of their
22 companies, but --

23 Q. All right.

24 A. -- but I've been involved in securities
25 litigation several times.

1 Q. And how, in the process of issuing
2 securities, you mentioned management representations,
3 is it your understanding that prior to the issuance
4 of securities that the management of a firm is
5 required to provide information to potential
6 investors that fully and completely disclose the
7 nature of the business and the risks associated with
8 that business so the investor can make an informed
9 choice about whether or not to purchase securities?
10 Is that your understanding of the structure we have
11 in this country?

12 A. It's generally true. There are different
13 degrees of disclosure requirements for different
14 kinds of securities and it depends on whether the
15 investors will be public or private and what sorts of
16 responsibilities they bear for their decisions to
17 invest, but generally public disclosure of some kind
18 about the future risks and opportunities is required.

19 Q. And do you understand that AEP is a
20 publicly traded company?

21 A. Yes.

22 Q. And is it also correct that Ohio Power
23 and Columbus & Southern are not publicly traded
24 companies?

25 A. That's my understanding. They're

1 subsidiaries.

2 Q. And AEP is the sole shareholder or sole
3 owner of the stock of Ohio Power and Columbus
4 Southern; is that correct?

5 A. I haven't reviewed that, but I have no
6 reason to doubt it.

7 Q. Okay. So if there was common equity
8 issued in the case of Ohio Power or Columbus &
9 Southern, that wouldn't happen, right? In the
10 structure that we call AEP.

11 A. It would be privately held equity inside
12 of AEP.

13 Q. Right. So the common equity issuer in
14 the AEP system would be AEP, American Electric Power
15 Company, Inc., right?

16 A. That is my understanding.

17 Q. And that's true with holding company
18 structures often, correct?

19 A. That often is. There can be minority
20 interests that are public, but generally that's not
21 the case.

22 Q. And as a publicly traded company, prior
23 to issuing securities, AEP electric -- American
24 Electric Power Company, Inc. would be obligated to
25 issue a prospectus, correct?

1 A. Again, depending on the nature of the
2 security, that could be required. Certain types of
3 debt instruments don't require the same disclosure.
4 It depends on who is the lender.

5 Q. And so we're clear, if we were talking
6 about the issuance of common equity by American
7 Electric Power Company, Inc., a publicly traded
8 company, your understanding is that there would be a
9 prospectus that would be required to be issued to
10 identify the lines of business and the risks and
11 other things that investors would want to know before
12 they invest in American Electric Power Company, Inc.

13 A. Yes.

14 Q. Right?

15 A. That's true for public offerings.

16 Q. And if there was a misleading or false
17 statement in that prospectus, the people that were
18 responsible for issuing the prospectus would be
19 subject to criminal and civil punishment, right?

20 A. Well, subject to a much richer test of
21 why it was misleading, but in principle that could
22 happen.

23 Q. Are you aware that American Electric
24 Power Company, Inc. issued common equity in 2002?

25 A. I was not.

1 MR. RANDAZZO: Your Honor, I would ask
2 that the document I've just distributed be marked as
3 IEU Exhibit No. 113.

4 EXAMINER PARROT: So marked.

5 We need another copy, Mr. Randazzo.

6 MR. RANDAZZO: I'm sorry.

7 Q. Now, I believe it was Mr. Kutik and
8 yourself --

9 EXAMINER PARROT: Just a moment,
10 Mr. Randazzo.

11 MR. RANDAZZO: Yes. I stand corrected.
12 I believe it's 112.

13 EXAMINER PARROT: Yes, it is.

14 MR. RANDAZZO: Thank you. I'm sorry.

15 EXAMINER PARROT: The exhibit is marked
16 as IEU Exhibit 112.

17 (EXHIBIT MARKED FOR IDENTIFICATION.)

18 Q. (By Mr. Randazzo) Now, a prospectus
19 issued by a publicly traded company in conjunction
20 with a proposed issuance of common equity would be a
21 source of information about the business plans of the
22 entity issuing common equity, the lines of business,
23 regulated and unregulated, that that company may be
24 in, as well as their expectations about the value
25 opportunities that are presented to potential

1 investors, correct?

2 A. Broadly that's correct.

3 Q. Do you have before you, sir, what has
4 been marked as IEU Exhibit 112?

5 A. I do.

6 Q. Would you accept, subject to check, that
7 that's the prospectus supplement that was issued by
8 American Electric Power Company, Inc. in conjunction
9 with a 9.25 percent equity units?

10 A. Yes, it seems to be.

11 Q. And in the lower left-hand corner you see
12 June 5, 2002; is that correct?

13 A. Yes.

14 Q. Would you accept, subject to check, that
15 this was issued after the completion of the
16 implementation of Ohio's electric restructuring?

17 A. I believe that was completed by
18 June 2002.

19 Q. Okay. Now, would you turn to page S-3
20 near the front of the document.

21 A. Okay, I have it.

22 Q. Now, do you see the descriptions of
23 "regulated operations" and "unregulated operations"
24 there?

25 A. Yes, the first and second bold sections

1 of that page.

2 Q. Do you see anywhere on that page a
3 reference to the sale of capacity? How about the
4 fourth bullet point under "Unregulated Operations."

5 A. Okay. Thank you. Yes, it describes the
6 unregulated operations as possibly participating in
7 long-term transactions to buy or sell capacity,
8 energy, and ancillary services of electric generating
9 facilities.

10 Q. Do you see the word "possibly" in that
11 statement at all? You added it.

12 A. No, I'm saying that I view this list as a
13 list of things they could do.

14 Q. Do you see at the top -- first of all,
15 we're dealing with a description of unregulated
16 operations; is that correct?

17 A. Yes, and that section is on unregulated
18 operations.

19 Q. Yeah. Would you read the first two lines
20 under that heading before the colon.

21 A. Okay. "Our unregulated business
22 operations focus on value-driven asset optimization
23 at each link of the energy chain through the
24 following activities:"

25 Q. Now --

1 MR. CONWAY: Your Honor, at this point
2 I'm just going to interject an objection to the
3 relevance of this line of questioning, its
4 appropriateness in any event from pursuing the
5 meaning of the company's securities filings with
6 Mr. Graves who is an outside consultant. It's just
7 not appropriate.

8 MR. RANDAZZO: Your Honors, this witness
9 has testified about what AEP expected as a basis for
10 concluding that the use of embedded cost would be
11 reasonable and has agreed that the prospectus issued
12 in conjunction with common equity by American
13 Electric Power, Inc. would be a place from which we
14 could obtain information about what those
15 expectations were, and I would like the opportunity
16 to talk to this witness about his view on the
17 expectations as they were stated by AEP Ohio in a
18 document which must fully and fairly disclose those
19 expectations to potential purchasers of securities.

20 MR. CONWAY: Your Honor, I believe the
21 witness declined to be a witness that would testify
22 as to what AEP's expectations are. He said he could
23 derive from publicly available information views
24 about their position, but I think he declined to say
25 that he was the witness who could speak about AEP

1 Ohio's expectations. That's the first point.

2 The second point is that this document is
3 from 2002, it was issued with regard to securities
4 that were themselves issued well before there was a
5 PJM capacity market, and so its relevance to the
6 issues that we have before us today is nonexistent.

7 There's no connection. And it's
8 inappropriate to take up this amount of time pursuing
9 this goose chase. And it's inappropriate to do it
10 with the witness Mr. Graves. We could just as well
11 have an empty chair up there and have Mr. Randazzo
12 ask his questions to the wall and we'd have just as
13 much -- it would have just as much relevance and
14 propriety as using Mr. Graves.

15 MR. RANDAZZO: Mr. Graves, so it's clear,
16 I don't think you're a wall.

17 EXAMINER PARROT: Anything else,
18 Mr. Randazzo?

19 MR. RANDAZZO: Your Honors, as Mr. Conway
20 indicated, Mr. Graves has also already indicated it
21 would be appropriate to look at publicly available
22 documents as to identify what AEP Ohio and AEP in
23 general expected. This is a publicly available
24 document.

25 Mr. Conway is not suggesting that it's

1 not an authority on the subject of my inquiry or that
2 there's anything misstated in this document, so I
3 will -- I believe the cross-examination is
4 appropriate.

5 EXAMINER PARROT: And as to the time
6 period? What's the relevance?

7 MR. RANDAZZO: Your Honor, we have --
8 your Honors, we have had testimony throughout this
9 proceeding dealing with things like the opportunity
10 that was available to AEP to recover stranded costs.

11 We have had testimony throughout this
12 proceeding saying that AEP viewed itself as a bundled
13 entity, vertically integrated entity, as a predicate
14 for a claim that somehow it was entitled to embedded
15 cost recovery.

16 I believe, if allowed, I will show that
17 is false based upon the statements made in this
18 prospectus.

19 EXAMINER PARROT: All right. The
20 objection is overruled.

21 Q. (By Mr. Randazzo) Now, will you turn to
22 page S-28 and S-29.

23 A. Okay, I have it.

24 Q. And do you see on the bottom of S-28
25 there is a organizational chart that shows the

1 corporate structure that existed at the time this
2 prospectus was issued and the proposed post
3 restructuring corporate structure on the following
4 page?

5 A. Yes.

6 Q. And underneath the "Regulated Holdco"
7 column on S-29 do you see boxes that are for Ohio
8 Power wires and Columbus Southern Power Company
9 wires?

10 A. Yes. On the left set of branches of the
11 corporate organizational tree there's a Regulated
12 Holdco which includes some wires companies.

13 Q. And underneath the AEP Enterprises column
14 on S-29, you will see OPCo Genco and Columbus
15 Southern Power Genco, correct?

16 A. Yes.

17 Q. Do you know at the time of implementing
18 Senate Bill 3 what the corporate separation plan was
19 that was submitted by Columbus Southern and Ohio
20 Power?

21 A. No.

22 Q. Did you review that for purposes of
23 forming your opinions in this case?

24 A. No, I did not.

25 Q. All right.

1 MR. RANDAZZO: Your Honors, I would ask
2 that a document titled Direct Testimony of William R.
3 Forrester on behalf of Columbus Southern Power
4 Company and Ohio Power Company be marked as IEU
5 Exhibit No. 113.

6 (EXHIBIT MARKED FOR IDENTIFICATION.)

7 Q. Sir, do you have before you what has been
8 marked as IEU Exhibit No. 113?

9 A. Yes.

10 Q. Will you accept, subject to check, that
11 this is testimony that AEP -- well, I should say
12 Columbus Southern and Ohio Power filed in the
13 electric transition plan proceeding to implement
14 Ohio's electric restructuring legislation?

15 A. I suspect this is part of that. I can't
16 imagine it's the whole plan.

17 Q. No.

18 A. It would be the world's most concise
19 plan, but --

20 Q. Right. Thank you for that.

21 I pulled several pages out of the
22 testimony and I'd like you to look at the back page.

23 A. The graph or the table? The figure I
24 guess.

25 Q. Yeah, the figure. And also then turn to

1 page 21 of the text that's in IEU Exhibit 113.

2 A. Okay.

3 Q. Now, do you see at line 9 on page 21 the
4 sentence that begins with "The two new subsidiaries"?

5 A. It's on line 10 in mine, but that's fine,
6 yes.

7 Q. Yes. I'm sorry. Yes, it is, I'm sorry.

8 And does that sentence indicate to you
9 that Columbus Southern and Ohio Power were proposing
10 to form two new subsidiaries to own and operate
11 transmission and distribution assets?

12 A. It says that, yes.

13 Q. And the sentence above that that begins
14 on line 9 contemplated that the existing Columbus
15 Southern and Ohio Power would own the generating
16 assets, right?

17 A. Yes.

18 Q. All right. Do you know if this was
19 approved, this proposed corporate separation plan was
20 approved by the Commission?

21 A. I don't know.

22 Q. Well, if it was approved by the PUCO, by
23 the Public Utilities Commission of Ohio, would the
24 organizational chart on page S-29 of the prospectus
25 underneath the corporate structure post restructuring

1 be consistent with the description in Mr. Forrester's
2 testimony to which I referred you to?

3 MR. CONWAY: Your Honor, I object, again
4 on relevance and also the propriety of using this
5 witness for whatever purpose, relevant or not, that
6 Mr. Randazzo is pursuing.

7 This is a document from the original ETP
8 case from 1999 and Mr. Forrester -- an excerpt of
9 Mr. Forrester's testimony. The witness has already
10 explained that he's not familiar with the corporate
11 separation plan that was approved then or proposed
12 then and whether or not it was approved, and since
13 that time there's been a lot of water over the dam,
14 and to use this witness as a pretext for injecting
15 into the record this information I think is
16 inappropriate.

17 We had Mr. Munczinski who actually
18 testified in this case who was a witness in this
19 proceeding earlier during the hearing and none of
20 these questions were asked of him, which even if not
21 relevant would have been an appropriate subject to
22 address them to.

23 And now we have Mr. Randazzo going
24 through this, at this point ancient history with a
25 witness who is not familiar with it and not a part of

1 that case, I think it's irrelevant and inappropriate.

2 EXAMINER PARROT: Response.

3 MR. RANDAZZO: Your Honors, I have a
4 couple more questions, foundational questions, as a
5 predicate for moving to more current documents that
6 explain how AEP itself implemented the plan that was
7 described in Mr. Forrester's testimony and is
8 described in the prospectus.

9 MR. CONWAY: And, your Honor, my
10 objections will continue and it will be the same
11 basis. First, relevance, but even beyond that, what
12 this witness has to do with the purpose of the
13 examination, particularly in light of when we had a
14 witness from the company who's familiar with the
15 history who was here before and none of these
16 questions were asked of him. It makes no sense and
17 it's inappropriate to bear upon this witness with
18 this material.

19 EXAMINER PARROT: Anything else?

20 MR. RANDAZZO: No.

21 EXAMINER PARROT: The objection is
22 overruled.

23 THE WITNESS: Can I hear the question
24 again?

25 Q. (By Mr. Randazzo) Let me restate it.

1 A. Okay.

2 Q. Is the description in Mr. Forrester's
3 testimony as well as the diagram on the back of the
4 testimony to which I referred you to consistent with
5 the diagram that's on the page S-29 dealing with the
6 corporate structure post restructuring?

7 A. Well, they're obviously not the same, but
8 there are some areas of apparent consistency. The
9 broad distinguishing of wires companies from
10 generation and wholesale from retail is constant.
11 There's a service company that's identified in each
12 case.

13 You know, the precise allocation of
14 functions and the number of entities that would be
15 providing those aren't comparable on the two charts,
16 but they may not be inconsistent.

17 Q. All right. But based on the prospective
18 places where I've directed you to this point, do you
19 think it would be fair to conclude that, with regard
20 to the generation function, the prospectus identified
21 that that would be part of the unregulated activities
22 of American Electric Power? Right?

23 A. I'm sorry, with regard to the prospectus
24 or with regard to the separation plan?

25 Q. With regard to the prospectus.

1 Generation is identified and the sale of capacity is
2 identified as part of the unregulated business,
3 correct?

4 MR. CONWAY: Your Honor, I just continue
5 to object to subjecting this witness to giving
6 opinions about what the prospectus from 2002 was
7 intended to show or to provide in the way of
8 information. There's no basis in this witness's
9 experience to do that. There's no basis that's any
10 superior in this witness's experience than anyone
11 around the table in this room could provide.

12 The witness who might have been able to
13 provide or shed some light on it has been on and is
14 now off, and so I find it troubling that the vessel
15 through which Mr. Randazzo seeks to inject his view,
16 his world view of what happened in 2002 is this
17 witness, the person who may be the most uniquely
18 unqualified to carry that job, so I object.

19 EXAMINER PARROT: And your continuing
20 objection is noted and, again, overruled.

21 Mr. Graves, you may answer the question
22 to the best of your knowledge.

23 A. Okay. Well, I'm only interpreting what I
24 say on the page here providing no other additional
25 contextual knowledge, but I think you perhaps

1 overstated the degree of exclusion of generation from
2 regulated operations based on S-29.

3 The first bullet has five dashed
4 subtopics underneath it and the fourth one says,
5 under Regulated Operations, "Optimize generation
6 assets to enhance availability of off-system sales."

7 So there's some continuing linkage
8 between generation and regulated operations.

9 Q. Okay. Let's move to another -- are you
10 familiar with FERC, what we call the FERC Form 1?

11 A. Sure, generally.

12 Q. And is that another document that
13 utilities subject to the Federal Energy Regulatory
14 Commission's jurisdiction are obligated to use to
15 provide accurate and complete information to
16 regulatory authorities?

17 A. There are some standard information
18 requirements, I don't know whether they're complete
19 in the sense that they cover everything you could
20 possibly want to know about a utility, but subject to
21 those guidelines, yes, the utilities are obligated to
22 file Form 1s annually with the Commission.

23 Q. And do you know whether or not the FERC
24 Form 1 also constitutes the annual report that's
25 submitted to the Public Utilities Commission of Ohio,

1 if you know?

2 A. I don't, but I wouldn't be surprised if
3 it's used.

4 MR. RANDAZZO: Your Honor, I have
5 distributed a document that has name of the
6 respondent in the upper left-hand corner, Columbus
7 Southern Power, in the right-hand corner it has
8 December 31, 2001, and at the bottom of the page it
9 has FERC Form 1, page 123. I would like it to be
10 marked as IEU Exhibit 114.

11 EXAMINER PARROT: So marked.

12 (EXHIBIT MARKED FOR IDENTIFICATION.)

13 Q. You accept, subject to check -- do you
14 have what's been marked as IEU Exhibit No. 114?

15 A. Yes.

16 Q. You accept, subject to check, that this
17 is a excerpt from the FERC Form 1 filed by Columbus &
18 Southern for the year 2001?

19 A. Yes, it certainly looks like it.

20 Q. All right. And as part of the FERC Form
21 1 and the 10-K filed with the Securities & Exchange
22 Commission and other documents issued by public
23 companies, publicly traded companies, they are
24 required to identify significant regulatory changes
25 and changes in accounting practices, right?

1 THE WITNESS: Could I hear that again?

2 (Record read.)

3 A. I suppose that's generally true. The
4 disclosure requirements are somewhat different for
5 the 10-K and the Form 1 because they don't use
6 identical accounting traditions, but they do
7 generally seek disclosures of changes in regulatory
8 accounting and policy.

9 Q. Okay. And with regard to the FERC Form
10 1, it would be your understanding that utilities are
11 obligated to provide accurate and complete
12 information, correct?

13 A. Sure, subject to the guidelines of the
14 standard system of accounts that's used.

15 Q. Right. Now, would you turn to page 123.5
16 which is the second page in IEU Exhibit 114.

17 A. I'm sorry, 123.5?

18 Q. Yes.

19 A. Okay, I have it.

20 Q. And do you see there the description of
21 "Customer Choice and Industry Restructuring"?

22 A. I do, at the bottom of the page.

23 Q. Do you have any reason to disagree with
24 Columbus & Southern's description of the electric
25 restructuring that was passed in Ohio?

1 A. No, I have no reason to disagree with it.

2 Q. All right. And at the top of the next
3 page, 123.6, do you see the statement "All customers
4 continue to be served by CSP for transmission and
5 distribution services"?

6 A. Yes.

7 Q. And several places in your testimony you
8 use the words "franchise service territory," right?

9 A. I think I mention that, yes.

10 Q. What's your understanding of the
11 franchise service territory of Ohio Power and
12 Columbus & Southern?

13 A. I don't know the chapter and verse of
14 what cities and --

15 Q. Well, let me -- let me shorten this up I
16 think.

17 A. Okay.

18 Q. Is it your understanding that they have
19 franchised service territory for generation service?

20 A. No. They have a, right now they have a
21 transmission and distribution franchise but they have
22 a standard service offer for customers within that
23 zone who don't go shopping.

24 Q. Right. And are there any other
25 opportunities that you're aware of for -- strike

1 that.

2 Let me ask you this question: Do you
3 know what an electric distribution utility is?

4 A. I think so.

5 Q. That would be an entity that just uses --
6 just operates the distribution segment of the
7 business, correct?

8 A. Yes, that sounds right.

9 Q. For purposes of your testimony did you
10 assume that Columbus Southern and Ohio Power are
11 something other than an electric distribution
12 utility?

13 A. It wasn't a distinction I was trying to
14 draw. My focus is on the fulfillment of their FRR
15 obligations and the pricing that's appropriate to
16 capacity in that, so I didn't review their
17 distribution operations.

18 Q. Continuing on IEU Exhibit 114, page
19 123.6, the first full paragraph on that page that
20 begins with the Ohio Act.

21 A. Yes, I see it.

22 Q. Do you have any reason to disagree that
23 the Ohio legislation provided for a five-year
24 transition period to move from cost-based rates to
25 market pricing for electric generation supply

1 services?

2 A. I see that, and I agree with that.

3 Q. And I'd like you to turn to page 123.7.

4 A. Okay.

5 Q. Do you see the italics there?

6 A. In the middle of the page?

7 Q. Yes.

8 A. Yes.

9 Q. The italics says "Discontinuance of the
10 Application of SFAS 71 Regulatory Accounting in
11 Ohio," right?

12 A. Yes.

13 Q. What's regulatory accounting?

14 A. Regulatory accounting is the mechanism
15 whereby the value of assets and costs incurred are
16 recorded for regulatory purposes.

17 Q. Okay. And if you discontinue regulatory
18 accounting, how is the value of assets recorded?

19 A. Well, I haven't reviewed FAS 71 for some
20 time.

21 Q. Which they discontinued.

22 A. Right. It doesn't describe every asset
23 that a utility holds. It has to do with, as I
24 recall, regulatory assets that are being amortized
25 over time and whether they have to be recorded at

1 book value or market value.

2 Q. I'm not asking you about 71. First of
3 all, if I was not regulated, I would not be eligible
4 for regulatory accounting, correct?

5 A. Correct.

6 Q. Okay. So -- and a lot of people think I
7 need to be regulated, so we'll get to that later.

8 And for nonregulated lines of business
9 that maintain a balance sheet that have assets on the
10 left side and liabilities on the right side, right?

11 A. Yes, as do utilities.

12 Q. As do utilities. But for nonregulated
13 lines of business the opportunity to maintain a value
14 on the asset side is subject to what is referred to
15 as an impairment test, right?

16 A. Generally that's true.

17 Q. What's an impairment test?

18 A. An impairment test is used for things
19 like goodwill and assets that have been recorded at a
20 value that could change over time and you want to see
21 if it still reflects the fair value of the asset.

22 Q. And for purposes of -- well, let's do
23 this by the numbers. In the event that the value
24 shown on the books for an asset no longer reflects
25 fair value, what is required at that point?

1 A. Well, it only applies to certain assets.
2 Most assets that are tangible assets are held for --
3 on a book accounting basis quite similarly to the way
4 utilities do it, but certain kinds of intangible
5 assets, as I mentioned such as goodwill, are revalued
6 annually to see if the accounting value that they had
7 when they were first acquired still reflects their
8 value and, if not, there's an adjustment up or
9 down --

10 Q. Okay.

11 A. -- to market value.

12 Q. So based on your understanding of
13 regulatory accounting and the text at page 123.7, is
14 it clear to you that after the Ohio electric
15 restructuring that Columbus Southern elected to
16 discontinue regulatory accounting for the generation
17 portion of their business?

18 A. Yes, that's correct.

19 Q. All right.

20 A. At least under FAS 71.

21 Q. Okay. Is there any other regulatory
22 accounting?

23 A. A broad question. I guess for generation
24 do you mean or for asset valuation outside of -- I
25 mean, yes, there's tomes of material on regulatory

1 accounting.

2 Q. Okay.

3 A. It's a big topic.

4 Q. All right. Now, would you look at the
5 next paragraph on page 123.7.

6 A. Okay.

7 Q. It begins "The discontinuance...."?

8 A. Yes, I have it.

9 Q. Does that paragraph contain your
10 understanding of the significance of discontinuing
11 regular inventory accounting?

12 A. Yes.

13 Q. Okay. Are you aware of whether or not
14 Columbus Southern or Ohio Power has continued to not
15 follow regulatory accounting for the generation
16 portion of their business?

17 A. I don't know specifically but I would
18 assume that's the case.

19 MR. RANDAZZO: Your Honor, I would like
20 to have marked for identification purposes a one-page
21 document that has Ohio Power Company in the left-hand
22 corner and in the right-hand corner under the box
23 Year Period of Report you'll see 2011 Q4.

24 EXAMINER PARROT: The exhibit will be
25 marked as IEU Exhibit 115.

1 (EXHIBIT MARKED FOR IDENTIFICATION.)

2 Q. Now, sir, do you have before you what's
3 been marked as IEU Exhibit No. 115?

4 A. I do.

5 Q. Would you accept, subject to check, that
6 this is the most recent FERC Form 1 that had been
7 filed by Ohio Power or Columbus Southern?

8 A. Yes.

9 Q. And will you accept, subject to check,
10 that for purposes of this FERC Form 1 Ohio Power and
11 Columbus & Southern have been combined?

12 A. Okay. I'll accept that.

13 Q. All right. Now, do you see at the top of
14 the page "Accounting for the Effects of Cost-Based
15 Regulation"?

16 A. Yes.

17 Q. And the last sentence of that paragraph.

18 A. I see it, yes.

19 Q. And would I be correct there that that
20 sentence indicates that Ohio Power, now referring to
21 both Columbus Southern and Ohio Power,
22 "...discontinued the application of 'Regulated
23 Operations' accounting treatment for the generation
24 portion of its business"?

25 A. Yes, it says that.

1 Q. And then it goes on to, in the next
2 paragraph, explain the significance of that; am I
3 correct?

4 A. Yes. That's closely related.

5 Q. Okay. And am I correct that in that
6 paragraph that once you discontinue rate regulated
7 operations that the accounting rules require the
8 recognition of an impairment of stranded net
9 regulatory assets and stranded plant costs if they
10 are not recoverable in regulated rates?

11 A. That's my understanding and that's also
12 what it says.

13 Q. Okay. What rates are currently in
14 effect? Strike that.

15 Would you agree with me that the proposed
16 capacity charge of AEP Ohio in this case is not
17 presently in effect?

18 A. Sure. That's true.

19 Q. Do you know what capacity charge is in
20 effect?

21 A. Yes. The RPM rate.

22 Q. It's your understanding that the RPM rate
23 is in effect; is that correct?

24 A. Yes.

25 Q. All right. Do you know whether or not

1 Columbus Southern and Ohio Power has done an
2 impairment analysis?

3 A. I don't know.

4 Q. Well, if there was some cost not
5 recoverable at the RPM rate which you understand is
6 presently in effect, would you expect that the
7 accounting rules would trigger the need for an
8 impairment analysis?

9 MR. CONWAY: Objection. The predicates
10 haven't been established and the opinion is well
11 beyond anything that this witness has covered in his
12 testimony, and it calls for speculation. It's
13 outside the scope of his testimony and it calls for
14 speculation.

15 EXAMINER PARROT: Overruled.

16 A. I don't know that by itself that would be
17 a sufficient condition to require an impairment
18 analysis. Impairment is a measure of present value
19 of the asset in relation to book value, not a
20 question of whether in any given short-run period the
21 asset is recovering its accounting costs. So that
22 would contribute to the likelihood that it would need
23 an impairment analysis, but it doesn't by itself
24 require one.

25 Q. Okay. Very helpful answer. So for

1 purposes of doing an impairment analysis to determine
2 whether there is stranded plant costs you would not
3 look to a short-term period, correct?

4 A. That's my understanding.

5 Q. Yeah. And it would be unreasonable to
6 look exclusively at a short-term period for purposes
7 of determining whether or not there would be stranded
8 plant costs, right?

9 A. Sure, and it would also be unreasonable
10 to look just at the RPM component or the capacity
11 price component of revenues for those assets.

12 Q. Precisely. What other revenue streams
13 would you be looking at?

14 A. Well, there's other market revenues that
15 might be available over a long period of time to
16 those assets that could contribute to their value.
17 Energy, ancillary services.

18 Q. Energy sales?

19 A. Sure.

20 Q. The words "ancillary services" get thrown
21 around a lot. What are ancillary services?

22 A. Ancillary services are payments from the
23 RTO to the generators for providing various kinds of
24 grid support adjustments to their operations, voltage
25 support, load following, regulation, black start,

1 things like that.

2 Q. Okay. And are there options under PJM's
3 market model for entities that can supply ancillary
4 services to be compensated on a cost-based
5 methodology?

6 A. There may be for some components, voltage
7 support and black start may fall into that category.

8 Q. Are there opportunities for suppliers of
9 ancillary services to receive more than their
10 embedded cost in the way of compensation?

11 A. Well, ancillary services as a rule are
12 fairly low in value relative to the embedded cost of
13 the generation that provides them, but relative to
14 the components of the generation that are diverted to
15 supply ancillary services it's certainly possible you
16 could recover all of your embedded costs on a portion
17 of your generation that's providing those services.

18 Q. Is it also possible to recover more than
19 the allocable embedded costs associated with
20 providing those services?

21 A. Conceivably, sure, if it's a market-based
22 ancillary price.

23 Q. So we have ancillary services and my
24 recollection is there may be seven or so of them.

25 A. That's about right.

1 Q. If Ohio Power and Columbus & Southern
2 were being compensated on an embedded cost
3 methodology for capacity, would it be consistent with
4 your notion of just and reasonable if they received
5 more than embedded costs for other products that are
6 produced by the generator? Like energy and ancillary
7 services.

8 THE WITNESS: Can I hear the question
9 again?

10 (Record read.)

11 A. So can you be a little more specific
12 here, do you mean on average? For shopping
13 customers? For nonshopping customers?

14 Q. Sure. Do you think it would be
15 appropriate for a generator to opportunistically use
16 an embedded cost methodology for one product provided
17 by a generator, say capacity, and then use
18 market-based pricing or above cost-based pricing for
19 the other products produced by the generator?

20 A. It would not necessarily be
21 opportunistic, no.

22 Q. But for impairment purposes, if we were
23 looking to see if a generating plant or a series of
24 plants were impaired in the sense that some of the
25 costs would be stranded, it would be your view that

1 it would be necessary to look at all the potential
2 revenue streams available from the use of those
3 plants over a lengthy period of time.

4 A. Yes, that's my understanding of the
5 impairment test as a general concept.

6 Q. Have you assisted companies in doing an
7 impairment test?

8 A. Not as a formal matter for accounting
9 purposes. I've certainly looked at the value of
10 assets in relation to their booked costs.

11 Q. Okay. And for purposes of looking at the
12 value of assets in relationship to their booked
13 costs, how would you go about determining the value
14 of the assets?

15 A. The market value?

16 Q. You said "value." I asked you "value."
17 Would you use the market value?

18 A. Well, it's part of the -- for an
19 impairment test it's part of the test but it's not
20 the whole test.

21 Q. Okay. So if the market value is above
22 the book or embedded cost value, then there wouldn't
23 be an impairment, right?

24 A. Correct.

25 Q. All right. So for purposes of estimating

1 the market value would you also look at all the
2 potential revenue streams available from that
3 utilization of that asset?

4 A. Generally, yes, you look at all the
5 sources of value.

6 Q. And so, again, we would look at capacity,
7 energy, ancillary services, revenues in the case of
8 an electric generating plant, right?

9 A. Yes. That is correct.

10 Q. And the valuation, market-based valuation
11 of the assets would also be done over a long period
12 of time, correct?

13 A. Typically that's the case, yes.

14 Q. And you would look for things like the
15 potential for life extension for generating assets,
16 for example.

17 A. This is getting a little close to the
18 edge of my knowledge, but my belief is that
19 contingent value is not generally recognized in
20 impairment tests, that it's a little too speculative
21 to incorporate. Although there may be such value,
22 they're more likely to reflect contingent loss
23 potential than contingent gain potential.

24 Q. All right. Now, based on the FERC Form 1
25 documents that I've given you that have been marked

1 as IEU Exhibit No. 114 and 115, it's clear to you
2 that beginning in 2001 at least AEP Ohio discontinued
3 a regulatory accounting for the generation portion of
4 its business and that discontinuance continues
5 through today.

6 A. That appears to be the case.

7 Q. And based upon IEU Exhibit 115 and the
8 second paragraph that I gave you, once that type of
9 accounting is discontinued, the value that can be
10 held on the books for generating plants is subject to
11 an impairment test, correct?

12 A. Yes, we've agreed on that.

13 Q. Based upon what you know from the
14 accounting rules, is AEP Ohio obligated to
15 periodically conduct an impairment test?

16 A. You know, I don't recall the standards,
17 but I suspect they require regular or periodic review
18 of that.

19 Q. So if one were trying to figure out if
20 RPM pricing would result in stranding embedded costs
21 associated with generating plants of AEP Ohio, we
22 might ask AEP Ohio to provide the impairment test,
23 right? The results of the test.

24 A. If you were trying to do a stranded cost
25 analysis for all time, yes, that would be helpful.

1 Q. Okay. Did you ask AEP Ohio for whether
2 it conducts an impairment test, and if so, whether
3 they would provide you with the results of the
4 impairment test?

5 A. No. It was not part of my testimony.

6 Q. So this, again, we're back to the
7 framework of your testimony which really involved the
8 binary analysis, should it be embedded costs or RPM
9 for a relatively short period of time, right?

10 A. Yes, that's right, for the next three
11 years.

12 Q. You are a witness in what us Ohio folks
13 call the ESP 2 as a modified case for AEP Ohio,
14 correct?

15 A. Correct.

16 Q. And as part of that responsibility you've
17 been subjected to our wonderful discovery process?

18 A. Yes.

19 Q. Okay. And is it true that you, in the
20 discovery process as you understand it, parties to a
21 proceeding have the opportunity to present what we
22 call interrogatories to elicit information or
23 requests for production of documents?

24 A. Of course.

25 Q. And you are aware, are you not, that

1 there have been a series of interrogatories put to
2 AEP Ohio in the ESP 2 modified proceeding, correct?

3 A. Yes.

4 Q. Have you been reviewing some of that
5 discovery?

6 A. Really not much. One or two questions
7 were directed at me and I reviewed those of course.

8 MR. RANDAZZO: Your Honor, I've just
9 handed out a document, on the top of it it has Ohio
10 Power Company's Responses to the Office of the Ohio
11 Consumers' Counsel's Discovery Requests, PUCO Case
12 11-346-EL-SSO and 11-348-EL-SSO Modified ESP First
13 Set, and I would ask that it be marked as IEU Exhibit
14 116.

15 EXAMINER PARROT: So marked.

16 (EXHIBIT MARKED FOR IDENTIFICATION.)

17 Q. Sir, do you have what has been marked as
18 IEU Exhibit 116?

19 A. I do.

20 Q. Would you turn to interrogatory 1-010?
21 I'm sorry the pages are not numbered, so -- for some
22 reason we're not smart enough to do that.

23 A. I have it. 110? Oh, 1-010.

24 Q. Yes, that's correct, I'm sorry.

25 A. Yes, I have it.

1 Q. And do you see there that there's a
2 question from the Office of Consumers' Counsel
3 related to stranded costs?

4 A. Correct.

5 Q. Because of the cessation of cost-based
6 regulation for generation in Ohio. Right?

7 A. Yes, this is referring to whether the
8 company previously sought stranded costs.

9 Q. And am I correct that in the company's
10 response it refers to the same cases, at least two of
11 the same cases that were on the front of
12 Mr. Forrester's testimony that we discussed earlier?

13 A. Yes, the first bullet refers to cases
14 1729 and 1730-EL-ETP and those are the cases in
15 Mr. Forrester's testimony.

16 Q. And I would like you to go to
17 interrogatory 1-012, please.

18 A. Okay. I have it.

19 MR. CONWAY: Your Honor, at this point
20 I'd just interpose an additional objection. These
21 interrogatories are from a different case. The
22 witness has not indicated that he had any role in the
23 preparation of the responses. In fact, the
24 interrogatory responses themselves indicate in each
25 case that those responsible are persons other than

1 this witness, and so I think it's inappropriate to
2 question him about the interrogatories themselves.

3 If Mr. Randazzo wants to ask us whether
4 these are statements made by the company in the other
5 case, we'd agree -- we'd agree to that. They appear
6 to be authentic. Their relevance may be a separate
7 matter, but using this witness to read portions of
8 the interrogatories into the record is not
9 appropriate.

10 MR. RANDAZZO: Well, if counsel will
11 stipulate that in response to OCC's question or
12 interrogatory that has the company's written down the
13 value, i.e., taken an accounting loss due to an
14 impairment of value, of any of the assets which it
15 plans to transfer to its new generating affiliate,
16 that the company responded after the objection "In
17 the third quarter 2011, the OPco generation assets
18 were tested for recoverability in accordance with
19 Accounting Standard Codification 360, Property, Plant
20 and Equipment. The test indicated that the
21 undiscounted cash flows exceeded the carrying value
22 and impairment was not applicable."

23 If you'll stipulate to that, I'll
24 withdraw the question.

25 MR. CONWAY: Your Honor, this has nothing

1 to do -- these responses have nothing to do with this
2 witness's testimony in this case; I object on that
3 basis. It's inappropriate to be questioning him
4 about these matters.

5 EXAMINER PARROT: The objection is
6 overruled.

7 THE WITNESS: So is there a question
8 pending?

9 EXAMINER PARROT: I believe so.

10 MR. RANDAZZO: Rather than go back to the
11 question I can -- as long as we can proceed without
12 further objections to the line of questioning. Let
13 me see if I can restate it.

14 Q. (By Mr. Randazzo) Do you have before you
15 the interrogatory 1-012?

16 A. I do.

17 Q. And am I correct that in that
18 interrogatory the company, Ohio Power, which now at
19 this point includes Columbus Southern and Ohio Power,
20 was asked the question about write-downs related to
21 assets which the companies plan to transfer to its
22 new generating affiliate?

23 A. Yes, that's the question.

24 Q. And am I correct that in the answer Ohio
25 Power, which now includes Columbus Southern and Ohio

1 Power, after objecting indicated that there was an
2 impairment analysis conducted in accordance with the
3 Accounting Standard Codification identified in the
4 answer and the test indicated that the undiscounted
5 cash flows exceeded the carrying value and impairment
6 was not applicable.

7 A. I see that. It doesn't tell us what the
8 undiscounted cash flows were so we don't know what
9 was assumed as to what the pricing of capacity would
10 be, for instance, in the test, but it certainly
11 passed whatever test they did.

12 Q. Right. Now, I'd like you to help me
13 understand the significance, the accounting
14 significance of an impaired asset. Let's say that I
15 had an asset on the books recorded at a hundred
16 dollars. I'm a publicly traded company, so let's
17 make it a billion.

18 I've got an asset on my books, a billion
19 dollars. I do an impairment test and I discover that
20 the value that I have on my books is overstated by
21 half. It's only worth 500 million. Are you with me?

22 A. Yes.

23 Q. That's the left-hand side of the balance
24 sheet, right? Correct.

25 A. The asset is, yes.

1 Q. Okay. So what happens once I do my
2 impairment analysis and discover that the billion
3 dollars is overstated by half, what happens on the
4 left-hand side of the balance sheet? What
5 adjustments do I need to make?

6 A. Well, if it's an asset that requires
7 being marked to market, then it has to be marked down
8 to a lower value.

9 Q. Okay. That was my understanding. Now,
10 it's called a "balance sheet" for a reason, right?

11 A. Yes.

12 Q. And the reason it's called a balance
13 sheet is that when you have an impaired asset on the
14 left-hand side like the one we just talked about
15 where the value has been reduced by half, there's a
16 corresponding adjustment on right side of the balance
17 sheet, correct?

18 A. Yes.

19 Q. So what would the adjustment -- where
20 would you make the adjustment on the right side of
21 the balance sheet?

22 A. Well, my recollection is you would take
23 an extraordinary loss which would reduce your net
24 income which would reduce your retained earnings
25 which would reduce your equity and that would balance

1 the balance sheet.

2 Q. Right. So the extraordinary loss that
3 you just described actually shows up on the income
4 statement, right?

5 A. Starts out there, right.

6 Q. And then because the extraordinary loss
7 produces or may produce negative net income, the
8 consequence on the balance sheet is a reduction in
9 common equity, correct?

10 A. Yes.

11 Q. All right.

12 A. The income statement is folded into the
13 balance sheet.

14 Q. And the reason that there's a reduction
15 in common equity is because it's the shareholders of
16 the firm that are the owners of the residual value of
17 the firm, right? The common shareholders.

18 A. Right.

19 Q. So in this case, in the case of AEP Ohio
20 the adjustment to the retained earnings or common
21 equity balance that we just discussed resulting from
22 an impairment of an asset that caused that asset's
23 value to drop in half from a billion to 500 million
24 would reduce the value of the parent's equity
25 ownership interest in Ohio Power, correct?

1 A. If AEP Ohio was the company that had the
2 impaired asset, their income would fall and that
3 would be folded up to the consolidated parent, but of
4 course they didn't find they had an impairment.
5 Subject to your premise that's the way it would work.

6 Q. Okay. Now, is there a separate
7 impairment analysis required at the parent?

8 A. No. That would be -- you've already
9 captured all the value in the first analysis, you
10 don't want to do it twice.

11 Q. Okay. All right. Let's talk about the
12 balance sheet of the parent and the same hypothetical
13 that I gave you. If the asset value of Ohio Power
14 drops in half from a billion to 500 million and that
15 is reflected on the right-hand side of the balance
16 sheet by a corresponding reduction in equity, the
17 dollar amount of equity, how does that flow through
18 to the parent corporation?

19 A. Well, it depends on the nature of the
20 organization of the company and how it does its
21 consolidation, but as a rough rule, when companies
22 are wholly owned, they are aggregated up to the
23 parent company's accounts, that is the parent company
24 reports them as a sum of the subsidiary balance
25 sheets, netting out cross-corporate assets that are

1 offsetting.

2 So it's basically just adding up the
3 pieces and not double counting anything.

4 Q. All right. But in the case of Ohio
5 Power, if there was an impaired asset, if generating
6 plants, the book value of generating plants was worth
7 less in the market than stated on the books, based
8 upon your understanding of the discontinuation of
9 regulatory accounting, it would be necessary to do an
10 impairment analysis at that point; is that right?

11 A. Well, you assumed in your conclusion that
12 they're worth less than the books in the first place.
13 You do an impairment analysis to find that out.

14 Q. Okay.

15 A. And that depends on what you assume to be
16 the character of the revenues and market
17 opportunities and so on that prevail in the future,
18 so it's not just a function of current conditions or
19 market prices, it's really a function of all the
20 contracts they have, the cost structures, the whole
21 works.

22 Q. Okay. The whole works. All right.
23 Would risk management strategies that have been
24 undertaken come into play for purposes of the
25 impairment analysis? In other words in --

1 A. Generally I would say no, but I'm not
2 positive that's -- there are some gray areas as to
3 when a risk management arrangement is tied to the
4 assets as opposed to being tied to a risk management
5 subsidiary operation.

6 Q. Do you know what "hedging" is?

7 A. Sure.

8 Q. Do you know what hedging is in the
9 wholesale electricity market context?

10 A. Of course.

11 Q. What is hedging in the wholesale electric
12 utility context?

13 A. Hedging is locking down a future price
14 for a revenue item or a cost item so that it is known
15 before the fact of being incurred.

16 Q. And how far out can you hedge your
17 position in the wholesale electric market?

18 A. Depends on what you want to hedge.

19 Q. Well, let's say I want to lock in a
20 revenue stream associated with the energy production
21 I have in my generating plants. How far out can I
22 lock in a -- is it possible to do bilateral contracts
23 for 20 years? Ten years?

24 A. In principle it's extremely unlikely you
25 would find a counterparty interested in that, but

1 there's nothing that per se would prevent it.

2 Q. Are you aware of whether or not AEP
3 Service Corporation on behalf of the AEP Operating
4 Companies has entered into long-term 10- to 20-year
5 full requirements contracts with other utilities?

6 A. I don't know. They may have.

7 Q. But if we were doing an impairment
8 analysis of the type that you described, we would
9 look at the revenue streams available from those
10 long-term contracts in addition to the revenue
11 streams that might be more obvious from participation
12 in things like PJM's market, right?

13 A. My general understanding is that there
14 are circumstances when that would be true and some
15 when it might not be true. The question of whether a
16 hedge is tied to the assets that are being evaluated
17 is a fairly technical one and one of some judgment
18 and occasional controversy.

19 You can certainly enter hedges that are
20 independent of specific assets and, in fact, that's
21 more common than not because most companies that
22 hedge their generation fleet do it at a portfolio
23 level and include lots of nongeneration assets, lots
24 of physical assets in their asset mix.

25 Q. Right.

1 A. So it's not easy to isolate, but under
2 certain conditions if a forward position is deemed to
3 be tied to specific assets, then it would be
4 incorporated in the impairment analysis I believe.

5 Q. Okay.

6 A. This is way beyond -- you should really
7 be asking an accountant or a CPA about this.

8 Q. Okay. I appreciate that. We have one
9 testifying shortly.

10 A. Okay. There's your guy.

11 Q. In the PJM structure, whether I'm an FRR
12 entity or not, I have -- if I'm a load-serving
13 entity, I have a capacity obligation, correct?

14 A. If I'm a load-serving entity?

15 Q. Right.

16 A. You have an obligation to buy capacity.
17 You don't have an obligation to supply capacity.

18 Q. So -- that's interesting. If I'm in the
19 RPM market, do I have to offer, and I'm not an FRR,
20 do I have to offer my generating capacity into the
21 RPM market?

22 A. If you have generation assets that you
23 want to place in the PJM energy markets, yes, you
24 must.

25 Q. Yeah. So if you're an RPM entity, you

1 don't have the choice of not offering your generating
2 assets into the capacity auction; is that correct?

3 A. Well, if you're an RPM entity, you
4 already have offered them in, right, that's what it
5 means to be an RPM entity.

6 Q. Right. And if you're an FRR entity you
7 do not have to offer your generating assets into the
8 RPM auction.

9 A. That is my understanding.

10 Q. If you know, do you have to be an FRR
11 entity or, excuse me, strike that.

12 If you know, do you have to own
13 generation to be an FRR entity?

14 A. I don't believe you have to literally own
15 the iron in the ground as the person who accounts for
16 it as the equity holder on their books, but you have
17 to have the rights to the capacity benefit of
18 sufficient assets to serve your FRR obligation.

19 Q. And do you know who the FRR entity is in
20 the case of the AEP Operating Companies?

21 A. I haven't reviewed their specific
22 contract, but I believe it's the five companies
23 combined in the past, and it will be four companies
24 in the future.

25 Q. So you're not aware of anything that

1 suggests that AEP Ohio specifically as a stand-alone
2 entity has selected the FRR option; is that correct?

3 A. I'm not the best witness for this, but
4 that's my general understanding, that the FRR
5 obligation is to the group of operating companies,
6 not just Ohio.

7 Q. Now, in the PJM structure what types of
8 resources can qualify as capacity?

9 A. Well, pretty much anything that's firmly
10 deliverable to the area or reliably available to
11 displace firm delivery needs.

12 Q. So the last part of your statement would
13 include things like energy efficiency?

14 A. Yes, certain kinds.

15 Q. And customers who are willing to
16 discontinue their use of electricity in response to a
17 request by PJM otherwise known as the demand response
18 part of capacity resources.

19 A. Yes, controllable or curtailable loads
20 can be capacity resources if they choose to
21 participate.

22 Q. Well, if I am a customer and I have an
23 ability to reduce using electricity in response to a
24 request by PJM, and I have selected -- I have been
25 selected in the RPM process as a capacity resource,

1 what price do I receive? Do I receive the RPM price?
2 Do I receive some embedded price? What price do I
3 receive?

4 A. You are paid at the RPM price. You're
5 part of the capacity mix.

6 Q. And that would be true even if I'm a
7 customer of Columbus Southern or Ohio Power, right?
8 A retail customer.

9 A. As far as I know. I haven't studied
10 specific customers in AEP's territory but I believe
11 that's correct.

12 Q. Okay. And in that circumstance -- strike
13 that.

14 Where a customer with a demand response
15 capability is being compensated based on RPM, do you
16 believe that the capacity resource associated with
17 the demand response is receiving just and reasonable
18 compensation?

19 A. It's not really a concept that applies to
20 a customer willingly entering into a contract of its
21 own volition to do so. They must deem it adequate,
22 but it's very rare for people to think of it as just
23 and reasonable when they're voluntarily doing
24 something.

25 Q. Well, AEP Ohio, as you understand it,

1 voluntarily elected FRR, right?

2 A. Yes.

3 Q. So would you differentiate your
4 determination as to what a just and reasonable
5 outcome is based upon the extent to which the entity
6 volunteered for the outcome?

7 A. No. I'm saying just and reasonableness
8 is a regulatory concept that has to do with
9 comparative rates and continuity of rates, and all
10 sorts of political and other kind of economic
11 considerations and willingness to enter a contract to
12 consume something privately is just done on whether
13 or not you think you would enjoy doing so for the
14 money involved, and you may be extremely glad to do
15 it or barely willing to do it. So there's extreme
16 differences in benefit to the participants and just
17 and reasonable is not normally one of the
18 considerations.

19 MR. CONWAY: Your Honor, if I might
20 inquire, we've been going with this witness for
21 approaching three and a quarter hours, it's almost
22 12:30 now. At what point might it be a good idea to
23 take a break for everyone's interests?

24 EXAMINER PARROT: Mr. Randazzo, are you
25 close to concluding at this point?

1 MR. RANDAZZO: Your Honors, I hope so.
2 But I could -- it probably is going to take me a
3 while to go through my testimony -- not my testimony,
4 just to clean up the stuff and make sure I'm not
5 duplicating anything that's been done already. I can
6 proceed, I don't think I've got more than 20 minutes,
7 maybe a half an hour left.

8 EXAMINER PARROT: All right. In light of
9 that, let's take a ten-minute break.

10 (Recess taken.)

11 EXAMINER PARROT: Let's go back on the
12 record.

13 Mr. Randazzo.

14 MR. RANDAZZO: Thank you, your Honors.

15 Q. (By Mr. Randazzo) Mr. Graves, in the case
16 of an FRR entity, that entity in the resource
17 adequacy context for PJM would be required to
18 identify the generating units that are part of its
19 plan to satisfy its resource adequacy obligation,
20 correct?

21 A. I think that's generally true, yes.

22 Q. And if one of those generating resources
23 happens to not be available for some reason, the FRR
24 entity has the opportunity to substitute capacity,
25 correct?

1 A. I think that's right. Assuming it has
2 other available capacity.

3 Q. Or it can buy capacity in the market,
4 correct?

5 A. Yes.

6 Q. And, again, the capacity resources that
7 an FRR entity can pledge to satisfy its resource
8 adequacy obligation do not have to be generating
9 assets that are owned by the FRR entity, correct?

10 A. That's my understanding.

11 Q. Right. So in the event that the FRR
12 entity has generating resources committed as part of
13 the capacity plan that's submitted to PJM and the
14 resources don't show up for work at the time when PJM
15 calls upon them, am I correct that the FRR entity
16 would pay a penalty that is equal to 1.2 times the
17 RPM determined price?

18 A. I understand that to be PJM's general
19 policy for nonperformance in the RPM market. I'm not
20 sure if it's identical for FRR but I wouldn't be
21 surprised.

22 Q. Okay. So at least with regard to the FRR
23 entity and the non-FRR entity, the structure for the
24 penalties, based on your understanding, would be the
25 same.

1 A. I have no firsthand knowledge but I'll
2 accept that.

3 Q. Now, in your testimony you talk about
4 harm to AEP Ohio associated with using an RPM-based
5 capacity price. Where you have that discussion in
6 your testimony are you talking about financial harm?

7 A. Sure.

8 Q. Okay. And for purposes of determining
9 financial harm would you look at things like whether
10 the value that's been recorded on the books has been
11 impaired?

12 A. Not necessarily because the impairment
13 analysis on the books wouldn't, I think, generally
14 assume or might not assume that the pricing that the
15 assets were going to experience was the RPM price.
16 So I think this is a contingency that would not be
17 the one that is used in the impairment analysis.

18 Q. Okay. Are you aware that in Ohio there's
19 an opportunity for utilities to seek rate relief in
20 circumstances where they're exposed to financial
21 harm?

22 A. I'm not aware of that.

23 Q. Okay. Fair enough.

24 I'd like to turn to page 112 or, excuse
25 me, IEU Exhibit 112, again, which was the prospectus.

1 A. Okay. I have it.

2 Q. Page S-2. The second full paragraph on
3 that page.

4 A. Okay.

5 Q. At least for purposes of this prospectus
6 at the time what AEP -- American Electric Power
7 Company, Inc. was telling prospective investors is
8 the regulated holding company will own integrated
9 utilities and Ohio and Texas transmission and
10 distribution assets, right?

11 A. I see that.

12 Q. And then the unregulated holding company
13 would own the Ohio and Texas generation assets, among
14 other things, correct?

15 A. Correct.

16 Q. So from those two sentences, again, is it
17 consistent with your understanding about the
18 organizational charts that we talked about
19 previously, that the distribution assets would be
20 placed into -- and transmission assets would be
21 placed into a separate company?

22 A. Well, they would be separate from the
23 unregulated holding company according to this.

24 Q. Right.

25 A. But there is also integrated utilities.

1 Q. Are you aware of any restrictions in Ohio
2 on the ability of an electric utility to transfer
3 distribution assets?

4 A. Not specifically. Generally regulatory
5 review is involved in changing ownership and title of
6 regulated assets but I don't know the Ohio rules.

7 Q. All right. Let's assume that the
8 structure that's described in the prospectus is the
9 one that we are dealing with, in other words, that
10 AEP Ohio is actually a wires company.

11 A. You mean assume that today or --

12 Q. Yes.

13 A. Okay.

14 Q. Assume that. In that case -- back up.

15 Are you familiar with corporate
16 separation requirements? Codes of conduct that apply
17 to electric utilities?

18 A. Generally, sure.

19 Q. Have you reviewed the corporate
20 separation requirements here in Ohio or the corporate
21 separation plan that was approved for AEP?

22 A. No, sir.

23 Q. Have you reviewed AEP corporate's
24 structure from the standpoint of the business
25 segments that are under the AEP umbrella, and by

1 "business segments" I mean generation, transmission,
2 distribution business segments?

3 MR. CONWAY: Your Honor, at this point
4 I'll interpose another objection. The topic that
5 corporate separation, what was proposed back in
6 2001 --

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

9 MR. CONWAY: -- and what is currently
10 being proposed is beyond the scope of his testimony.

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

13 Q. Now, if I'm an FRR entity and I submit a
14 capacity plan to PJM that's accepted by PJM, when the
15 generating unit is not called upon by PJM to provide
16 capacity, I can use it for other things, right? I
17 can sell energy from the unit.

18 A. Well, the energy use of the unit is a
19 little distinct from the capacity use of the unit in
20 general. The units are dispatched into the PJM
21 market which determines their energy production and
22 their capacity value is inherent in their reliability
23 and their being earmarked for particular customers'
24 support. That doesn't govern the energy usage of the
25 asset.

1 Q. Okay. Are you familiar with ledger
2 accounting?

3 A. Sure.

4 Q. What is your understanding of ledger
5 accounting?

6 A. That's the typical process whereby
7 accounting entries for debits and credits are
8 recognized over the course of time in a year to
9 ultimately create the income and balance sheet
10 statements.

11 Q. And within a holding company structure
12 would there be ledger accounting to reflect
13 transactions between various business segments within
14 the holding company, based on your experience?

15 A. It's not something I've reviewed but it
16 wouldn't be -- to the extent there are intercompany
17 transactions there would be ledger recognition of
18 those.

19 MR. RANDAZZO: Your Honors, I'm handing
20 out a document, its case caption is application of
21 Ohio Power Company and Columbus Southern Power
22 Company for certain findings under 15 United States
23 Code Section 729 and 17CFR Section 250.53. And I
24 would ask that it be marked for identification
25 purposes as IEU Exhibit 117.

1 EXAMINER PARROT: So marked.

2 (EXHIBIT MARKED FOR IDENTIFICATION.)

3 Q. Sir, do you have what has been marked for
4 identification purposes as IEU Exhibit 117 before
5 you?

6 A. I do.

7 Q. Are you familiar with the term "exempt
8 wholesale generators"?

9 A. Broadly.

10 Q. Will you accept, subject to check, that
11 this is an application that Ohio Power and Columbus &
12 Southern made to this Commission in Case No.
13 01-3289-EL-UNC?

14 MR. CONWAY: And once again, your Honor,
15 I object to a line of questions relating to this 2001
16 corporate separation proceeding -- component to a
17 corporate separation proceeding. There is no
18 relevance that I can see to this proceeding. This is
19 the moribund proceeding from 2001 and the witness has
20 already indicated that he's not familiar with Ohio
21 Power Company's or the Columbus Southern Power
22 Company's or combined company's corporate separation
23 status let alone the history of it. So I think it's
24 inappropriate.

25 EXAMINER PARROT: The objection is

1 overruled.

2 Q. Will you accept that this is the
3 application that I described earlier that was
4 submitted by Ohio Power and Columbus Southern in the
5 case I referenced earlier, the case number's on the
6 front page?

7 A. It does appear to be a request to
8 redesignate or designate certain assets of EWG
9 assets.

10 Q. And an exempt wholesale generator was an
11 entity that could be formed under the Public Utility
12 Holding Company Act; is that correct?

13 A. I don't know the legal auspices under
14 which it was authorized.

15 Q. Would you turn to page 5, please.

16 A. Okay.

17 Q. At the bottom of page 5 the paragraph
18 that is numbered 11, where it begins with the word
19 "The" right before you turn to page 6.

20 A. Okay, I have it.

21 Q. Do you see that Columbus & Southern and
22 Ohio Power there are saying that the purpose of this
23 application is to satisfy the requirements of Senate
24 Bill 3 to separate control of the generating plants
25 from the regulated wires business?

1 A. Yes, that's the text, or a paraphrasing
2 of the text.

3 Q. And they, Columbus & Southern there
4 describes in the next sentence the purpose of the
5 corporate separation request, right?

6 A. Well, it's a purpose. It doesn't say it
7 is the purpose.

8 Q. Okay. Now, attached to the document that
9 I've handed to you is a Form U-1 which is described
10 on page 8, correct?

11 A. There's a reference to Form U-1 in the
12 top of paragraph 16 on page 8.

13 Q. And the Form U-1 that is referenced there
14 is attached to the back of the document that I handed
15 you, it's about maybe a quarter of the way in.

16 A. Yes, about five or six pages later
17 there's an amendment to No. 2 to Form U-1 and that
18 appears to be a significant part of the remainder of
19 the document.

20 Q. All right. And before we get to the U-1,
21 after the text of the application that ends at page 9
22 there is an Exhibit 1 that lists the generating
23 facilities that are the subject of the application;
24 is that correct?

25 A. Yes, that's what they appear to be.

1 Q. All right. And on the first page is CPL.

2 A. Correct.

3 Q. And that would be a -- is that the Texas
4 operating company?

5 A. I think that's right.

6 Q. Okay.

7 A. Certainly the plants are that are beside
8 it.

9 Q. And the next page would be for Columbus &
10 Southern listing the generating assets to be
11 transferred to the EWG, right?

12 A. Yes.

13 Q. And then the Ohio Power generating
14 facilities.

15 A. Correct.

16 Q. Okay. Now, if we would go to the U-1 and
17 the glossary of terms.

18 A. All right. I'm in it.

19 Q. First page. Do you see CSP EDC?

20 A. Yes.

21 Q. And there would it be correct to say that
22 the CSP EDC is defined as a to-be formed entity to
23 hold the transmission and distribution assets of
24 Columbus Southern Power? Right?

25 A. Yes. A to-be formed EDC, or energy

1 delivery company.

2 Q. Right. And if we turn to the next page,
3 we'll see a similar definition for Ohio Power EDC.

4 A. Correct.

5 Q. And we also see a definition of Ohio
6 Power PGC which is what Ohio Power would be after the
7 transfer of the distribution and transmission assets,
8 correct?

9 A. That's the power generating company, yes.

10 Q. That's correct.

11 Right?

12 A. Yes. Correct.

13 Q. And on item 1 of the U-1 after the
14 glossary of terms --

15 A. "Description of the Proposed
16 Transaction"?

17 Q. Right.

18 A. Okay.

19 Q. See the paragraph that has the two
20 bulleted items?

21 A. Yes. I'm sorry, I do see that.

22 Q. There again, do you see the plan to have
23 the generation activities in the power generation
24 company and the transmission and distribution
25 activities in the distribution utilities, right? Or

1 distribution companies.

2 A. I see that.

3 Q. Turn to page 6 of the U-1. Now we have a
4 number at the bottom of the page.

5 A. Okay.

6 Q. Do you see there that Columbus Southern
7 Power and -- the U-1 is describing that Columbus
8 Southern Power and Ohio Power are going to make
9 transfers to comply with the Ohio statute that
10 provides for competitive retail electric service
11 commonly referred to as Senate Bill 3?

12 A. I see that.

13 Q. Right? And it goes on to state that "The
14 statute directs vertically integrated electric
15 utilities that offer retail electric service in Ohio
16 to separate their generating and other competitive
17 operations (such as aggregation, marketing, and
18 brokering) and related assets from their transmission
19 and distribution operations and assets." Do you see
20 that?

21 A. I do.

22 Q. And then the next line, the next sentence
23 says that on September 28th, 2000, the PUCO
24 approved corporate separation plans that were filed
25 to explain how they will comply with Senate Bill 3.

1 Correct?

2 A. Yes.

3 Q. All right. Will you accept, subject to
4 check, that this application was approved by the
5 Public Utilities Commission of Ohio?

6 A. Sure. But I have no firsthand knowledge,
7 so just taking your word for it.

8 Q. Subject to check.

9 A. Okay.

10 MR. RANDAZZO: Your Honors, I would like
11 a document that has the same case caption as the
12 prior exhibit but is titled "Columbus Southern Power
13 Company's and Ohio Power Company's Memorandum Contra
14 Ohio Consumers' Counsel's Motion to Deny Application
15 For EWG Status," and the remainder of the language
16 there.

17 EXAMINER PARROT: So marked.

18 (EXHIBIT MARKED FOR IDENTIFICATION.)

19 Q. Sir, do you have before you what has been
20 marked as IEU Exhibit 118?

21 A. Okay.

22 Q. Would you accept, subject to check, that
23 this is a memorandum that Columbus & Southern and
24 Ohio Power filed in response to the efforts by our
25 residential consumer advocate to participate in the

1 EWG proceeding that was initiated by the application
2 that is IEU Exhibit 117?

3 MR. CONWAY: Your Honors, I again
4 interpose an objection to the line of questions
5 asking this witness about a document that obviously
6 he's never seen before and then proceeding to ask him
7 questions about whether or not certain sections of
8 the exhibit say what is in the exhibit.

9 MR. RANDAZZO: I have one question, your
10 Honor.

11 EXAMINER PARROT: Please proceed,
12 Mr. Randazzo.

13 Q. Will you accept that, subject to check?

14 MR. RANDAZZO: One question after the
15 subject to check.

16 A. Okay.

17 Q. Turn to page 6 and the first full
18 paragraph on that page.

19 A. "OCC seems to believe...."?

20 Q. Yes.

21 A. Okay.

22 Q. Would you read that?

23 A. Okay. Not --

24 Q. To yourself.

25 A. All right.

1 Okay, I've read it.

2 Q. All right. Do you see there that
3 Columbus Southern and Ohio Power were referring to
4 requirements in the Ohio Revised Code, namely Section
5 4928.38?

6 A. Yes, I see that.

7 Q. And asserting that, as a result of
8 statutory law of Ohio, that consumers do not continue
9 to have a hold on generating plants owned by
10 companies?

11 A. Yes, they are citing the excerpt from the
12 Ohio Revised Code to counter what they described as
13 the OCC's position.

14 Q. For purposes of your testimony, sir, were
15 you aware that Ohio Revised Code Section 4928.38
16 states, as Columbus and Ohio Power state here, that
17 an electric utility that receives transition revenues
18 shall be wholly responsible for how to use those
19 revenues and wholly responsible for whether it is in
20 a competitive position after the market development
21 period? Were you aware of that provision in Ohio
22 law?

23 A. I have not reviewed the code or the
24 transition revenues that AEP did or did not receive.

25 Q. Okay. So you weren't aware of this

1 specific provision in Ohio law, you answered it more
2 generally.

3 A. Correct, I was not aware.

4 Q. Turn to page 7.

5 A. I have it.

6 Q. First full paragraph.

7 A. Okay.

8 Q. Am I correct there that in that first
9 full paragraph the plain language indicates that
10 Columbus Southern and Ohio Power are responding to
11 the Consumers' Counsel's claim that Senate Bill 3
12 only deals with retail electric service?

13 A. Yes, that's the essence of the paragraph.

14 Q. And it goes on to explain why Columbus
15 Southern and Ohio Power believe OCC is wrong.

16 A. Yes.

17 Q. And then goes on to discuss the
18 separation that was approved by the Commission of the
19 company's noncompetitive wires business from the
20 competitive generation business, right?

21 A. I'm sorry, I didn't -- can you restate
22 the question? I only heard the premise, I didn't
23 hear the question part.

24 Q. Yes. I'm sorry. The paragraph goes on
25 to discussion the Commission's approved separation of

1 the noncompetitive wires business from the
2 competitive generation business, right?

3 A. The last sentence is about that, yes.

4 Q. Now, the next paragraph on that page --

5 MR. CONWAY: I thought we were just going
6 to have one question back when I made my objection.

7 MR. RANDAZZO: Fair enough. Fair enough.

8 Q. Are you aware of any commitments that
9 Columbus & Southern and Ohio Power made in
10 conjunction with the Commission's approval of the
11 application that is IEU Exhibit 117?

12 A. I'm pretty sure the answer is no, but can
13 you remind me of which one is IEU 117?

14 Q. Yeah, that would be the application in
15 Case No. 01-3289-EL-UNC.

16 A. That's the EWG application?

17 Q. Yes. Yes, sir.

18 A. No, I have not -- I was not a party to
19 that process nor have I reviewed its history or
20 documentation.

21 Q. All right. But you indicated earlier
22 that contracts or commitments may affect your
23 conclusion about just and reasonable results,
24 correct?

25 A. That's a pretty imprecise paraphrasing of

1 my previous comments, but --

2 Q. Okay.

3 A. Let's just say context matters.

4 Q. Okay.

5 MR. RANDAZZO: Your Honors, I would ask
6 that a document that is a copy of a letter that was
7 submitted in Case No. 01-3289 with AEP's logo on it
8 be marked for identification purposes as IEU Exhibit
9 119.

10 EXAMINER PARROT: So marked.

11 (EXHIBIT MARKED FOR IDENTIFICATION.)

12 Q. Sir, do you have before you what's been
13 marked as IEU Exhibit 119?

14 A. I do.

15 MR. CONWAY: And, your Honors, again, I
16 object to the line of questions on the same basis as
17 before.

18 EXAMINER PARROT: And your objection is
19 noted and, again, overruled, Mr. Conway.

20 Q. Would you turn to the last page of that
21 document. By the way, do you know who Henry Fayne
22 is?

23 A. I don't.

24 Q. F-a-y-n-e.

25 A. I'm not familiar.

1 Q. Okay. Will you accept, subject to check,
2 that this is a letter that AEP filed in the case that
3 we've been discussing, the EWG case, on October the
4 8th, 2002?

5 A. Certainly it's stamped that date.

6 Q. Right. And there's another stamp on
7 there that indicates it was received by the Chairman
8 of the Commission on September the 23rd, 2002,
9 correct?

10 A. Correct.

11 Q. And the Chairman of the Commission is the
12 individual to whom the letter is addressed, right?

13 A. Yes.

14 Q. Would you turn to the third page.

15 A. Okay.

16 Q. First full paragraph.

17 A. I see it.

18 Q. The last or the second sentence, also the
19 last sentence in that paragraph.

20 A. I see it.

21 Q. And there would you agree that American
22 Electric Power, Columbus Southern Power, and Ohio
23 Power are committing to not seek recovery through
24 higher rates to any consumers to compensate AEP,
25 Columbus Southern, and Ohio Power for any possible

1 losses that may be sustained on the investments or
2 for an inadequate return on such investments?

3 MR. CONWAY: Your Honor, I would object
4 to asking this witness to opine about what AEP or
5 AEP Ohio was committing to do in 2002. He has no
6 basis for providing an opinion as to what the
7 commitment was --

8 MR. RANDAZZO: Well, let me withdraw the
9 question.

10 MR. CONWAY: -- in 2002.

11 MR. RANDAZZO: See if we can speed this
12 up.

13 Q. Do you read the plain language there as
14 indicating that AEP, Columbus Southern, and Ohio
15 Power are making a commitment?

16 MR. CONWAY: Same objection.

17 EXAMINER PARROT: Overruled.

18 A. Yes. It's a conditional one not quite as
19 broad as the passage you read. As I read it it says
20 that under the condition that the cost of capital is
21 affected by this transaction they will not seek
22 adjustments for any shortfalls in the difference
23 between the requirements and their returns due to the
24 change in the cost of capital.

25 Q. Right.

1000

1 A. I don't know that it's broader than that.

2 Q. Okay. Would you turn to the first page
3 of the letter.

4 A. Of the letter?

5 Q. Yes.

6 A. Okay, I have it.

7 Q. Would you read the first paragraph to
8 yourself.

9 A. The numbered one under "Financial
10 arrangements"?

11 Q. No, the first paragraph of the letter
12 under "Dear Chairman Schriber."

13 A. Sure, I've read it.

14 Q. Does the plain language there indicate to
15 you that the letter is being written to confirm that
16 Columbus Southern Power and Ohio Power and AEP's
17 intention is to require that the wires business
18 adhere to the financial arrangements portion of the
19 Commission's corporate separation? Do you see that?

20 A. Yes, I see that.

21 Q. Do you see the "Financial arrangements"
22 section?

23 A. I do.

24 Q. And I take it that American Electric
25 Power or Columbus Southern or Ohio Power did not

1 bring this letter to your attention for purposes of
2 you preparing your testimony.

3 A. I have not seen it before you gave it to
4 me now.

5 Q. Just a couple more questions, I believe.
6 If one were going to use an embedded cost methodology
7 to establish rates, there are a variety of ways to
8 translate an embedded cost methodology into rates,
9 correct?

10 A. There are different patterns of cost
11 recovery that are consistent with embedded cost
12 rates, if that's what you mean.

13 Q. Right. And by "different patterns of
14 cost recovery," you are referring to, are you not,
15 the differences between traditional cost-based
16 ratemaking which tended to front-end load the revenue
17 requirement compared to a levelized approach, for
18 example?

19 A. Yes, that's a good example.

20 Q. And in the front-end loaded example
21 option for implementing an embedded cost ratemaking
22 methodology, it tended to impose the greatest
23 responsibility on customers at the commencement of
24 the rates, right?

25 A. That's true for a new asset. For an old

1 asset it imposes the least responsibility, so it's a
2 blend over time.

3 Q. Right. Now, is the methodology, if you
4 know, is the methodology that you understand that
5 Ohio Power has used in this proceeding a levelized
6 front-end loaded or some other version of the
7 embedded cost methodology?

8 A. Are you referring to their ESP 2 -- or,
9 I'm sorry, to the basis for the 355?

10 Q. Yes, sir.

11 A. Well, I have not reviewed it closely, but
12 my understanding is that the calculations by
13 Dr. Pearce are based on the current net book value of
14 the assets as reported on a Form 1 which would be
15 generally a mid-life approach using front-end loaded
16 annualized carrying charges.

17 Q. Okay. So, in other words, the difference
18 between a front-end loaded approach and a levelized
19 approach deals with the effect of depreciation
20 principally, correct?

21 A. That's a big factor, yes.

22 Q. And in the levelized approach
23 depreciation is assumed to take place more evenly
24 during the life of the asset, correct?

25 A. Actually, no. Under conventional

1 approach the depreciation is even and under a
2 levelized approach the depreciation is back-end
3 loaded.

4 Q. Back-end loaded, okay. And have you --
5 you have made presentations to organizations like
6 NARUC, correct?

7 A. Yes.

8 Q. And am I correct that in the course of
9 making those presentations you have identified
10 alternatives to traditional additional embedded cost
11 methodologies that produce different patterns?

12 A. Yes, of the kind we just described.

13 Q. Right. And would I be correct that in
14 the course of those presentations you have said that
15 front-end loading may be inefficient and inequitable
16 under some circumstances, noting that in competitive
17 markets assets more typically grow in value with
18 inflation, less obsolescence, economic depreciation,
19 generally back-end loaded?

20 A. Yes, I made that statement, I agree with
21 it. It is circumstantial as to whether it is the
22 case or not but it can be true.

23 Q. Yes. And when you say it's
24 circumstantial, one would need to look at the facts,
25 correct?

1 A. Yes, that's right.

2 MR. RANDAZZO: Thank you, you are a very
3 kind witness. I appreciate it.

4 At this point, your Honor, I'm done with
5 my cross-examination of the witness.

6 Thank you very much for your patience as
7 well.

8 EXAMINER PARROT: Mr. Kurtz.

9 MR. KURTZ: Thank you, your Honor.

10 MR. CONWAY: Your Honor, just a moment,
11 please, Mr. Kurtz. Your Honor it's now 1:30, we've
12 been going since a little after 9:00 o'clock. The
13 witness has been cooperative, I think it would be
14 appropriate to take a break to get lunch.

15 EXAMINER PARROT: Let's go off the
16 record.

17 (Discussion off the record.)

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

20 - - -

21 CROSS-EXAMINATION

22 By Mr. Kurtz:

23 Q. Good afternoon, Mr. Graves. The thrust
24 of your testimony, the purpose of it was to determine
25 whether or not the RPM or fully embedded cost was the

1 appropriate compensation to AEP for providing
2 capacity to CRES suppliers; is that correct?

3 A. Sure. The purpose of my testimony is to
4 explain the reasons why embedded cost pricing is
5 reasonable. I understand that not to be the entirety
6 of the proposal that AEP is pursuing and is willing
7 to live with, but -- nor is that the case now, but my
8 primary purpose is to contrast the two.

9 Q. Okay. And you, as you just stated, your
10 conclusion was that embedded cost is more reasonable,
11 more appropriate, more economically efficient,
12 however you characterized it.

13 A. I didn't say it was more efficient.

14 Q. Okay.

15 A. I do say it's more reasonable than all
16 RPM pricing.

17 Q. And in your testimony you state you did
18 not review the \$355 calculation by Dr. Pearce?

19 A. Only in a very general level. I'm aware
20 of the structure of the calculation but I haven't
21 validated the inputs or the assumption.

22 Q. Now, are you aware that the staff
23 presented the testimony of two witnesses that
24 concluded that the embedded cost of AEP's capacity
25 was \$144 a megawatt-day, not \$355?

1 A. I've heard that's the case. I have not
2 reviewed it and I don't have a response to whether
3 that's a valid analysis.

4 Q. Would your testimony continue to be that
5 embedded cost is more appropriate than RPM if the
6 Commission concluded that AEP's embedded cost was
7 \$144?

8 A. It's a big hypothetical because I think
9 it's quite a long ways from what the company
10 perceives its embedded costs to be, but I'm not
11 testifying about the correct value for the embedded
12 costs, so through review of those calculations its
13 determined it's some number other than 355 and that
14 fairly compensates embedded costs, then that's what
15 I'm worried about. I'm not specifically sponsoring
16 the validity of the 355.

17 Q. So if the Commission determined that 144
18 was the correct embedded cost number, nothing in your
19 testimony, none of your conclusions, would change;
20 isn't that true?

21 A. Yes, I guess that's fair.

22 Q. And that would be true even if the \$144 a
23 megawatt-day for compensation is higher than RPM in
24 the first two planning years at issue here; isn't
25 that correct?

1 A. Yes, 144 is above the 20 to 30 dollars
2 that prevail in the next two RPM years.

3 Q. And \$144 is less than RPM in the third
4 planning year, correct?

5 A. A little bit, as I recall. Yes.

6 Q. A little bit. And you would still
7 continue to believe that embedded cost is appropriate
8 even if it were less than RPM in the last planning
9 year.

10 A. Yes. Subject to the understanding that
11 embedded cost is a way of providing reasonable
12 recovery for the investments that AEP has made, if
13 that number is, in fact, 144, that's fine, but it's
14 not a question of whether it's higher or lower than
15 one year's RPM price.

16 MR. KURTZ: Thank you, your Honors.

17 EXAMINER PARROT: Mr. Yurick?

18 MR. YURICK: No questions, thank you,
19 your Honor.

20 EXAMINER PARROT: Mr. Sugarman?

21 MR. SUGARMAN: Thank you.

22 - - -

23 CROSS-EXAMINATION

24 By Mr. Sugarman:

25 Q. Good afternoon. If you can't hear me,

1 please let me know.

2 A. I'm fine. Thanks for checking.

3 Q. Would you agree that the scope of your
4 assignment for your testimony in this proceeding was
5 fairly narrow?

6 A. I guess compared to what would be the
7 question.

8 Q. Okay. Compared to the primary purpose
9 that you stated was to comment upon the embedded cost
10 whether it's just and reasonable, correct?

11 A. That's the core purpose of my testimony,
12 right, and I guess in that sense it's a fairly
13 specific scope.

14 Q. Instead of narrow, it's specific in
15 scope.

16 How long did it take you to perform the
17 assignment necessary to present your direct testimony
18 that has been marked and that's in front of you
19 today?

20 MR. CONWAY: Objection. Relevance.

21 EXAMINER PARROT: Overruled.

22 A. As a matter of elapsed calendar time I
23 think I was engaged about a month before the original
24 filing in the fall and I spent on the order of a week
25 and a half of preparatory time in reviewing materials

1 and writing it and then there were some updates for
2 the amendment filing, that couple of days worth of
3 time.

4 Q. Are you able to quantify for the
5 Commission how long hour-wise you spent on your
6 assignment?

7 MR. CONWAY: Objection. Again,
8 relevance.

9 EXAMINER PARROT: Overruled.

10 A. I can certainly do it. Roughly estimated
11 I would say on the order of 80 hours to prepare the
12 written report and then, of course, some preparatory
13 time for this hearing and reviewing other
14 testimonies, depositions and so on. Excluding all
15 the transactional aspects of this case, about 80
16 hours of analytic preparation and report writing.

17 Q. Thank you.

18 Now, looking at Appendix A which -- do
19 you have that in front of you? It's attached to your
20 testimony, just in case we need to refer to it.

21 A. Yes.

22 Q. At least by my count, and subject to
23 check, it appears that at least in the last ten years
24 you've provided 43 testimonies and written --
25 presented or published 34 papers.

1 A. That sounds about right.

2 Q. All right. And in those 43 testimonies
3 have you generally presented your opinion on the
4 matters that have been the subject of those
5 testimonies?

6 A. I'm sorry, can I hear that again?

7 Q. Sure. In the matters in which you've
8 presented testimony, the 43 in the last ten years --

9 A. Okay.

10 Q. -- have you generally presented your
11 testimony in the form of opinions on the matters that
12 have been the subject of your testimony?

13 A. There are opinion aspects certainly in
14 that they involve interpreting economic situations.
15 Oftentimes there's a fair amount of analytic evidence
16 as well which is less opinion and more public fact or
17 objective record.

18 Q. Okay. And in the matters in which you've
19 offered opinions, have those been offered by you as
20 an expert?

21 A. I think without exception that's the
22 case. I've never been -- virtually never been a fact
23 witness.

24 Q. It may have happened but nothing comes to
25 mind at the present time.

1 A. Right.

2 Q. All right. Now, your opinion in those
3 matters on which you testified and you mentioned that
4 in your educational background the relevant expertise
5 in your prefiled testimony, have those opinions been
6 offered by you based upon a reasonable degree of
7 certainty within the field or the subject matter of
8 the testimony offered in those proceedings?

9 A. Well, I've always been accepted as an
10 expert in my offered testimony, so I would say to
11 that standard, yes.

12 Q. Okay. Now, in this particular case
13 you've testified both in your prefiled testimony and
14 again -- well, especially in your prefiled testimony
15 that you are commenting on the policy question of
16 whether it would be just and reasonable for AEP Ohio
17 to use embedded cost pricing for capacity; is that
18 correct? And if you will, I'm referring to the
19 prefiled testimony and your response to the third
20 question and I'm looking at the last sentence.

21 MR. CONWAY: Can we have a page
22 reference, Mr. Sugarman?

23 MR. SUGARMAN: It should be on page 3,
24 Mr. Conway.

25 Q. Do you have the reference?

1 A. I do. And that is the statement I make
2 at the bottom of page 2, wrapping over to the top of
3 page 3.

4 Q. Okay. That you're commenting on this
5 policy question here, correct?

6 A. Yes.

7 Q. And where did you derive the policy
8 question upon which you then proceed to comment?

9 A. Well, that was posed to me as the issue
10 under debate for which I could contribute some
11 viewpoint by AEP when they contacted me to assist.

12 Q. So that was the specific scope of your
13 assignment given to you by AEP for this proceeding
14 and for your testimony. Do I understand that
15 correctly?

16 A. Sure. Subject to the rest of the
17 description in my report, but I've agreed that's the
18 basic purpose of my appearance here.

19 Q. All right. And on the last page of your
20 testimony where you are asked to summarize your
21 conclusions, sir, do you see where you state that you
22 conclude that the proposed use of embedded costs for
23 AEP Ohio's capacity rate is just and reasonable and
24 would have no adverse impacts on efficient retail
25 competition? Did I read that correctly?

1 A. You did.

2 Q. That's your conclusion, right?

3 A. Yes, sir.

4 Q. And the comments and the conclusions that
5 we've just reviewed are not opinions, are they, that
6 you're offering for consideration by this Commission,
7 are they?

8 A. I guess I don't know formally what you're
9 trying to circumscribe as an opinion versus some
10 other kind of conclusion. They are the result of my
11 review of the market circumstances and the situation
12 that -- situation and obligations AEP faces.

13 Q. If you look at the summary of your
14 conclusions and opinions in your prefiled testimony,
15 which is -- should be on page 3 and 4. Do you have
16 that part of your testimony, sir?

17 A. Okay.

18 Q. And the opinions you offer the Commission
19 in response to that question as to "Please summarize
20 your conclusions and opinions," you do not restate
21 the comments or the conclusions as to whether or not
22 the proposed use of embedded costs are just and
23 reasonable, do you?

24 A. I guess in that section I don't
25 explicitly say that embedded costs are just and

1 reasonable, but it's not for want of disagreeing with
2 myself at the beginning of the report and changing my
3 mind at the end. I just didn't include it in both
4 places.

5 Q. It's not explicitly stated as an opinion
6 by you in any aspect of your prefiled testimony, is
7 that correct, that you are opining as to the specific
8 subject matter of whether embedded costs are just and
9 reasonable to AEP Ohio; is that correct?

10 A. Well, didn't we just read on page 18 that
11 I do conclude they're just and reasonable?

12 Q. You conclude, but you do not say that you
13 opine, do you?

14 A. No, I don't describe that as my opinion,
15 I described it as my conclusion.

16 Q. Is the conclusion or comment that it
17 would be unjust or unreasonable for AEP Ohio to use
18 something other than embedded cost pricing for
19 capacity based upon any reasonable degree of
20 scientific or other certainty within your areas of
21 expertise?

22 A. That actually is not my conclusion.
23 You've paraphrased it in a way that's not accurate.
24 I didn't say nothing else could be just and
25 reasonable. I said embedded costs could be just and

1 reasonable and RPM would not be. There are other
2 possible arrangements that would be just and
3 reasonable. I have not studied all of those, but I
4 did not conclude that nothing else could be just and
5 reasonable.

6 Q. And if you heard that as my question,
7 then I need to restate it.

8 In your testimony in the comments that it
9 would be just and reasonable to AEP Ohio to use
10 embedded cost pricing for capacity, is that based
11 upon any reasonable degree of scientific or other
12 certainty within the area of your expertise?

13 A. The notion of being just and reasonable I
14 don't think is normally captured as a scientific
15 conclusion. It's a judgment about the economic
16 reasonableness of something in light of fairness
17 considerations, impacts on markets, continuity of
18 prior arrangements, relationship to the cost
19 structure of the parties involved, and I consider
20 several aspects of that including how it could affect
21 markets and the circumstances facing AEP.

22 I don't look at all of those. Some of
23 them I'm relying on other parties to explain and
24 support.

25 Q. But to the specific question -- I

1 understand the qualification. The specific question
2 being that your conclusions and comments are not
3 based upon any reasonable degree of scientific or
4 other certainty within your areas of expertise, you
5 would agree with that statement, correct?

6 MR. CONWAY: Objection, your Honor. That
7 just mischaracterized the witness's answer.

8 MR. SUGARMAN: I'm not characterizing,
9 I'm asking the witness a question.

10 MR. CONWAY: He answered it and you
11 mischaracterized it.

12 A. Well I would say no, I offered my opinion
13 inside the boundaries of what economic analysis and
14 policy traditions are, as I understand them, and I
15 have a great deal of experience in that space so I
16 feel I'm squarely in the mainstream of legitimate
17 economic conclusions.

18 Q. Well, within that mainstream of your
19 economic conclusions you're not telling this
20 Commission, are you, that it would be either unjust
21 or unreasonable were AEP Ohio to use something other
22 than embedded cost pricing for capacity, are you?

23 A. I agree with that.

24 Q. Okay.

25 MR. SUGARMAN: That's all the questions I

1 have.

2 EXAMINER PARROT: Ms. Kern?

3 MS. KERN: No questions, your Honor,
4 thank you.

5 EXAMINER PARROT: Mr. Jones.

6 MR. JONES: Thank you, your Honor.

7 - - -

8 CROSS-EXAMINATION

9 By Mr. Jones:

10 Q. Good afternoon, Mr. Graves, I have a few
11 questions for you. As to what AEP Ohio is proposing
12 for a rate to charge CRES providers, what's your
13 understanding of how long this rate would be in
14 effect if it was approved by the Commission?

15 A. Under the proposed ESP 2 amendment or --
16 I need a little more clarification as to what
17 circumstances you're assuming prevail.

18 Q. Assuming that the Commission approves the
19 company's proposal to charge 352.72 for the capacity
20 rate to CRES providers, and that was a decision by
21 the Commission, they approved that rate, how long is
22 your understanding would that rate be in effect?

23 A. It's my understanding it would change
24 every year as the Form 1 is released and the
25 underlying cost elements shift. So I guess it would

1 be a year at a time and revised with the next Form 1.

2 Q. The rate would not -- would the rate go
3 past June 1st, 2015?

4 A. Not to my knowledge, but I'm not
5 sponsoring their implementation plan so you might
6 direct that to other witnesses better.

7 Q. So you don't know; is that your answer?

8 A. Well, let me provide backup just a tiny
9 bit. As I said, the rate will change, as I
10 understand it, annually, so the 352 would certainly
11 not prevail in June of 2015 simply because prices
12 would have changed by then.

13 At that point, as I understand it, they
14 will be going to RPM-based supply and pricing and it
15 would -- whatever its value was at the time would
16 end. But that's just my understanding, there are
17 probably company witnesses who can explain the
18 transition better than me.

19 Q. And I'm asking the question what is your
20 understanding as to when it would end?

21 A. The 352 would be in effect for one year,
22 I believe, and then would change.

23 Q. Aside from the adjustments that you're
24 referring to based on each year's adjustment, I mean
25 how long --

1 A. So you mean when would embedded cost
2 price change.

3 Q. That's correct.

4 A. If it was entirely embedded cost pricing
5 I think it would last through the FRR transition
6 period and then stop, that's my understanding.

7 Q. So to June 1st, 2015.

8 A. That's my understanding.

9 Q. And, Mr. Graves, you would agree with me
10 that there is, between now and that time and such
11 time as the company would no longer be an FRR entity,
12 that there is no need to develop new capacity in the
13 AEP Ohio territory to maintain adequate reliability?

14 A. That appears to be the case.

15 Q. And would you agree with me that demand
16 for capacity has been low and will continue to be low
17 for some time?

18 A. Well, we've certainly been in a recession
19 that knocked down a lot of growth and rates of
20 recovery don't look extremely rapid, so that's part
21 of my conclusion that there is likely to be adequate
22 supply through 2015.

23 Q. And if you would refer to your testimony
24 on page 8, lines 13 to 15, let me know when you're
25 there.

1 A. Okay.

2 Q. And would you read that, please, those
3 lines?

4 A. The question at line 13?

5 Q. Lines 13 to 15, your answer. On page 8.

6 MR. CONWAY: Excuse me. Mr. Jones, on my
7 copy there's a question that starts at line 13 and
8 continues on through line 15. Is that --

9 MR. JONES: I'm sorry, I'm actually
10 reading from the one that has the edits there, that's
11 why my pages are off. I apologize.

12 Q. Let's see, Mr. Graves, it would be the
13 last sentence of your answer to -- right before the
14 question of why does AEP Ohio need to recover its
15 embedded capacity costs from CRES providers. Do you
16 see that?

17 A. The last full sentence is what you want
18 me to read?

19 Q. Yes, please.

20 A. Okay. "It is more likely that if market
21 prices increase materially, CRES providers will turn
22 their former AEP Ohio customers back to AEP Ohio as
23 the default service provider."

24 Q. Okay. And, Mr. Graves, you already know
25 what the market prices are going to be for capacity

1 between now and June 1st, 2015; do you not?

2 A. The RPM prices, yes.

3 Q. Yes. And that there will not be a
4 material increase in those prices during that period
5 from today's price; is that correct?

6 A. Certainly the capacity prices are fixed,
7 energy price could change, I don't think it's
8 terribly likely, but this is not a forecast, it's an
9 observation about what could happen.

10 Q. But you're saying that there would not be
11 a material increase in capacity prices during that
12 period of time from today's capacity prices; is that
13 correct?

14 A. To the contrary, the capacity prices will
15 be continually declining.

16 Q. And, Mr. Graves, I want to refer you to
17 another piece of your testimony. I'm going to be
18 off, again, I apologize, I have on page 10, it's
19 either going to be on page 10 or 11 of your
20 testimony, it's on the economic issues and CRES
21 capacity pricing and it's the first answer to the
22 first question underneath that topic.

23 A. That begins "Absent the recovery"? Or is
24 it to the question before that?

25 Q. That would be line 13, page 10.

1 A. Okay.

2 Q. And there you have as part of your answer
3 in parentheses you have "(potentially reallocating
4 those shortfalls to the non-shopping AEP Ohio
5 customers)." Do you see that?

6 A. I do.

7 Q. And how would AEP Ohio potentially
8 reallocate those alleged shortfalls to nonshopping
9 AEP Ohio customers?

10 A. I don't have a specific mechanism in mind
11 nor do I even know for sure that that has regulatory
12 feasibility. What I'm getting at here is that to the
13 extent there's a cost recovery shortfall it either
14 falls on shareholders or it has to be transferred to
15 someone else and the only place to transfer it would
16 be to nonshopping customers.

17 Q. So that would be in a separate
18 proceeding?

19 A. Presumptively. I don't know the
20 procedural mechanism whereby it could occur. And it
21 might not. It could just be a loss to shareholders.

22 Q. Mr. Graves, my next question starts at
23 the bottom of page 10 and moves over to page 11 with
24 the answer, and you talk about the capacity cost
25 that's collected from nonshopping customers. Do you

1 see that part of your answer to that question?

2 A. I believe so.

3 Q. Okay. Your understanding of where that
4 information comes from is what -- where did AEP Ohio
5 get that rate approved; do you know? Where they
6 would collect that charge?

7 A. The non-- what is "that rate" that you're
8 talking about?

9 Q. The rate that nonshopping customers are
10 paying for capacity currently.

11 A. That's part of their ESP which has been
12 set periodically over time.

13 Q. And is that the SSO rate that's been in
14 effect since 2009, do you know?

15 A. I don't know when it was last updated.

16 Q. And are you saying in your testimony that
17 the company, AEP Ohio, has in their bundled
18 generation rate they're charging a capacity rate of
19 355.72 to their customers? Is that your testimony?

20 A. No, not explicitly. What I'm saying is
21 it's collecting -- the company witnesses believe they
22 are collecting roughly the 355 number from the G
23 component of their SSO service. I don't know that
24 it's an explicit charge or that it's exact, but
25 they're comfortable that it's pretty close.

1 Q. You're just taking the word of another
2 AEP Ohio witness, is that correct, for your
3 understanding of that?

4 A. As I explained, I'm not sponsoring their
5 cost-of-service analysis. I'm addressing the
6 question of the circumstances under which embedded
7 cost pricing is reasonable in relation to RPM.

8 Q. And that's my point. You haven't done
9 any analysis, correct? So you wouldn't know other
10 than what you've been told; is that correct?

11 A. Yes; I'm relying on other AEP witnesses
12 in that regard.

13 Q. Okay. Mr. Graves, I have another
14 question that pertains to page 12 of your testimony,
15 the question concerning the energy credits.

16 A. Okay.

17 Q. And the second sentence you have there,
18 you say "The concern is that energy operating margins
19 could become occasionally so high that if fully
20 deducted, the net capacity costs would become
21 negative." Do you see that?

22 A. Yes, I see it.

23 Q. Fully deducted from what? From what rate
24 are you thinking about there when you make that
25 statement?

1 A. From the CRES embedded cost charge of
2 355.

3 Q. From the 355 --

4 A. Yes.

5 Q. -- .72 rate.

6 Mr. Graves, you used the term
7 "free-riders" here multiple times in your testimony I
8 think on page 13, 14, 15, a couple pages there. Is
9 that your term or did you get that from somewhere
10 else?

11 A. Free-rider, it's a standard term in
12 economic literature. Widely used.

13 Q. Does that mean somebody's getting
14 something for nothing?

15 A. Well, if they were fully free-riders,
16 yes, they would be getting something for nothing, or
17 avoiding some responsibility that they should be
18 paying for.

19 Q. So the context you're using it here is
20 that they're fully not paying anything?

21 A. I don't mean they're not paying anything.
22 But the point is to the extent they're not paying
23 their commensurate share of costs, it's much like if
24 pollution, for instance, is not priced and a firm can
25 emit pollution and not incur a cost for that, they

1 are free-riding on their ability to impose an
2 externality on society, it doesn't mean they're not
3 incurring other costs but to that extent they're
4 doing it for free.

5 Q. But that is not the case in this case, if
6 they were to pay RPM price, they would not be free;
7 is that correct?

8 A. It would not be free but RPM pricing
9 would be considerably below the price that is
10 being -- at which that capacity is being carried by
11 AEP and it would create a situation where CRES
12 providers can take the existing nonshopping customers
13 and swap them over to a new service where they simply
14 don't pay as much as the exact capacity as they were
15 paying and AEP simply eats the loss.

16 Q. But my point is they're not free, right?
17 The charge is not free, correct?

18 A. It's not the charge that's the basis for
19 the free-rider part, it's the difference between the
20 charges that's the free.

21 Q. Okay. Now, Mr. Graves, I want you refer
22 you to your testimony on page 14, line 20.

23 A. Sorry, what line?

24 Q. Line 20.

25 A. Okay.

1 Q. Page 14. And there, if you would, would
2 you read that sentence for me where it begins there?

3 A. Beginning with "If CRES providers?

4 Q. Yes.

5 A. Sure. "If CRES providers gained access
6 to AEP Ohio's capacity with the RPM-based rates, they
7 would have little or no incentive to contract forward
8 for FRR capacity in the future, in a manner that
9 would actually signal their need and willingness to
10 pay for it to potential developers."

11 Q. Now, when you say "in the future," do you
12 mean post June 1st, 2015, or what do you mean by
13 "future" when you're using it in that context? When
14 is the future?

15 A. Here I'm describing a general principle
16 and impact of changing price structures. The point
17 is not that's a problem in the future that has to be
18 solved in 2015. We happen to be in a situation where
19 we could make this change and there probably would be
20 no adverse impacts on capacity.

21 But as a matter of the way these kinds of
22 changes alter the attractiveness of developing
23 utility infrastructure, simply transferring existing
24 assets to someone else at a price below their cost
25 doesn't create any efficiency benefits or any

1 incentives or any signal about the need for or
2 benefit from new resources. So that's true in
3 general. It happens we don't have a likely problem
4 by 2015 that needs to be cured, but it doesn't make
5 it more fair to ignore that.

6 Q. So you're talking post June 1st, 2015,
7 is your answer, correct?

8 A. In all likelihood that would be the next
9 time we would need capacity.

10 Q. Mr. Graves, I want to refer to the same
11 page, line 11.

12 A. Okay.

13 Q. There you say "This tends to create an
14 incentive to let others solve the capacity
15 development problem/obligation." What capacity
16 development problem are you referring to there?

17 A. I'm explaining there what a free-rider is
18 in system reliability management.

19 Q. Well, you're characterizing it as there's
20 a capacity development problem that would need to be
21 addressed. Isn't that what your testimony says
22 there?

23 A. Yes.

24 Q. Well, I'm asking you what problem are you
25 identifying?

1 A. I'm describing the reason why we have
2 obligations for everyone to support reliability in a
3 pool because it is a public good on a network system
4 so if the system is made more reliable because one
5 person is more nervous about it than others, all the
6 others can relax and not participate, which creates
7 perverse incentives for free-riders to wait and
8 eventually that discourages those who would develop
9 it from actually being willing to invest.

10 So to prevent that you have to enforce
11 equitable sharing of the obligation, otherwise you
12 don't get the right amount of social development of
13 those resources. It's a standard problem in
14 economics and I'm describing it in general terms
15 here.

16 Again, I'm not saying there's a forecast
17 that we are facing a crisis of that time by 2015, I'm
18 just saying that's appropriate of reasonable utility
19 pricing that it addresses this shared responsibility
20 problem.

21 Q. Mr. Graves, you would agree with me that
22 there is no problem with reliability in the pool
23 between now and June 1st, 2015, correct?

24 MR. CONWAY: Objection, he's already
25 answered that question, your Honor, at least two or

1 three times.

2 MR. JONES: Your Honor, he used that as
3 an answer to my last question suggesting there would
4 be a problem with, you know, with their contributing
5 to their share for reliability of the pool.

6 MR. CONWAY: Your Honor, he specifically,
7 well, his testimony and the transcript will say what
8 it says, but that's a mischaracterization of his
9 testimony. And it's also a question that he's
10 addressed at least two or three times now in the last
11 ten minutes.

12 MR. JONES: I'm addressing his answer,
13 your Honor.

14 EXAMINER PARROT: The objection is
15 overruled. You may answer, Mr. Graves.

16 A. Okay, I had previously answered that and
17 my answer was that I do not foresee a problem by
18 2015.

19 Q. (By Mr. Jones) For pool reliability.
20 Reliability in the pool.

21 A. Yes, that's correct.

22 Q. Thank you.

23 Mr. Graves, I want to refer you to your
24 testimony on page 16, line 15.

25 A. Okay, I have it.

1 Q. There you say, I'll start at the
2 beginning of the sentence, "RPM-based capacity prices
3 would provide a more efficient short term signal...."
4 How would you define "short-term" there?

5 A. I'd say for a year or less.

6 Q. I just have one last question here, it's
7 in your testimony on page 18, line 14, and you say
8 that "In contrast, requiring the RPM-based rate
9 without other financial compensation adjustments
10 would simply entail AEP Ohio being forced to
11 subsidize its own bypass."

12 What are you referring to there when you
13 say "without other financial compensation
14 adjustments"? What's that refer to?

15 A. The problem with going to a hundred
16 percent RPM is the financial shortfall and the large
17 wealth transfer for some operational gains that would
18 occur by simply shifting customers from AEP to CRES
19 providers. So that creates financial harm that could
20 be mitigated in other ways.

21 One way is to use the embedded cost
22 pricing, another way is to set up some kind of rate
23 stabilization plan, or in principle if it were still
24 feasible as a regulatory matter some sort of lost
25 revenue correction. There's a variety of things that

1 can be done to mitigate financial risk.

2 There could be an earnings catch-up
3 process that was alluded to this morning as actually
4 being in place in Ohio, but those have to be reliable
5 enough to work, but more than one way could be used
6 to plug a leak.

7 Q. So that's not limited to embedded costs
8 then, is that your testimony?

9 A. That's correct.

10 MR. JONES: That's all I have. Thank
11 you.

12 EXAMINER PARROT: All right. Very good.
13 Let's take a break for lunch, we will reconvene at
14 3:15.

15 Thank you, Mr. Graves.

16 THE WITNESS: Thank you.

17 (Luncheon recess taken.)

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Monday Afternoon Session,
April 23, 2012.

- - -

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

Any redirect, Mr. Conway?

MR. CONWAY: Thank you, your Honor.

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REDIRECT EXAMINATION

By Mr. Conway:

Q. Mr. Graves, this morning when you were in
discussions with Mr. Kutik, do you recall several
questions regarding the August 2011 Brattle Group
report?

A. On capacity markets, on PJM's capacity
markets?

Q. Yes.

A. Yes, I do recall that.

Q. Do you believe there's any inconsistency
between The Brattle Group's August 2011 report and
your testimony in this proceeding?

A. No, I think they're consistent.

Q. And do you recall an exchange with
Mr. Kutik in which the discussion focused on the
energy and ancillary service credit or offset

1 against, I think it was the, it may have been the
2 gross CONE amount? Do you recall that?

3 A. Yes, we discussed how net CONE is
4 converted from gross CONE.

5 Q. And I believe there was a reference to a
6 three-year look-back for information data regarding
7 the energy and ancillary services credit that is then
8 used in connection with that conversion. Do you
9 recall that?

10 A. I do.

11 Q. Could you explain the lag between the
12 three years of data used for the EM - AES offset and
13 the base residual auction and the subsequent delivery
14 year?

15 A. Yes. As I understand it, the gross CONE
16 is converted to net CONE by taking out the energy and
17 ancillary services that that type of unit would have
18 had in the three years prior to the base residual
19 auction under the LMP prices that prevailed in PJM,
20 so it uses three years before the BRA and then the
21 BRA itself sets a price for three years later, so the
22 gap between the two is potentially as much as six
23 years.

24 Q. And what impact does that gap or that lag
25 have on the use of the three-year look-back of data

1 as a proxy for the offset?

2 A. It raises the chance that the energy
3 offset won't be descriptive of what the actual
4 realized energy and ancillary service offsets would
5 turn out to be.

6 Q. And do you recall a line of questions, I
7 believe it was during the discussions you had with
8 Mr. Randazzo regarding the capacity pricing that's
9 currently in effect for AEP Ohio?

10 A. I believe so.

11 Q. And I believe you mentioned the RPM rate,
12 the current RPM rate, the \$145 rate being in effect.
13 Do you recall that?

14 A. Yes.

15 Q. What's your understanding of the capacity
16 pricing that is currently in effect for AEP Ohio?

17 A. I think my previous description of it as
18 being based on RPM was oversimplified. I understand
19 there's a two-tier structure where the first portion
20 of available capacity to CRES providers is at the RPM
21 rate and then it goes to 255 a megawatt-day I
22 believe, or something approximately like that, for
23 the second tier.

24 Q. And also in the course of your
25 examination by Mr. Randazzo I believe there was some

1 discussion of impairments. Do you recall that?

2 A. Yes.

3 Q. And specifically there was one discussion
4 you had which was I believe related to one of the
5 documents he showed you that focused on the
6 impairment reporting or decision that related to the
7 third quarter of 2011 and AEP Ohio's generation
8 assets. Do you recall that?

9 A. Yes.

10 Q. And I believe in the course of the
11 discussion you indicated that whether an asset is
12 impaired depends on all of the revenue flows related
13 to the asset. Do you recall that?

14 A. Yes, that's generally what I said.

15 Q. Could you describe, in addition to the
16 capacity revenues that CRES providers serving
17 nonshoppers would pay to the company, what other
18 revenue streams there might be related to the
19 generation assets that would be relevant to any
20 impairment analysis?

21 A. I have not specifically reviewed that
22 impairment analysis but I can speak to what I expect
23 would be the relevant types of revenues to include,
24 and that would include things like the capacity
25 contributions or fixed cost contributions earned from

1 payments from nonshopping customers under the
2 standard service offer rate; payments from pool
3 members for their share of capacity that's
4 transferred or priced at cost internally; there may
5 be long-term contracts for some capacity with certain
6 parties that are rates with considerable returns; and
7 there's energy and off-system and ancillary sales in
8 the off-system markets as well which can produce a
9 margin. So all of those would have to be considered
10 to know there's an impairment.

11 Q. Mr. Graves, do you have with you still on
12 the stand the exhibits, the various exhibits that
13 Mr. Randazzo showed to you and then discussed in some
14 respects with you?

15 A. Yes, I have quite a few.

16 Q. I'd like to just quickly have you again
17 take a look at each of them. Just so that the record
18 is clear I'm referring to IEU Exhibit 112, the
19 prospectus supplement from 2002 for AEP, Exhibit --
20 IEU Exhibit No. 113 which is an excerpt from
21 Mr. Forrester's direct testimony in the original ETP
22 case, 99-1729 back in 2000, and then the excerpt from
23 the Columbus Southern Power Company FERC Form No. 1
24 marked as IEU Exhibit 114.

25 And then the additional excerpt from an

1 Ohio Power Company FERC Form No. 1 for 2011 marked as
2 IEU Exhibit 115, and then the packet of discovery
3 responses in the modified ESP proceeding that is
4 currently pending involving AEP Ohio, Case No. 11-346
5 and 348 which was marked as IEU Exhibit 116.

6 And then IEU Exhibit No. 117, which is
7 the OPCo's -- Ohio Power's and Columbus Southern
8 Power's application in a PUCO case No. 01-3289 back
9 in 2001-2002, Exhibit 118 for IEU which is the Ohio
10 Power and Columbus Southern Power memo contra an OCC
11 motion in that case, that case being the 01-3289 case
12 back in 2002, and then finally IEU Exhibit 119 which
13 is the letter from Mr. Fayne to Chairman Schriber of
14 the PUCO in that same case, 01-3289.

15 Do you have all those before you?

16 A. Yes, I do.

17 Q. Had you ever seen any of these documents
18 before Mr. Randazzo began examining you concerning
19 them?

20 A. No, I had not.

21 Q. And did you -- I take it, then, that they
22 played no role in your preparation of your testimony
23 for this case; is that correct?

24 A. That's correct, I did not rely on them in
25 any way.

1 Q. And you did have some opportunity at
2 Mr. Randazzo's request to at least skim through each
3 of those documents, correct?

4 A. Yes.

5 Q. And having done that do you have any
6 personal knowledge about the regulatory context that
7 might have applied at the time each of the documents
8 was created or filed?

9 A. No, there's none for which I was involved
10 or have firsthand knowledge of how they were
11 developed or used.

12 Q. And do you have any familiarity with the
13 particular facts and circumstances that would have
14 underlaid each of the documents when each was
15 prepared or filed?

16 A. I do not.

17 MR. CONWAY: Your Honor, that's all I
18 have on redirect.

19 EXAMINER PARROT: Mr. Kutik?

20 MR. KUTIK: Thank you, your Honor.

21 - - -

22 RE CROSS-EXAMINATION

23 By Mr. Kutik:

24 Q. Mr. Graves, with respect to the energy
25 and ancillary services offset that you discussed with

1 Mr. Conway, the establishment of net CONE for the
2 planning year 2015 and 2016 would look back at the
3 years 2009 through 2012 for the energy and ancillary
4 offset; is that right?

5 A. Planning years through 2012, yes, so the
6 one ending this year.

7 Q. And would it be fair to say that energy
8 prices during that period of time were fairly low?

9 A. Yes, that's correct.

10 Q. So when AEP Ohio joins the RPM process in
11 2015-2016, as part of that planning year, they will
12 be able to get, for lack of a better term, the
13 benefit of those low prices in the establishment of a
14 net CONE price, correct?

15 A. Unless energy prices stay comparably low
16 that they would at least be getting a small -- a
17 smaller offset than if energy prices were higher.

18 Q. Now, the formula for the establishment of
19 net CONE included the energy and ancillary services
20 offset as set forth in the reliability assurance
21 agreement, correct?

22 A. I believe so.

23 Q. And that was an agreement that was
24 entered into by numerous stakeholders holding a
25 variety of points of view.

1 A. I'm sure that's true. I don't know what
2 their points of view were, but it would be
3 astonishing if they were in complete agreement.

4 Q. So they are representing a fair result as
5 far as all those folks were concerned, correct?

6 A. I don't know how many of them, how
7 unanimously it was supported, but at least it was
8 supported enough to be deemed acceptable to a
9 deciding majority.

10 Q. And so a deciding majority of
11 stakeholders from a variety of points of view
12 believed that the final result of the RAA was fair,
13 it was a fair result, correct?

14 MR. CONWAY: Your Honor, at this point
15 I'll object. This has gone now well beyond the scope
16 of my redirect.

17 EXAMINER PARROT: Response.

18 MR. KUTIK: Your Honor, this all has to
19 do with he believes that the offset is perhaps
20 inappropriate or somehow unbalanced, and I'm
21 establishing that a whole bunch of other people
22 didn't agree.

23 MR. CONWAY: That's not -- that was not
24 the scope of my redirect. This is plowing new ground
25 entirely.

1 MR. KUTIK: This is my -- I have two more
2 questions left.

3 EXAMINER PARROT: The objection is
4 overruled.

5 Please continue, Mr. Kutik.

6 Do you need the question reread?

7 THE WITNESS: I think I have it.

8 I guess I don't feel comfortable
9 concluding that it was deemed fair by the parties.
10 It was probably deemed acceptable under the
11 conditions, and conditions have changed since then,
12 some of those parties may no longer feel like it's a
13 good metric, and it's the kind of thing which is
14 subject to review and potential revision in the RPM
15 process. And I don't know where people stand now as
16 to whether they like it, but at least at the time, as
17 I agreed, there was enough support to condone it and
18 approve it.

19 Q. And deem it acceptable.

20 A. Implicitly we can say that because it was
21 approved.

22 Q. And the RAA was accepted by the Federal
23 Energy Regulatory Commission, correct?

24 A. Yes, that's my understanding.

25 Q. And so we can assume from that that the

1 Commission felt that the RAA provisions were just and
2 reasonable, correct?

3 A. I don't know that that's the way it was
4 described in the approval but it's probable that they
5 would have taken that standard.

6 MR. KUTIK: Can I have one minute, your
7 Honor.

8 Q. Now, we talked earlier about the Brattle
9 studies of the PJM process, correct?

10 A. Yes.

11 Q. And isn't it a fact that the stakeholders
12 as a result of that report reaffirmed various
13 portions of the RAA?

14 A. You know, I don't know to what extent all
15 of it has been put against stakeholder support, there
16 are revisions under consideration of several terms
17 and some are being implemented so I don't know what
18 the status of its overall re-approval is.

19 Q. Okay. Fair enough.

20 MR. KUTIK: I have no further questions,
21 thank you.

22 EXAMINER PARROT: Ms. Kaleps-Clark?

23 MS. KALEPS-CLARK: No questions, your
24 Honor, thank you.

25 EXAMINER PARROT: Ms. Kingery?

1 MS. KINGERY: No questions, your Honor.

2 EXAMINER PARROT: Mr. Randazzo?

3 MR. RANDAZZO: Just a couple, I think.

4 - - -

5 RECROSS-EXAMINATION

6 By Mr. Randazzo:

7 Q. You were asked a question about your
8 understanding regarding the RPM rate for the charge
9 for capacity that's currently in place. Do you
10 recall that?

11 A. I do.

12 Q. Yeah. What was your understanding at the
13 time that you prepared your testimony?

14 A. As to what that rate was?

15 Q. Yeah.

16 A. I understood there to be a two-tier
17 structure in place as I described, I simply
18 misdescribed it in response to your question earlier.

19 Q. Okay. That's fine.

20 And how is community aggregation treated
21 in that two-tier structure?

22 A. That gets a bit into the details that I'm
23 not as comfortable with. I believe there's an extra
24 portion of tier-1 rights that are set aside for
25 community aggregation such that a bit more than

1 21 percent is the tier 1 target but I think it can be
2 larger if there's some community aggregation, but
3 it's not unlimited as far as I know.

4 Q. What is not unlimited?

5 A. The amount of tier 1 capacity available
6 to community aggregation. But I'm not an expert in
7 that. I know there's a special provision for some
8 allowance for it.

9 Q. Okay. You were asked some questions
10 about the things or you were asked a question about
11 the scope of the considerations to do an impairment
12 analysis. Do you recall that question?

13 A. Yes.

14 Q. Would dividend policy be one of the
15 things you would look at?

16 A. I would not normally think so as it's not
17 a feature of the asset value, that's a financial
18 transfer.

19 Q. Do you know what the -- would you accept,
20 subject to check, that for 2011 the net income
21 reported on the combined Columbus Southern and Ohio
22 Power FERC Form 1 was \$464,992,339?

23 MR. CONWAY: Could I have that question
24 read back, please?

25 (Record read.)

1 MR. CONWAY: Your Honor, at this point
2 I'll interpose another objection. I think this is
3 beyond the scope of my questions which simply asked
4 the witness to describe the revenue flows that might
5 support the relevance to an impairment analysis. I
6 didn't ask him about the net income, combined net
7 income of Columbus Southern and Ohio Power on the
8 FERC Form 1.

9 EXAMINER PARROT: Response?

10 MR. RANDAZZO: Your Honor, your Honors,
11 it's a foundation question and if I don't connect in
12 the next question, I will withdraw both questions.

13 EXAMINER PARROT: All right. Please
14 proceed.

15 Q. (By Mr. Randazzo) Will you accept that,
16 subject to check, that net income reported on line 2
17 at page 120 of the 2011 FERC Form 1 for the combined
18 Ohio Power and Columbus & Southern shows a net income
19 of \$464,992,339?

20 A. Sure, I'm happy to accept that.

21 Q. Would you accept, subject to check, that
22 the dividend for that same period on common stock
23 paid from the combined Columbus Southern and Ohio
24 Power to the parent was \$650 million?

25 MR. CONWAY: Objection. The basis is my

1 previous basis. It's beyond the scope.

2 MR. RANDAZZO: It's the other foundation
3 question, your Honor.

4 EXAMINER PARROT: So there's two
5 foundation questions.

6 MR. RANDAZZO: I'm sorry, I thought I
7 indicated there was one more foundation.

8 EXAMINER PARROT: I didn't interpret it
9 that way, you maybe said that but, okay, let's --

10 A. Sure, I'm happy to accept that as well.

11 Q. Okay. So when a company pays more in
12 dividends than it receives in net income, are you
13 saying that you would not consider that for purposes
14 of an impairment analysis?

15 A. Sure, I am saying that. An impairment
16 analysis is about the value of the assets, not the
17 cash balances of the parties that are holding them
18 and whether they need that cash for internal purposes
19 or not, that's a financial transfer that doesn't
20 reveal anything about the value of the assets.

21 Q. All right. When you pay dividends out
22 that are greater than net income, does it affect your
23 capitalization ratio?

24 MR. CONWAY: Objection. Same basis.

25 EXAMINER PARROT: Overruled.

1 A. Compared to not paying dividends, sure,
2 it affects your balance sheet, but it may not affect
3 it adversely, it just changes it.

4 Q. And when you -- well, let's back up. You
5 said compared to not paying them. And my question
6 asked you to accept a situation, subject to check, a
7 situation where Ohio Power and Columbus & Southern is
8 actually paying dividends to the parent greater than
9 net income. Did you understand my earlier questions
10 that way?

11 A. I did.

12 Q. Yeah.

13 MR. CONWAY: Your Honor, I asked the man
14 what revenue streams were relevant to the impairment
15 analysis and it was a follow-up to a
16 cross-examination question in the same vein. I
17 didn't ask him to get into the area of balance sheet
18 effects of subject to check dividend payments made
19 upstream from AEP Ohio. It's beyond the scope of my
20 redirect examination.

21 EXAMINER PARROT: The objection is
22 overruled.

23 Q. Did you understand previously --

24 A. So I believe I understood your question,
25 and my -- I think my answer is the same. If you pay

1 out a large dividend, it changes your equity, it may
2 not change your capitalization structure depending on
3 what else you also had cash available for, perhaps
4 you retired comparable amounts of debt in parallel.

5 There's no per se impact and it is not a
6 per se indication of high value or low value of the
7 underlying assets. It's a property of the cash needs
8 of the parties, not of the asset values.

9 Q. And for purposes of doing an impairment
10 analysis you would not look at such things as
11 dividend policy as I understood your prior answer; is
12 that correct?

13 A. Yes, that's the same answer.

14 Q. Okay.

15 MR. RANDAZZO: That's all I have. Thank
16 you very much.

17 EXAMINER PARROT: Mr. Royer?

18 MR. ROYER: No questions.

19 EXAMINER PARROT: Mr. Kurtz?

20 MR. KURTZ: No questions.

21 EXAMINER PARROT: Mr. Yurick?

22 MR. YURICK: No questions, your Honor,
23 thank you.

24 EXAMINER PARROT: Ms. Kern?

25 MS. KERN: No questions, thank you.

1 EXAMINER PARROT: Mr. Jones?

2 MR. JONES: No questions, your Honor.

3 EXAMINER PARROT: Thank you very much,
4 Mr. Graves.

5 THE WITNESS: Thank you.

6 EXAMINER PARROT: You are excused.

7 Mr. Conway.

8 MR. CONWAY: Thank you, your Honor, at
9 this time AEP Ohio moves for the admission of
10 Mr. Graves' testimony which I believe is Exhibit 105.

11 EXAMINER PARROT: Are there any
12 objections to the admission of AEP Exhibit 105?

13 Hearing none, Exhibit -- AEP Exhibit 105
14 is admitted into the record.

15 (EXHIBIT ADMITTED INTO EVIDENCE.)

16 EXAMINER PARROT: Mr. Kutik.

17 MR. KUTIK: Your Honor, FES moves for the
18 admission of FES Exhibit 118. We are not moving for
19 the admission of Exhibit 119.

20 EXAMINER PARROT: Are there any
21 objections to the admission of FES Exhibit 118?

22 MR. CONWAY: Just one moment, your Honor.
23 This is the order denying rehearing?

24 MR. KUTIK: Yes.

25 MR. CONWAY: No objection, your Honor.

1 EXAMINER PARROT: FES Exhibit 118 is
2 admitted.

3 (EXHIBIT ADMITTED INTO EVIDENCE.)

4 EXAMINER PARROT: Mr. Randazzo.

5 MR. RANDAZZO: I would move the admission
6 of what have been marked as IEU Exhibits 112 through
7 118.

8 EXAMINER PARROT: I'm sorry, did I hear
9 you correctly, through 118? You're not moving 119?

10 MR. RANDAZZO: Yes, 119, that too, thank
11 you.

12 EXAMINER PARROT: Are there any --

13 MR. RANDAZZO: 119 being the letter to
14 Dr. Schriber I believe.

15 EXAMINER PARROT: Are there any
16 objections to the admission of IEU Exhibits 112
17 through 119?

18 MR. CONWAY: Yes, your Honor. The
19 witness exhibited no familiarity with the documents,
20 was not familiar with the regulatory or factual
21 context in which the documents were prepared or
22 filed, and all that we have on the record is
23 Mr. Randazzo's request that he accept, subject to
24 check, that they are what they purported to be and so
25 I don't think that they get into the record based on

1 the witness's testimony.

2 EXAMINER PARROT: Mr. Randazzo.

3 MR. RANDAZZO: Yes, your Honors. There
4 has been no suggestion that the documents are not
5 authentic. Some of the documents are AEP business
6 records. Some of the documents are required to be
7 filed from a regulatory perspective.

8 This witness, as others, have told a
9 story about why it is they believe that embedded cost
10 pricing is appropriate, and told a story that
11 includes the notion that somehow we are still dealing
12 with a bundled vertically integrated entity, they
13 have told a story that implies that somehow the
14 accounting that is peculiar to regulated entities is
15 still relevant, and I believe the documents that we
16 have tried to bring forward so that the Commission
17 can see what AEP actually said itself about such
18 things are perhaps some of the most relevant
19 documents that have been made available in this
20 record.

21 AEP has brought forward witnesses that
22 have selective knowledge and select memories about
23 what happened, and from our perspective, unless the
24 Commission is willing to actually dig into these
25 kinds of records, we're going to continue to engage

1 in this fantasy that has been concocted by AEP with
2 no information to support it, this fantasy about
3 financial harm without doing an impairment analysis
4 to determine what the impact would be, discovery
5 responses that suggest that the impairment analysis
6 that has been done reveals that there is no problem.

7 So with that explanation, your Honor, I
8 would ask that you overrule the objection and let
9 some of this information finally get to a place where
10 the people that have not lived through this situation
11 over the last ten or so years have an opportunity to
12 better understand what has transpired.

13 MR. CONWAY: Your Honor, if I might make
14 a few reply comments.

15 EXAMINER PARROT: Sure, Mr. Conway.

16 MR. CONWAY: Thank you. I think the
17 proper place and time to argue about which positions
18 are fantastic is in the post-hearing briefs which --
19 or post-hearing arguments which all parties have an
20 opportunity to engage in.

21 The question here is, is this witness a
22 proper conduit for Mr. Randazzo's effort to introduce
23 these documents, and the answer is clearly no.

24 Mr. Randazzo has a witness who is about to take the
25 stand who he could have tried to use as a conduit for

1 these documents but, for whatever reason, decided not
2 to. That's not the company's decision, that was
3 Mr. Randazzo's decision.

4 Mr. Randazzo could have talked about --
5 talked with witnesses of the company such as
6 Mr. Munczinski or Mr. Allen about these documents,
7 none of which -- none of which he did. And perhaps
8 he could have found a conduit through one of the two
9 of them to do it.

10 The point that I'm making is that there
11 is no basis for getting these documents in through
12 Mr. Graves. And, frankly, I disagree with
13 Mr. Randazzo's portrayal of these documents as
14 telling partially, let alone all of the story, about
15 the topics covered in them, and so I disagree.

16 I don't disagree with Mr. Randazzo's
17 right to present his case as he sees fit, but I do
18 disagree with the manner in which he's trying to do
19 it through this witness. Thank you.

20 EXAMINER PARROT: Mr. Randazzo, before we
21 issue a ruling I'd like to ask you about IEU Exhibit
22 113 and that's an excerpt of the Forrester testimony.

23 MR. RANDAZZO: Yes.

24 EXAMINER PARROT: In reviewing your IEU
25 Exhibit 106 it looks like that testimony has already

1 been admitted into the record; is that correct?

2 MR. RANDAZZO: That is correct, your
3 Honor. That is my error. Yes.

4 EXAMINER PARROT: So it's not really
5 necessary for us at this point, I don't believe, to
6 also admit IEU Exhibit 113. Is there any reason that
7 you see for us that we should do that?

8 MR. RANDAZZO: As long as the record is
9 clear it's the same thing as the prior exhibit.

10 EXAMINER PARROT: I just want to be sure
11 it is. It looks to me like it is.

12 MR. RANDAZZO: That's my understanding.

13 EXAMINER PARROT: Well, in light of that
14 we are going to not admit IEU Exhibit 113 because,
15 again, that testimony that's already been admitted
16 the record as IEU Exhibit 106.

17 Thank you both for your patience. At
18 this point we are going to admit IEU Exhibits 112 as
19 well as 114 through 119.

20 (EXHIBITS ADMITTED INTO EVIDENCE.)

21 EXAMINER PARROT: I believe IEU has our
22 next witness.

23 MR. RANDAZZO: We do, your Honor, but if
24 the company has rested its direct case I have a
25 motion that I would like to make. It will be short.

1 EXAMINER SEE: Go ahead, Mr. Randazzo.

2 MR. RANDAZZO: Your Honors, the
3 companies, as I understand it, have rested their
4 direct case, and the Commission set this proceeding
5 to allow the companies to present information on
6 appropriate capacity charges.

7 There are three ways in which the
8 Commission can set prices: One applies to
9 noncompetitive services; the companies have not put
10 forward the evidence that is required to prosecute an
11 application based upon a request to increase prices
12 for noncompetitive services, there's been no
13 identification of rate base, no identification of the
14 property that's used and useful for providing
15 service, none of the requirements that are embedded
16 in traditional ratemaking as applied to Ohio law, the
17 inventory that's required by 4909.05, none of the
18 procedures required by 4908-18 and 19 have been
19 followed. None. No attempt to follow them.

20 The Commission has emergency ratemaking
21 authority, and the Commission's criteria for using
22 that authority which deal with imperiled financial
23 circumstances require that there be a demonstration
24 of an emergency prior to the grant of temporary
25 relief.

1 The evidence is reviewed with strict
2 scrutiny and subject to a clear and convincing
3 demonstration of the presence of extraordinary
4 circumstances. Emergency relief can not be granted
5 if the emergency request is filed merely to
6 circumvent some other option.

7 And, finally, the Commission will not
8 grant temporary relief due to financial peril more
9 than the minimum level necessary to avert and relieve
10 the emergency.

11 None of the information the applicants
12 have provided is directed at the criteria that the
13 Commission has long used to evaluate when to
14 intervene to address a financial problem.

15 We then come to the pricing mechanisms
16 that are available for competitive services. Now,
17 throughout this process repeatedly, in the discovery
18 fight as well, is a legal view that somehow the
19 electric distribution utility, AEP Ohio, which
20 includes both Columbus Southern and Ohio Power, is a
21 competitor, that somehow it is competing with
22 competitive retail electric service suppliers
23 including governmental aggregation entities for the
24 love and affection of retail customers and, more
25 importantly the money I guess.

1 That is a legal impossibility under Ohio
2 law. The electric distribution company cannot be a
3 competitor. The only supply opportunity that it has
4 is as a default supplier, period. End of story.

5 The service at question here, some people
6 may say it's competitive, some people may say it's
7 noncompetitive, the important point is the rule of
8 law dictates the kind of information that you have to
9 provide and when you can obtain an increase in
10 prices. None of that has been provided in this case.
11 None.

12 The Commission's criteria and standards
13 precedents also say that any intervention by the
14 Commission due to financial harm shall not be longer
15 than the demonstration of the emergency, longer than
16 the period for which an emergency is demonstrated.
17 Hasn't been any demonstrated.

18 The Commission did AEP a great favor by
19 intervening and restoring capacity charges in the ESP
20 2 settlement based upon an allegation that not doing
21 so would impose financial harm. There's been no
22 proof whatsoever of any financial harm. None.

23 And as a consequence of the Commission's
24 effort to make an opportunity for AEP Ohio, AEP Ohio
25 has not stepped forward to carry the burden of proof,

1 which is the burden of first coming forward with
2 enough information to satisfy the statutory criteria,
3 or the burden of persuading anybody that its theory
4 has merit based upon the law and circumstances.

5 We move to dismiss and I would ask the
6 Commission to terminate the restoration of the
7 two-tier capacity charges because the only reason the
8 Commission restored the two-tiered capacity charges
9 was based on an allegation of financial harm, which
10 when given the opportunity to do so, AEP Ohio has
11 failed to demonstrate, according to the Commission's
12 long-standing criteria that are used to measure
13 financial harm.

14 MR. NOURSE: Your Honor, briefly respond.
15 Regarding the motion to dismiss, as the Bench is
16 aware, the same arguments have been raised in a
17 written motion to dismiss, the company's responded,
18 other parties have responded. I think the Bench has
19 already indicated they're going to issue -- defer a
20 ruling and issue the entry or opinion and order.

21 I won't repeat those responses, I'll just
22 add a couple things regarding Mr. Randazzo's
23 additional comments.

24 First, with respect to the discovery
25 dispute which he's not part of and has already been

1 ruled upon, I think the statement mischaracterizes
2 AEP Ohio's arguments as portraying itself as a
3 competitor to CRES providers, that doesn't -- it's
4 not accurate and doesn't reflect positions we put in
5 the written discovery disputes.

6 Second, regarding the interim relief that
7 was granted in a March 7th entry and Mr. Randazzo
8 is challenging that and seeking to terminate it, I
9 would submit that's an untimely challenge to that
10 March 7th order; it should not be entertained.

11 I would also submit that it's speculative
12 when he attributes particular purposes and intentions
13 to the Commission's entry in that regard.

14 Finally, your Honor, I would note that
15 the statements about the burden of proof are
16 presumptuous as this proceeding, I would submit, is
17 a, more akin to a Commission-ordered investigation
18 and don't necessarily agree that the company has the
19 burden of proof, and I obviously disagree with the
20 characterization that the company has not met a
21 burden of persuasion or otherwise met its duty to
22 present evidence in accordance with the Commission's
23 entries in this case.

24 Thank you, your Honor.

25 EXAMINER SEE: Thank you.

1 MR. RANDAZZO: If I may just for the
2 record, we did file an application for rehearing with
3 regard to the March 7th order. It was granted by
4 the Commission. So I just wanted to point that out
5 to make sure everybody's aware of that.

6 EXAMINER SEE: The Bench is aware of it.

7 And just so we're all clear, the
8 applications for rehearing as to the
9 March 7th entry were granted to allow the
10 Commission some additional time to consider the
11 issues raised in those applications and will be
12 addressed on the merit at a later date.

13 In regard to the oral motion that
14 Mr. Randazzo made here today, we'll take those issues
15 up at a later date as we indicated earlier and we
16 will address the arguments in the written motion to
17 dismiss as well as the issues raised here today.

18 MR. RANDAZZO: Thank you.

19 EXAMINER SEE: With that, let's move on
20 to the next witness.

21 Mr. Randazzo.

22 MR. RANDAZZO: Yes, your Honors, at this
23 time I would ask that Mr. Edward Hess, J. Edward
24 Hess, I believe, be called as a witness and sworn to
25 give testimony.

1 EXAMINER SEE: Mr. Hess, if you would
2 raise your right hand.

3 (Witness sworn.)

4 EXAMINER SEE: Thank you. Have a seat.
5 Mr. Randazzo.

6 - - -

7 J. EDWARD HESS

8 being first duly sworn, as prescribed by law, was
9 examined and testified as follows.

10 DIRECT EXAMINATION

11 By Mr. Randazzo:

12 Q. Mr. Hess, would you state your name and
13 your business address, please.

14 A. My name is J. Edward Hess, my business
15 address is 21 East State Street, Columbus, Ohio,
16 43215.

17 Q. For purposes of this proceeding,
18 Mr. Hess, did you cause to be prepared direct
19 testimony?

20 A. Yes, I did.

21 MR. RANDAZZO: Your Honor, I believe
22 everyone should have a copy of Mr. Hess's direct
23 testimony at this point. If anybody needs a copy, I
24 have a few extras. I would ask that that prefiled
25 direct testimony of J. Edward Hess be marked as IEU

1 Exhibit 120.

2 EXAMINER SEE: I think you reserved, did
3 you reserve IEU --

4 MR. RANDAZZO: I'm sorry, Mr. Darr did.
5 That's correct, thank you.

6 EXAMINER SEE: The exhibit is so marked
7 as IEU Exhibit 101.

8 (EXHIBIT MARKED FOR IDENTIFICATION.)

9 Q. Mr. Hess, do you have what's been marked
10 for identification purposes as IEU Exhibit 101?

11 A. Yes, I do.

12 Q. Do you have any changes or corrections
13 that you would like to make in that testimony?

14 A. I have three corrections. Page 2, the
15 third line up after "Dr. Edward P. Kahn," I would
16 like to insert "William R. Forrester,"
17 F-o-r-r-e-s-t-e-r, comma.

18 Page 3, line 4, after the word -- after
19 the name "Graves," comma, William A. K-l-u-n.

20 And then page 9, line 6, a new sentence
21 would read -- should read "Dr. Landon updated his
22 schedules on April 19th, 2000, in the same ETP
23 case."

24 Q. Could you read that sentence again?

25 A. Yes, sir. "Dr. Landon updated his

1 schedules on April 19th, 2000, in the same ETP
2 case."

3 Q. Okay. Mr. Hess, at page 15 you discuss
4 or describe your understanding of what we have come
5 to call in this proceeding RPM; is that correct?

6 A. Yes.

7 Q. And is that understanding based upon --
8 are you relying on Mr. Kevin Murray for that
9 understanding?

10 A. Yes, I am. At line 21 through 22 I'm
11 pretty clear that according to IEU Witness Kevin
12 Murray.

13 Q. Now, with regard to the bottom of page 2
14 where you're listing the documents you reviewed
15 before your recommendation, to the extent that there
16 are other documents mentioned in your testimony, you
17 would have reviewed those as well, correct?

18 A. I say that on page 3, the first and the
19 second line, first full sentence.

20 Q. Okay. Now, if I were to ask you the
21 questions that are contained in IEU Exhibit 101,
22 would the answers you would give here today be as set
23 forth therein?

24 A. Subject to those corrections, yes.

25 MR. RANDAZZO: Your Honors, I would move

1 the admission of IEU Exhibit 101 and make Mr. Hess
2 available for cross-examination.

3 EXAMINER SEE: Ms. Kern?

4 MS. KERN: No questions, your Honor.

5 EXAMINER SEE: Mr. Royer?

6 MR. ROYER: No questions.

7 EXAMINER SEE: Mr. Yurick?

8 MR. YURICK: No questions, thank you,
9 your Honor.

10 EXAMINER SEE: Mr. Kurtz?

11 MR. KURTZ: No questions.

12 EXAMINER SEE: Ms. Kingery?

13 MS. KINGERY: No questions, your Honor.

14 EXAMINER SEE: Mr. Hayden?

15 MR. HAYDEN: No questions.

16 EXAMINER SEE: Ms. Kaleps-Clark?

17 MS. KALEPS-CLARK: No questions, your
18 Honor, thank you.

19 EXAMINER SEE: Mr. Jones?

20 MR. JONES: No questions, your Honor.

21 EXAMINER SEE: Mr. Nourse?

22 MR. NOURSE: Thank you, your Honor.

23 - - -
24
25

CROSS-EXAMINATION

By Mr. Nourse:

Q. Good afternoon, Mr. Hess.

A. Good afternoon.

Q. So in your testimony you are advancing or supporting an argument made by IEU that the AEP Ohio's -- and I'll refer to AEP Ohio to include, especially when you refer back to this time period, Columbus Southern Power and Ohio Power; do you understand that?

A. Understood, yes.

Q. So you're advancing the argument that the ETP stipulation operates today to preclude the proposal in this case for a cost-based capacity charge; is that accurate?

A. Yes.

Q. So, Mr. Hess, are you saying that the same analysis or a comparable analysis was done in the ETP cases as is being advanced in this case by the company?

A. No. I am saying it's a more complete analysis that was performed then. This is a short period for an item. The complete analysis was performed in 2000 for the ETP case.

MR. RANDAZZO: Mr. Hess, would you speak

1 up, please.

2 Q. Okay. But in the ETP case why don't you
3 give us your understanding in your own words of the
4 analysis that was done to support the calculation of
5 stranded generation investment. That was intended to
6 be a question.

7 A. I'm sorry, I thought I answered that
8 question in my testimony. I'm looking for it.

9 Q. Okay.

10 A. At page 7, question 14, the answer to
11 question 14, actually specifically about line 16.

12 Q. Okay. So this analysis that was done in
13 the ETP case -- first of all, the company's position
14 in this regard was supported by Dr. Landon and
15 Mr. Kahn, K-a-h-n, is that your understanding?

16 A. I believe it was Dr. Kahn, but, yes.

17 Q. Dr. Kahn, okay. And you reviewed that
18 testimony in preparing your testimony in this case,
19 correct?

20 A. Yes.

21 Q. Okay. So the basic exercise, is it
22 accurate that at that time was to take a long-term
23 view of the energy market and determine whether that
24 on a net-present-value exceeds the -- exceeds or is
25 less than the net present value of essentially a

1 regulated revenue stream?

2 MR. RANDAZZO: Hold on. Just objection
3 or clarification. When you say "energy market," what
4 are you referring to?

5 MR. NOURSE: Well, I'm asking him to
6 describe the exercise and how he would characterize
7 it, so he's referred me to page 7 and I'm trying to
8 boil it down a little bit more.

9 Q. I think in some cases in your testimony
10 you refer to the concept of above market, correct?

11 A. Correct.

12 Q. Okay. And so it's your position, is it
13 not, that at the time of the ETP case there is an
14 evaluation of whether the net book value of the
15 generation fleet, AEP Ohio, exceeded, was greater
16 than, or was less than a future projection of
17 electricity prices; wholesale and retail?

18 A. I think actually one of the reasons I
19 wanted to include Dr. Landon's JHL-2 on my testimony
20 is to give kind of a clear picture of some of the
21 analysis that we went through.

22 As I mentioned in my testimony, there
23 were several different ways to do this. As you can
24 see in the analysis, at least from 15, and I'm right
25 now on Exhibit JEH-1, page 1 of 4, the dispatched

1 generation of all the units was multiplied times a
2 projected market rate and then the associated
3 expenses for that generation were excluded from that,
4 and then specific adjustments were made to that
5 further down, and then that value, the net value of
6 that cash flow was discounted back and compared to
7 the net value -- net book value of the generating
8 plants at 12/31/00.

9 Q. Okay. Well, let me do this, I've got the
10 full testimony I'd like to mark as an exhibit from
11 both Dr. Landon and Dr. Kahn and distribute that and
12 I want to ask you some questions about it. Do you
13 have it with you?

14 A. I could use a copy.

15 MR. NOURSE: Okay. If these weren't so
16 heavy, I'd carry them around at the same time.

17 Let me first mark -- let me first
18 identify this exhibit, your Honor, it's direct
19 testimony of John H. Landon on behalf of CSP and OPCo
20 in the, okay, I don't have the case number, just a
21 second. I think it's 1729 and 1730.

22 EXAMINER SEE: Yes.

23 MR. NOURSE: 99-1729 and 1730-EL-ETP, as
24 AEP Exhibit --

25 EXAMINER SEE: 106 I believe is your next

1 exhibit.

2 MR. NOURSE: Okay. Thank you.

3 Let's go ahead and mark as 107 the
4 testimony of Edward P. Kahn in the same cases.

5 EXAMINER SEE: The exhibits are so
6 marked.

7 (EXHIBITS MARKED FOR IDENTIFICATION.)

8 Q. (By Mr. Nourse) Mr. Hess, this is the
9 same testimony you said you reviewed in preparing
10 your testimony?

11 A. Yes. Just so it's clear, Dr. Landon did
12 supplement his testimony.

13 Q. Yeah, okay. In terms of the numbers that
14 you use in your JEH-1, however, they would correspond
15 to this version of the testimony, correct?

16 A. That's correct.

17 Q. Okay. In fact, if you look at
18 Dr. Landon's testimony, I think there's a more
19 readable summary of those numbers on page 44. Do you
20 agree?

21 A. Yeah, they're a little better on this
22 exhibit.

23 Q. And those are the same numbers, the
24 bottom-line numbers that you've used in your
25 testimony and in your JEH-1 that replicates --

1 A. Those are the same four pages, yes.

2 Q. Yeah. Okay. So now with respect to
3 Dr. Landon, his analysis of forward pricing, you talk
4 about that a little bit. In your testimony, first of
5 all, page 9, line 7, in Q and A 16 you're talking
6 about the comparison of Landon's methodology to the
7 proposed cost-based formula in this case, correct?

8 A. Page 9?

9 Q. Of your testimony.

10 A. Yes, what was the reference, I'm sorry?

11 Q. Q and A 16.

12 A. Got that.

13 Q. Right. That's where you're comparing
14 Dr. Landon's methodology in the ETP cases to the
15 proposed cost-based formula advanced by the company
16 in this case, correct?

17 A. Yes.

18 Q. Okay. So with respect to Dr. Landon's
19 analysis, his forward projections cover the period
20 2001 to 2030; is that correct?

21 A. That's correct.

22 Q. Okay. And the formula rate in this case
23 covers the 2010 calendar year, correct?

24 A. That's correct.

25 Q. And does Dr. Landon's forward view of

1 electricity prices cover both wholesale and retail?

2 A. It covers full generation, yes.

3 Q. So that it does cover wholesale and
4 retail electric sales in the future?

5 A. Yeah, the top line was total gigawatts
6 generated, his price would have been covering both
7 wholesale and retail.

8 Q. Now, can you turn to page 34 of
9 Dr. Landon's testimony, it would be 106. And this is
10 the section of his testimony that starts on page 33,
11 it covers the forward prices that he recommends,
12 correct?

13 A. That's correct.

14 Q. Okay. And looking at page 34, can you
15 read the sentence that starts in the middle of line 7
16 and ends in the middle of line 9?

17 A. "In order to assign value to a generating
18 asset, we would need estimates of future electricity
19 spot prices for the entire duration of the remaining
20 useful life of that asset."

21 Q. Okay. So would you agree that based on
22 that statement it was Dr. Landon's view that an
23 appropriate forward analysis of the market price for
24 a particular generating asset should match up with
25 the useful life of asset?

1 THE WITNESS: Could I have the question
2 repeated, please?

3 (Record read.)

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

6 Q. Okay. Well, the sentence you read on
7 page 34 indicates Dr. Landon's opinion, does it not,
8 that an appropriate forward estimate would match up
9 with the entire duration of the remaining useful life
10 of that asset, correct?

11 MR. RANDAZZO: Can I ask for a
12 clarification? Are you asking him to just focus on
13 that one sentence or the entire answer?

14 MR. NOURSE: He can look at anything else
15 in the testimony he wants to. I was directing his
16 attention to that sentence.

17 MR. RANDAZZO: Thank you.

18 A. If you're asking me, I mean, the revenue
19 valuation methodology would cover the entire life of
20 the generating plant, the cash associated with the
21 entire life of the generating plant, yes.

22 Q. Well, yeah. And this is the side of the
23 equation in stranded cost valuation that was done
24 that looked at the forward energy price, correct?

25 A. Correct.

1 Q. And having read Dr. Landon's testimony in
2 preparation of your own in this case, is it your
3 understanding that Dr. Landon would have accepted a
4 one-year RPM price or a three-year advanced RPM price
5 for a one-year delivery period as an appropriate
6 forward price to use in that comparison?

7 A. I'm sorry, Mr. Nourse, I don't understand
8 the question.

9 Q. Based on this discussion we've had about
10 Dr. Landon's view that if you're going to look
11 forward to the future energy prices and make a
12 judgment as to whether a plant is above market, he's
13 saying that you should look at the entire duration of
14 the remaining useful life of that asset, correct?

15 A. Yes.

16 Q. And so would it be appropriate in that
17 context of Dr. Landon's position to use a one-year
18 RPM price such as you're comparing it to in this
19 case?

20 MR. RANDAZZO: I object to the
21 characterization.

22 MR. NOURSE: The witness can explain his
23 position.

24 EXAMINER SEE: Go ahead and answer the
25 question, Mr. Hess.

1 A. It's a part of my criticism of this
2 request is that the reduced value driven by 2010 was
3 incorporated into his analysis. 2010 was accounted
4 for in his calculation.

5 Q. Okay. But in this case aren't you
6 saying, correct me if I'm wrong, that anything above
7 the RPM price is above market and should be rejected
8 as untimely stranded cost recovery?

9 A. I'm saying that that valuation would have
10 been included in this analysis and it was determined
11 at that minute in time that there were no stranded
12 costs.

13 Q. So it's your belief that the RPM price
14 would have been reflected in Dr. Landon's analysis?

15 A. RPM prices weren't available at that time
16 but the projected market prices were.

17 Q. Was Dr. Landon's -- let me back up.
18 Dr. Kahn actually and Dr. Landon worked together in a
19 sense presenting the company's case at that time or
20 the company's valuation for stranded costs in that
21 case; did they not?

22 A. Yes. Dr. Kahn ran the model for
23 Dr. Landon.

24 Q. Okay. So Dr. Kahn is the source of the
25 forward energy prices, correct?

1 A. Yeah, I believe his model calculated
2 every third year and Dr. Landon estimated what the
3 prices were in between those periods.

4 Q. Okay.

5 A. Dr. Kahn's model also dispatched the
6 units based upon certain prices and that's -- he was
7 responsible for the top line, the generation of the
8 output of the plants.

9 MR. RANDAZZO: Mr. Hess, could you speak
10 up, please, or get closer to the microphone.

11 Q. Okay, we'll get back to Dr. Kahn, I just
12 wanted to make that link and to make sure you agreed
13 with that understanding.

14 All right. So let's go back to what
15 Dr. Landon did, then. So you just indicated a moment
16 ago that the RPM market was not in place in year 2000
17 when this analysis was done, correct?

18 A. Not to my knowledge; yes.

19 Q. Was there a capacity market, was there
20 any kind of capacity market indicator that was a
21 public pricing indicator available at that time?

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

23 Q. Is it fair to -- is it fair to
24 characterize the analysis that Drs. Kahn and Landon
25 relied on in that ETP case as looking at an

1 energy-only forward price?

2 A. To my knowledge, it was the projection of
3 what the generating units would realize for the
4 generation, the projected prices.

5 Q. Okay. Well, let's look at Dr. Kahn's
6 testimony a little bit and we can tie this together a
7 little bit. That's AEP Exhibit 107, if you could
8 turn your attention to page 16 first.

9 A. I have that.

10 Q. And this page shows, and he discussed in
11 the text, there's a table showing the input
12 assumptions. Do you see that?

13 A. Yes.

14 Q. Okay. And does this table, can you
15 review this, does that refresh your recollection that
16 the modeling was done on an energy-only basis?

17 A. No. Again, I had assumed it was the
18 projected prices for the generating plants.

19 MR. RANDAZZO: Mr. Nourse, you might look
20 at the bottom of page 17 where it talks about AEP's
21 capacity.

22 MR. NOURSE: Your Honor, I object to that
23 kind of whatever he's trying to assist Mr. Hess here.

24 Q. Mr. Hess, let's look at the table I just
25 directed your attention to. And do you see where it

1 says "Market Structure"?

2 A. Yes.

3 Q. And what does it indicate for the
4 variables that we used for that input?

5 A. That the second column is "ISOs energy
6 only."

7 Q. Now, if you could look at page 18 and
8 direct your attention to the next-to-last sentence on
9 page 18, does that refresh your recollection that the
10 forward prices were an energy-only basis?

11 A. That's what he states here, yes.

12 Q. Okay. Can you turn to Exhibit EPK-5
13 attached to Dr. Kahn's testimony.

14 A. I have that.

15 Q. And does this table not also confirm that
16 the scenarios that Dr. Kahn had developed were
17 reflective of market clearing prices in
18 dollars-per-megawatt-hour calculated down to the
19 totals reflected there?

20 THE WITNESS: Could I have the question
21 reread, please?

22 (Record read.)

23 A. Yes.

24 Q. Now, Mr. Hess, would it be your opinion
25 or understanding that a forward view of energy prices

1 vintage the year 2000 would be different than a
2 forward view of energy prices as we sit here today in
3 2012?

4 A. Yes.

5 Q. And would you agree that a forward
6 view -- well, let me back up.

7 Part of Dr. Kahn's analysis reflected
8 essentially two different environmental scenarios; is
9 that your understanding?

10 A. No. Two different gas prices.

11 Q. Okay. But what's your understanding of,
12 we're still looking at EPK-5 for the moment, the base
13 environment versus alternative environment?

14 A. I'm sorry. I don't know what that is.

15 Q. Is it your understanding that Dr. Kahn
16 looked at one scenario of environmental future
17 regulation -- or costs based on regulation?

18 A. Yes.

19 Q. And you mentioned the two gas -- forward
20 gas price scenarios that are reflected in EPK-5 that
21 is low gas and high gas, right?

22 A. Yes.

23 Q. And that future gas price was essentially
24 used as a proxy for future energy prices; is that
25 correct? Is that your understanding?

1 A. No, I think Dr. Landon's more specific
2 about the gas being on the margin. It would have had
3 an impact on the dispatching, generation dispatching.

4 Q. Okay. Well, is it fair to say that the
5 forward gas prices that Dr. Kahn used were a driver
6 for the modeling he did on future energy prices?

7 A. Yes.

8 Q. Okay. Now, Mr. Hess, you, of course,
9 recount in your testimony that you previously worked
10 in this building on a lot of the same cases including
11 the ETP case. You were a member of the staff,
12 correct?

13 A. Yes.

14 Q. Okay. And you also worked on AEP's other
15 case, the rate stabilization plan and the ESP 1 case
16 as well on behalf of staff?

17 A. That's correct.

18 Q. And in your testimony in the ESP 1
19 proceeding did you have an opportunity to address
20 staff's view of AEP's stranded cost claim that
21 originated in the ETP case?

22 A. Are you referring to the request for
23 Sporn?

24 Q. Yes, there was a request for closure --
25 plant closure costs and that was the context in which

1 you, I believe, addressed it. Is that your
2 recollection?

3 A. Yes.

4 Q. Okay. And was it your opinion in that
5 case conveying staff's position that the economic
6 value in the generation fleet of AEP was never
7 specifically addressed by the Commission?

8 A. I don't remember that in my testimony.

9 Q. Do you remember stating a position on
10 behalf of staff that it could be assumed that the net
11 value of AEP's fleet was not stranded?

12 A. Yes.

13 Q. And did you state in that case that staff
14 assumes that the net value of the generating fleet of
15 AEP is still positive?

16 A. The net value of AEP's fleet is still
17 positive?

18 Q. Do you recall whether that was your
19 testimony?

20 A. I don't recall making that statement.
21 I'd like to see it.

22 Q. Okay. I can mark this as an exhibit, but
23 I have a couple copies.

24 MR. NOURSE: Counsel, do you have copies
25 of his testimony?

1 MR. RANDAZZO: No.

2 MR. NOURSE: Okay, I've got one for you.

3 MR. RANDAZZO: Thank you.

4 Q. I'd direct you to page 8, Mr. Hess. Do
5 you see the answer that starts on line 5 and ends on
6 line 17?

7 A. Yes.

8 Q. And there you are talking about the, what
9 you're referring to as the economic value of the
10 generation fleet in the ETP cases, correct?

11 A. Yes.

12 Q. And in the last -- in the sentence that
13 goes from line 9 to line 11 -- excuse me, line 9 to
14 line 11, you state, do you not, that the economic
15 value of the fleet was never specifically addressed
16 by the Commission, and you state an assumption that
17 the net value was not stranded, correct?

18 MR. RANDAZZO: I object to the
19 characterization. It's not --

20 MR. NOURSE: I asked him if it's correct.
21 He's reading it and he can explain.

22 EXAMINER SEE: The objection is
23 overruled.

24 A. I think what I meant by "never
25 specifically addressed," I don't think the Commission

1 ever quantified a value for it.

2 Q. And, therefore, you're saying it could be
3 assumed that the net value was not stranded; isn't
4 that your testimony?

5 A. It could be assumed -- it could be
6 assumed that the company's fleet was not stranded,
7 that's correct.

8 Q. All right. And did staff have that
9 assumption?

10 A. Yes, I think we agreed to that, that
11 there were no transition costs associated with the
12 generating fleet and that we agreed with the company
13 on that.

14 Q. And you state at lines 16 and 17 that we,
15 and by that I mean, I take it you refer to the staff,
16 are assuming that net value of the generating fleet
17 is still positive. Do you see that?

18 A. Yes.

19 Q. So by "still positive" does that suggest
20 that you or staff believed all along that there was
21 never a stranded investment in AEP generation fleet?

22 A. That's correct, it was never a stranded
23 investment in AEP's generating fleet.

24 Q. Okay. And your statement in the full
25 sentence of line 15 through 17 is saying because the

1 market rates have increased significantly since that
2 time of the ETP cases, the stranded benefit would
3 only be even greater; is that what you're saying
4 there?

5 A. I don't say "because." I say given that
6 the market rates have increased significantly.

7 MR. RANDAZZO: Mr. Hess, please speak up.

8 EXAMINER SEE: Just a minute, Mr. Nourse.

9 MR. NOURSE: I'm sorry.

10 EXAMINER SEE: Let us switch out the
11 microphone, please.

12 Q. You say "given," you don't say "because."
13 With that correction, do you agree with the rest
14 of --

15 A. There were no stranded investments in
16 2000 and there were no stranded investments in 2009.

17 Q. Now, let's go back to your testimony here
18 in this case. Let me ask you first to go to page 4,
19 and in line 17 you make a statement that the period
20 for recovering stranded generation plant costs ended
21 by no later than December 31st, 2005, correct?

22 A. Yes.

23 Q. Okay. And what was supposed to happen on
24 January 1st, 2006?

25 A. The market development period ended.

1 Q. And what happened to SSO rates at that
2 time? What was supposed to happen under Senate
3 Bill 3 to SSO rates?

4 A. As did happen, they continued to stay on
5 market rate.

6 Q. You say continued to stay at market rate.
7 Is it your belief that the SSO rate for nonshopping
8 customers during the market development period
9 reflected a market rate?

10 A. It had to, 4928.14 said that it had to.

11 Q. Okay. And so the unbundled legacy rates
12 were fairly characterized as a market rate with
13 respect to the generation rate?

14 A. As defined by the legislature, yes.

15 Q. Okay. But let's back up, Mr. Hess. I
16 mean, wasn't the notion that, I'll say the unbundled
17 generation rates during the market development
18 period, were those rates constrained in any way?

19 A. They were frozen, yes.

20 Q. Okay. And so what was supposed to happen
21 January 1st, 2006, relative to those constrained --

22 A. They were no longer frozen.

23 Q. And was it supposed to be a fully
24 market-based SSO rate at that time?

25 A. As it was, yes.

1 Q. Your opinion was the rates -- well, first
2 let me ask you, the actual rate plan that was adopted
3 for 2006 through 2008, those were referred to as rate
4 stabilization plans?

5 A. Yes.

6 Q. Okay. And it's your opinion that the SSO
7 rates that were adopted under the rate stabilization
8 plan for AEP Ohio was a fully market-based rate?

9 A. It had to be, yes, sir.

10 Q. Well, I'm not asking you what the law
11 said. I'm not even referring to the statutes. I'm
12 asking you for your opinion in connection with my
13 point about constraints or free of constraints, was
14 the rate under the ESP -- excuse me, the RSP in 2006
15 a unconstrained market rate?

16 A. It was a market rate. It was constrained
17 by the company's plan.

18 Q. So the company agreed to not go to
19 market; isn't that fair?

20 A. No. The company agreed to provide a
21 market rate.

22 Q. Were market rates higher at that time
23 than the SSO rates, in your opinion?

24 A. Could I ask you too, when you say "the
25 company," what company are you referring to? The

1 distribution company? The distribution function?

2 Q. I'm talking about SSO rates in our entire
3 discussion.

4 A. So it was the distribution company would
5 have had to provide market-based rates, yes.

6 Q. Again, I'm not asking you what the
7 statute said.

8 A. And I'm not just responding to the
9 statute. It was a market-based rate, yes.

10 Q. So it's your opinion -- let me ask you
11 this: Was it your understanding that the Commission
12 requested AEP Ohio that AEP Ohio file a rate
13 stabilization plan?

14 A. It requested the distribution function of
15 Columbus & Southern and Ohio Power to file a rate
16 stabilization plan, yes.

17 Q. That's what I'm talking about. The EDU,
18 the SSO rates, you understand those acronyms, right?

19 A. Yes.

20 Q. So did the Commission request that the
21 AEP Ohio electric distribution utility file an SSO
22 plan that maintains stability and did not go to a
23 true market rate at that time?

24 A. No, sir. I don't think they said do not
25 go to a true market rate. I think they asked you to

1 provide a rate stabilization plan.

2 Q. And your opinion is the rate --
3 stabilization plan rates that largely continued the
4 prior rates, correct?

5 A. No. There were percentage increases
6 applied to both of the generation rates that had been
7 in place before.

8 Q. Okay. What were those percentage
9 increases?

10 A. 3 percent for Columbus & Southern and
11 7 percent for Ohio Power with the potential of an a
12 additional 4 percent for both companies.

13 Q. Okay. And is it your opinion that those
14 particular percentages matched up with a true market
15 rate at that time?

16 A. Yes. They had to, Mr. Nourse.

17 Q. Well, okay.

18 Mr. Hess, let me ask you this: Do you
19 understand, is it your opinion that the opportunity
20 for stranded costs under Senate Bill 3 was linked to
21 getting to charge market rates after the market
22 development period?

23 A. Well, first of all, are we referring to
24 transition costs under the statute?

25 Q. Yes, and I'm focusing on nonregulatory

1 asset transition costs or stranded generation like
2 the focus of your testimony here.

3 A. That was linked to going to market rates?
4 I don't know the answer to that.

5 Q. Okay. If I were to read to you a
6 provision in the law 4928.37 that says that the
7 transition cost recovery provides an electric
8 utility, quote, the opportunity to receive transition
9 revenues that may assist it in making the transition
10 to a fully competitive retail electric generation
11 market, period, end quote, does that help make the
12 connection --

13 A. No.

14 Q. -- to refresh your memory?

15 A. Could you read it again? I'm sorry.

16 Q. The statute 4928.37 says that Senate Bill
17 3 provides an electric utility, quote, the
18 opportunity to receive transition revenues that may
19 assist it in making the transition to a fully
20 competitive retail electric generation market,
21 period, end quote.

22 A. I'll agree that that's an accurate
23 reading, yes.

24 Q. Okay. So receiving the transition
25 revenues was quid pro quo for going to the fully

1 competitive generation market starting in 2006,
2 correct?

3 A. I don't think that's what that says. It
4 says that assists the utility company in getting to a
5 fully -- to a full market.

6 Q. And were the transition revenues to
7 continue beyond the market development period?

8 A. Transition cost recovery could, if it was
9 associated with the regulatory asset.

10 Q. Again, I'm asking about the nonregulatory
11 asset, the stranded generation that's the topic of
12 your testimony.

13 A. Okay. No, they could not go beyond
14 12/31/05.

15 Q. Okay. Let me ask you to turn to page 5
16 of your testimony. The first full sentence on page
17 5, can you read that sentence? I just want to
18 clarify what you mean by that sentence for the
19 record.

20 Have you read it?

21 A. Yes.

22 Q. Are you saying that nonshopping customers
23 were deemed to contribute to stranded cost recovery
24 without paying anything more than their unbundled
25 generation rate?

1 A. Yes.

2 Q. So the unbundled generation rate was
3 deemed to recover stranded costs without any
4 additional generation transition charge?

5 A. Yes.

6 Q. So continuation of the same default
7 supply price on January 1st, 2006, would that have
8 been a form of additional transition revenue after
9 the market development period under your view?

10 A. No. That would have been just a market
11 rate without continuation of the GTC as it would have
12 been identified as.

13 Q. Okay. And you're familiar with the terms
14 that were used at the time of big "G" and little "g"?

15 A. Yes.

16 Q. What does that mean to you?

17 A. Big "G" was the amount left over after we
18 unbundled the D and the T from the vertically
19 integrated rate, and little "g" was the difference
20 between big "G" and any stranded cost recovery
21 charge.

22 Q. And was little "g" bypassable for
23 shoppers?

24 A. Well, are we talking about CSP and Ohio
25 Power here?

1 Q. Yeah.

2 A. I believe that's correct, yes. It was an
3 avoidable charge model.

4 Q. Okay. So this statement, the sentence at
5 the top of page 5, is that even applicable to
6 AEP Ohio?

7 A. Yes.

8 Q. How so?

9 A. Well, embedded within the default
10 generation supply price during the market development
11 period was a recovery mechanism for stranded costs.

12 Q. Are you saying that AEP Ohio received
13 recovery of stranded generation costs that did not
14 relate to regulatory assets?

15 A. I'm sorry. That's correct. No. You're
16 right. I was confused there. There was no GTC built
17 into the standard service offer for Ohio Power and
18 CSP.

19 Q. Okay. Now, is it your opinion that the
20 ETP stipulation that was entered into covered the
21 period from 2001 to 2005, the end of 2005?

22 A. No. There were provisions in there that
23 went beyond 2005.

24 Q. Such as?

25 A. The regulatory asset recovery mechanism,

1 a distribution rate freeze.

2 Q. So the first one, the regulatory asset
3 recovery mechanism, that's, again, that's not related
4 to stranded generation investment, or stranded
5 generation costs, correct? Those are other
6 regulatory assets that may relate to the transition,
7 to competition; is that your understanding?

8 A. They were regulatory assets, yes, as
9 defined by 4928.1(F)(26) I believe.

10 Q. All I'm asking, those regulatory assets
11 did not relate to stranded generation investment,
12 correct?

13 MR. RANDAZZO: Could I have the question
14 read back, please.

15 (Record read.)

16 A. I think for the most part a lot of them
17 were directly related to the generating assets.

18 Q. Okay. But are you saying the regulatory
19 assets that were recovered through GTC under the
20 stipulation constituted stranded generation costs?
21 As that term is --

22 A. Did you mean to say "RTC"?

23 Q. Yes.

24 A. Yeah, we were required to break it down
25 between regulatory asset transition costs and other

1 generation-related transition costs. And the RTC
2 recovery mechanism related to the regulatory asset
3 recovery -- transition cost recovery mechanism.

4 Q. Okay. Can you turn to page 6. At the
5 top of the page you're listing the four -- your
6 understanding of the four criteria that qualify
7 receipt of transition revenue, right?

8 A. Yes. Can I correct that?

9 Q. Okay.

10 A. To identify transition costs. These were
11 the four criteria.

12 Q. Okay. Well, all right. But those are
13 the screening criteria to see if something was
14 eligible for collection as a transition charge,
15 correct?

16 A. Screening mechanism, the criteria for
17 determining whether an item was recoverable as
18 transition costs to be recovered by a transition
19 charge, yes.

20 Q. Okay. And with respect to kind of the
21 issue that you're raising now in your testimony
22 today, that really relates to criteria No. 3, right?

23 A. I'm not certain what you're asking me.

24 Q. Okay.

25 A. If we're -- I don't understand the

1 question.

2 Q. Okay. Your position today is that
3 generation costs, capacity costs that exceed the RPM
4 capacity market price are equal to those costs that
5 are unrecoverable in a competitive market; is that
6 accurate?

7 A. Yeah, my testimony is that the capacity
8 cost formula requested by the company would not
9 qualify as a transition cost. And those costs were
10 accounted for in the original calculation.

11 Q. Those costs, let's focus in on that.
12 Those costs that you referred to, you're saying the
13 costs that would exceed the RPM -- the current RPM
14 price, right?

15 A. Yes.

16 Q. Okay. And your basis for saying the
17 costs that exceed the RPM price today were -- are
18 unrecoverable in a competitive market is the ETP
19 stipulation and testimony, correct?

20 A. Correct.

21 Q. Okay. On page 6 you also make reference
22 and I believe somewhere in here you might, yeah, you
23 refer to advice of counsel at the bottom of 6
24 carrying over to page 7. Do you see that statement?

25 A. Yes.

1 Q. And you're referring to RC 4928.141 which
2 you say was added after Senate Bill 3, excluded any
3 previously authorized allowances for transition costs
4 with the exclusion becoming effective on and after
5 the date the allowance was scheduled to end under the
6 prior rate plan. That's -- you're stating your
7 understanding of that provision, right?

8 A. Yes.

9 Q. Okay. And I'm going to read you what
10 4928.141 says. Quote, A standard service offer under
11 Section 4928.142 or 4928.143 of the Revised Code
12 shall exclude any previously authorized allowances
13 for transition costs, for such exclusion being
14 effective on and after the date that the allowance is
15 scheduled to end under the utility's rate plan,
16 period, end of quote.

17 Does that refresh your recollection of
18 what that provision does?

19 A. Yes.

20 Q. And is that referring to previously
21 authorized allowances for transition costs?

22 A. I'm sorry, Mr. Nourse, could you read
23 that for me again?

24 Q. Yeah. Let's just look at your testimony.
25 At the top of page 7, line 1, you say "...excluded

1 any previously authorized allowances for transition
2 costs....." So that's the scope of that provision,
3 right, it's talking about previously authorized --

4 MR. RANDAZZO: We'll stipulate to that.
5 We'll stipulate to that.

6 MR. NOURSE: Yeah.

7 Q. So does this provision apply to AEP Ohio
8 that you discuss here?

9 A. No. Yeah, I see your point now. No, no
10 uneconomic plan, no GTCs had been previously
11 authorized.

12 Q. Okay. Mr. Hess, do you agree that the
13 capacity charge at issue in this case is a wholesale
14 charge paid from a CRES provider to PJM who in turn
15 pays AEP Ohio?

16 A. And then later passed on to the retail
17 customer, yes.

18 Q. Passed on to the retail customer by the
19 CRES provider?

20 A. Yes.

21 Q. Okay. Well, let's talk about that. You
22 assume that in your testimony, page 16. Do you want
23 to jump there? And the first part of answer 24,
24 that's what you're referring to?

25 A. I'm sorry. What am I referring to?

1 Q. In your prior answer just now you said
2 the capacity charge paid by CRES providers is passed
3 through to retail customers.

4 A. Yes.

5 Q. And that's what you're referring to here
6 on page 16 starting in line 9, you say it's common
7 sense that CRES providers will pass through changes
8 such as, you go on to say capacity charge.

9 A. Yes.

10 Q. Okay. The decision whether to pass
11 through such a charge or an increase in a capacity
12 charge like that is the CRES provider's, individual
13 CRES provider's decision, correct?

14 A. Well, I mean, the decision would be
15 theirs but they wouldn't be an ongoing entity and
16 they wouldn't be able to sustain their business if
17 they didn't pass that cost on.

18 Q. Well, when you say pass it on, let's
19 clarify it. You're just saying the retail rates
20 generally speaking would cover the cost of doing
21 business including capacity charges they pay, right?

22 A. Okay.

23 Q. Well, let me ask it this way: If the
24 Commission adopts a capacity charge increase from the
25 RPM, the two-tiered system in place right now to

1 something higher, are you saying that all of the CRES
2 retail customers will experience rate increases in
3 direct proportion to the increase that occurs?

4 A. Some of the terms and conditions that
5 I've seen would do that, yes.

6 Q. Would allow the CRES provider to pass it
7 through if they choose to do so; is that what you're
8 saying?

9 A. Yes.

10 Q. Okay. So if a CRES provider already had
11 a high margin, they were able to absorb that
12 increase, or some other cost of doing business
13 changed, they wouldn't necessarily pass it on in the
14 form of a retail rate increase, would they?

15 A. Well, again, Mr. Nourse, I assume here
16 for the regulatory model we have to assume that that
17 cost is passed on or the entity isn't going to
18 survive.

19 Q. What regulatory model are you talking
20 about?

21 A. The establishment of a retail rate.

22 Q. Does the Commission approve CRES retail
23 rate levels or increases?

24 A. No.

25 Q. Now, you stated that CRES providers

1 wouldn't be an ongoing concern or business if they
2 didn't pass through their costs to their customers, a
3 moment ago, right?

4 A. Yes.

5 Q. Would the same be true for AEP Ohio?

6 A. It would be for AEP Ohio, but I don't
7 think you could look at a short-term -- if you're
8 referring to if you didn't recover these costs in the
9 two-year period, I think it's unfair. It has to be
10 looked at over a longer term period.

11 A CRES provider's contract is only for
12 two or three years, one, two, or three years.

13 Q. So that's your opinion.

14 A. Yes.

15 Q. Okay. Now, also -- let me go back to
16 where we were before. Actually, I'm going to cover
17 another item while we're on page 16 here. The bottom
18 half of answer 24, you're stating that AEP Witness
19 Baker and Witness Thomas have included RPM-based
20 capacity prices as part of the MRO test. Is that
21 accurate?

22 A. No.

23 Q. What are you stating here by --

24 A. That they have included capacity price as
25 a necessary component of a competitive retail market,

1 not RPM. I don't think Laura Thomas --

2 Q. Okay. So, yeah --

3 A. I think her -- I think the capacity price
4 that she used was the formula method. I think Craig
5 used the RPM; if I remember correctly, Laura used the
6 formula based method.

7 Q. Okay. And, again, is all you're saying
8 here is that the capacity prices paid by a CRES
9 provider are a cost of doing business?

10 A. Yes.

11 Q. Okay.

12 A. As recognized by AEP Ohio.

13 Q. Right. Okay. Now let me ask you just in
14 terms of your sort of overarching argument as I
15 understand it that the ETP stipulation, you know, is
16 a controlling document or has a commitment that
17 controls today whether AEP Ohio can charge a
18 cost-based rate for capacity. That's an accurate
19 summary of your argument, isn't it?

20 A. I think it was a commitment by AEP not to
21 do this into the future, yes. And in fairness that
22 we all agreed there were things that were given up by
23 the other parties who signed that settlement and I
24 think in fairness AEP should be held to that
25 commitment.

1 Q. Right. So is it fair to say that
2 everyone that signed the ETP stipulation also
3 understood as a premise or a prominent feature of
4 Senate Bill 3 that fully market-based SSO rates would
5 be paid starting in 2006?

6 A. I can't speak for any other parties. I
7 don't know the answer to that. As I stated earlier
8 in my testimony, that is what happened.

9 Q. That is a requirement -- that was a
10 requirement under Senate Bill 3, was it not?

11 A. What was a requirement under Senate Bill
12 3?

13 Q. Charging fully market-based rates
14 starting January 1st, 2006?

15 A. Yes, it was required under 4928.14.

16 Q. So is there any reason the parties would
17 have contemplated, let alone addressed, any future
18 restrictions under a future regulatory regime that
19 may be different than that?

20 A. Again, I can't answer for any of the
21 other parties.

22 Q. Well, you are stating -- you just stated
23 two answers ago that you're asserting the rights of
24 parties that signed the stipulation in your fairness
25 argument about the package deal, so I'm asking you is

1 there a reason that parties in that agreement, given
2 the current state of affairs under Senate Bill 3,
3 would have addressed any future restrictions that
4 might apply to a future regulatory regime that came
5 into being after Senate Bill 3?

6 MR. RANDAZZO: Could I have the question
7 read back?

8 MR. NOURSE: I would suggest we read the
9 question before. Or let me just rephrase it.

10 Q. So, Mr. Hess, is there any reason the
11 parties to the ETP stipulation would have
12 contemplated, let alone addressed in any future
13 restrictions under a future regulatory regime that
14 might be different than the one embodied in Senate
15 Bill 3?

16 A. No, and that is what was applied.

17 Q. So, Mr. Hess, in your opinion has
18 anything changed about the platforms that were
19 enacted with Senate Bill 3 as we sit here today?

20 A. No. The policy of the state is to
21 continue to go towards retail rates, policy of the
22 Commission has been that way.

23 Senate Bill 221 did allow a little bit
24 more discretion by the Commission in establishing a
25 market-based rate, but the general platform has not

1 changed nor has the Commission's position on it.

2 Q. Okay. We'll get to that.

3 So, Mr. Hess, is your argument based
4 on -- is your argument that AEP is currently
5 precluded from charging a cost-based capacity charge
6 based on Senate Bill 3 or is it based on the
7 stipulation that you refer to in your testimony?

8 A. Well, Senate Bill 3 limited transition
9 cost recovery for uneconomic plant through
10 12/31/05 and the company said that they would not
11 charge customers for uneconomic plant. So a
12 combination of the two.

13 Q. So that period in the market development
14 period, Senate Bill 3 permitted recovery of
15 transition costs subject to certain criteria, and
16 the -- I'm sorry, you were nodding your head, do you
17 agree with that?

18 A. That's correct, yes.

19 Q. And the stipulation said that AEP was not
20 going to pursue that possible transition cost
21 recovery period; is that right?

22 A. Well, I'm looking for the language from
23 the stipulation. I think I have it somewhere here in
24 my testimony. AEP Ohio committed not to impose any
25 lost revenue charges, generation transition charges,

1 GTCs on any switching customers.

2 Q. All right. And lost revenue charges are
3 defined under Senate Bill 3 -- were they? Were they
4 defined under Senate Bill 3?

5 A. No.

6 Q. Okay. So what is your interpretation of
7 what that phrase means?

8 A. No GTC, no uneconomic plant. GTC was the
9 assumed acronym for the recovery of uneconomic --
10 transition charges associated with uneconomic plant.

11 Q. And that allowance or possibility of
12 recovering GTC was limited to the market development
13 period, was it not?

14 A. By Senate Bill 3, yes, it was.

15 Q. Okay.

16 A. And in addition to that, AEP Ohio said
17 that they would never do that.

18 Q. Where do you see where they said they
19 would never do that?

20 A. Well, I assume it doesn't say "never."
21 It says we will not impose any lost revenue charges,
22 generation transition charges, on any switching
23 customers.

24 Q. Okay. So, again, that's your --

25 A. There was no time limit on that so I

1 assumed it was forever.

2 Q. But you stated that the law, Senate Bill
3 3, restricted the time limit to the five-year window
4 of the market development period, did it not?

5 A. Yes.

6 Q. Okay. Now, Mr. Hess, would your argument
7 be the same regardless of whether AEP asked for
8 nothing under the transition cost recovery allowance
9 or whether it asked for billions of dollars and
10 recovered billions of dollars, or whether it asked
11 for something and then gave up their claim? Do any
12 of those scenarios really make a difference as we sit
13 here today?

14 A. Well, the fact is the company did ask for
15 something and gave up their claim.

16 Q. So that's one of the three scenarios.
17 Would your argument be the same if AEP never advanced
18 a claim for transition charges?

19 MR. RANDAZZO: Could I have a
20 clarification. You keep using the word "arguments,"
21 Mr. Nourse, are you asking about his opinions?

22 MR. NOURSE: Well, I think it stands for
23 itself. I'm asking about his testimony, his
24 positions. Obviously, he stated in his testimony
25 he's supporting arguments, Mr. Randazzo, that you're

1 making and so if there's any lack of clarity there,
2 please let me know.

3 A. My testimony's based on the commitment of
4 the company not to charge GTC rates to shopping
5 customers. The scenario as to whether or not they
6 had requested it, had not requested it, or any of the
7 three scenarios that you had put before me, I don't
8 think would change that opinion based upon that
9 statement.

10 Q. Right. So your position is really based
11 on what Senate Bill 3 allowed and didn't allow; is
12 that accurate?

13 A. No. It's based upon the company's
14 commitment not to do it.

15 Q. All right. Did the ETP stipulation, in
16 your opinion, govern SSO pricing after the market
17 development period?

18 A. I don't remember a specific provision of
19 that. I don't think it did, no.

20 Q. Would you characterize the rate
21 stabilization plan for AEP Ohio as providing an
22 additional transition period beyond the market
23 development period?

24 A. No. I think it's probably better
25 characterized as just a rate stabilization period.

1 Q. So in your opinion, Mr. Hess, the rate
2 stabilization plan fully implemented Senate Bill 3's
3 requirements for market-based rates starting in
4 January 2006?

5 A. It had to, Mr. Nourse.

6 Q. Okay. Let me talk to you a little bit
7 more about Senate Bill 221. First of all, did IEU
8 support Senate Bill 3 in proceeding to fully
9 competitive retail shopping in Ohio?

10 A. Did IEU-Ohio support that?

11 Q. Yeah.

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

13 MR. NOURSE: Okay. Let me mark AEP
14 Exhibit --

15 MR. RANDAZZO: We'll stipulate we did.

16 MR. NOURSE: -- 108.

17 MR. RANDAZZO: If it shortens this up.

18 A. Yeah, I don't know specifically but I
19 would have to assume, knowing Mr. Randazzo, that they
20 did, yes.

21 MR. NOURSE: Well, we don't want to
22 shorten our presentation up, Mr. Randazzo.

23 MR. RANDAZZO: No, we don't want to do
24 that but we'll stipulate that we supported Senate
25 Bill 3 that was passed unanimously except for one

1 vote by the General Assembly.

2 Q. Mr. Hess, do you have Exhibit 108?

3 EXAMINER SEE: Mr. Nourse, you're going
4 to have to mark this as 108, the Exhibit is so
5 marked.

6 MR. NOURSE: I believe that's what we're
7 up to, your Honor.

8 EXAMINER SEE: Yes.

9 (EXHIBIT MARKED FOR IDENTIFICATION.)

10 A. I have that, yes.

11 Q. (By Mr. Nourse) Okay, Mr. Hess, if you
12 could turn to page 4, first of all, this is a motion
13 to intervene by IEU-Ohio in the ETP cases that you've
14 been discussing, correct?

15 A. Yes.

16 Q. Okay. Could you review the statements
17 made on page 4.

18 A. I see those, yes.

19 Q. Okay. And is it accurate to say that IEU
20 has been active in state and federal regulatory
21 proceedings to advocate retail competition in Ohio?

22 A. Yes.

23 Q. And is it accurate to state that -- well,
24 let me just read a sentence that's the last full
25 sentence on the page. "IEU-Ohio's direct interest in

1 these proceedings is also the result of the effect
2 these proceedings will have upon the formation of a
3 dynamically efficient generation market that must be
4 functioning by no later than December 31st, 2005,
5 (as required by Chapter 4928, Revised Code) to
6 promote -- protect and to promote public interest."
7 Do you see that?

8 A. Yes.

9 Q. Is it fair to say that the consensus,
10 view, and expectation around the year 2000 was that,
11 number one, the market rates would remain below
12 standard service offer rates after the market
13 development period?

14 MR. RANDAZZO: Could I have the question
15 read back?

16 MR. NOURSE: Let me rephrase.

17 Q. Mr. Hess, is it your understanding that
18 the advocates of Senate Bill 3 believe that market
19 rates will be more favorable than SSO rates after the
20 market development period?

21 A. Can you explain to me what you mean by
22 "more favorable"?

23 Q. Lower.

24 A. I don't believe that's correct, no.

25 Q. Do you believe they thought market rates

1111

1 would be higher?

2 A. Than -- particularly whose rates?

3 Q. SSO rates.

4 A. For what company?

5 Q. AEP Ohio.

6 A. Yeah, I don't know the answer to that. I
7 don't know that there was an assumption in 2000 about
8 where rates would be in 2006; higher or lower.

9 Q. Okay. And as we proceeded through the
10 market development period and we entered into rate
11 stabilization plans in the Ohio EDUs, did AEP --
12 excuse me, did IEU maintain its position that the
13 Commission should proceed to a fully competitive SSO
14 environment?

15 A. I don't remember that.

16 Q. Do you recall whether IEU advocated
17 making changes to Senate Bill 3 as the rate
18 stabilization plans were drawing to an end?

19 A. I don't remember that.

20 Q. Okay.

21 MR. NOURSE: Your Honor, I'd like to mark
22 AEP Exhibit 109.

23 EXAMINER SEE: The exhibit is so marked.

24 (EXHIBIT MARKED FOR IDENTIFICATION.)

25 Q. Mr. Hess, do you see the document

1 entitled "Electricity Post 2008, A Common Sense
2 Blueprint for Ohio"?

3 A. Yes.

4 Q. And does this appear to be an IEU-Ohio
5 document?

6 A. At the top right corner of that page it
7 has the IEU logo on it.

8 Q. Okay. Looking at the first page, the
9 fourth paragraph, it says "The rate shock clock is
10 ticking in Ohio." Do you see that?

11 A. Yes.

12 Q. Do you have an understanding of what that
13 means?

14 A. No.

15 Q. If you look at page 5, in the middle of
16 the page, can you read the paragraph that starts "The
17 PUCO was also somewhat passive...."? Read it out
18 loud, please.

19 A. "The PUCO was also somewhat passive
20 during all the rate stabilization proceedings as the
21 utilities threatened to 'go to market' if
22 stakeholders and the PUCO did not accept the
23 utility's rate stabilization plan demands. As a
24 result of the PUCO's response to these 'go-to-market'
25 threats, customer representatives found themselves

1 with little leverage to achieve outcomes that were
2 materially different than those associated with the
3 demands of the utilities."

4 Q. Okay. And does this suggest to you that
5 market rates were equal to the SSO rates? Reflected
6 in the rate stabilization plans?

7 A. No. I'm not sure what this means.

8 Q. Well, it uses the word "threatened" --
9 "threat" multiple times, so is it fair to assume if
10 someone's threatening to go to market that would
11 result in a rate increase?

12 A. No, it simply means that it was
13 threatening to go to market.

14 Q. And you don't have any idea, first page,
15 what the statement "the rate shock clock is ticking
16 in Ohio" means?

17 A. No.

18 Q. Do you know what "rate shock" is?

19 A. It's a substantial increase in rates. A
20 one-time substantial increase in rates.

21 Q. Okay. Let's look at page 2. There's a
22 box there that has a summary of recommendations. Do
23 you see that?

24 A. Yes.

25 Q. And could you read No. 2 and state your

1 understanding of what that means?

2 A. I understand factually that the request
3 to repeal the generation service as a competitive
4 service, I'm not sure I understand what it does mean.

5 Q. Okay. Could you turn to page 11 of the
6 document. Can you review the paragraph "Getting back
7 to the 'good old days'...." And does that help your
8 understanding of what No. 2 means?

9 A. I'm still -- I still don't really
10 understand what it means.

11 Q. Okay. On page 11 can you read the
12 sentence right above the bold, read it aloud, please.

13 A. "We recommend that the General Assembly
14 repeal the statutory --"

15 Q. No, I'm sorry. Above the bold area, the
16 sentence right before that.

17 A. "If the statutory declaration that
18 generation service is competitive is repealed,
19 generation service would be classified as a
20 noncompetitive service and the market-based pricing
21 standard would not apply until such time as the PUCO
22 might determine that generation service met the
23 competitive service criteria."

24 Q. So doesn't that suggest to you that IEU's
25 position at that time was that generation service was

1 not fully competitive?

2 A. It could suggest that, yes.

3 Q. Okay. Can you go back to page 2 and
4 review item 3.

5 A. I see it.

6 Q. Okay. And was it your understanding that
7 under Senate Bill 3 electric distribution utilities
8 could transfer or sell generation units without the
9 PUCO's approval?

10 A. Yes.

11 Q. And here IEU is recommending that that
12 provision be repealed such that the -- so the
13 Commission could, quote/unquote, manage the risks
14 presented by claims and schemes like those of
15 Monongahela Power. Do you see that, unquote?

16 A. It's 4928.17(E).

17 Q. Is the provision that had previously
18 allowed generation asset to be transferred without
19 approval that's what's being --

20 A. Okay. And your question was?

21 MR. RANDAZZO: If it will move this
22 along, we will stipulate that we recommended that.

23 Q. Okay. So IEU here was recommending that
24 the Commission be -- that that provision be repealed;
25 is that your understanding?

1 A. Yes.

2 Q. And that the Commission be given
3 authority, again, to approve generation transfers; is
4 that your understanding?

5 A. Yes.

6 Q. And IEU's purpose, stated purpose here
7 was to give the Commission authority to, quote,
8 manage the risks presented by claims and schemes like
9 those of Monongahela Power, unquote, correct?

10 A. That's what it reads, yes.

11 Q. And what's your understanding, you were
12 involved with the, I'll call it Mon Power situation
13 because I don't like to say "Monongahela." You were
14 involved in that when you were on staff?

15 A. Yes.

16 Q. And what's your understanding of the
17 situation being referred to here?

18 A. I'm not sure what situation is being
19 referred to here. Monongahela Power wanted -- ended
20 its market development period at the end of '03 and
21 started buying power I believe in the day-ahead
22 market. It was only allowed to charge its rates that
23 were a part of its unbundled -- that it had unbundled
24 as part of Senate Bill 3 and it deferred the costs
25 between what it was purchasing power for and what it

1 was charging customers.

2 Q. Did Mon Power or Allegheny transfer the
3 assets that were previously owned by Mon Power in the
4 EDU to an affiliate?

5 A. I don't believe Monongahela Power ever
6 owned any generating assets.

7 Q. Okay. But did the -- what Mon Power and
8 Allegheny wanted to do was charge a market price for
9 purchased power, essentially, supporting the SSO
10 offer; is that correct?

11 A. Yes, during '04 and '05.

12 Q. Okay. So is it your understanding that
13 IEU here in recommendation 3 is saying the Commission
14 should be given authority to block transfers of
15 assets to avoid this situation of having to be faced
16 with paying market rates?

17 A. I don't know the answer to that. I'm not
18 even certain what IEU's referring to here when it's
19 referring to those owed Monongahela Power.

20 Q. Is it fair to say there was a big stir-up
21 in terms of litigation with this issue when Mon Power
22 attempted to pass through market rates?

23 A. Well, again, I responded to you about
24 what I was involved with with Monongahela Power. I'm
25 not sure what's being referred to in the IEU document

1 when it references Mon Power.

2 Q. My last question was related to --

3 A. And yes, there was a big stir-up.

4 Q. Okay. Please turn to page 3 of this
5 document. There's a statement or there's a paragraph
6 that starts "SB 3 assumed that effective
7 competition...." Do you see that?

8 A. Yes.

9 Q. Can you read aloud the first sentence in
10 that paragraph?

11 A. "SB 3 assumed that effective competition
12 would lower prices relative to 1999 levels and
13 billions of dollars were paid to Ohio electric
14 utilities - all of them - as 'stranded' or
15 'transition' costs based upon estimates of the future
16 electric prices that would be produced by effective
17 competition."

18 Q. Okay. So does this statement, is it
19 consistent with you stated your personal
20 understanding earlier that the move to lower
21 market-based prices would be forthcoming in exchange
22 for paying stranded costs; do you recall your earlier
23 statement on that?

24 A. I don't think I ever said that. I never
25 assumed lower market prices were coming.

1 Q. Well, I'm asking you if this statement is
2 consistent with what you stated your personal view
3 earlier to be.

4 A. Well, it certainly isn't as far as Senate
5 Bill 3 assumed that the effective competition would
6 lower prices relative to 1999 levels.

7 Q. Next let me ask you about the statement
8 here that says "...billions of dollars were paid to
9 Ohio electric utilities - all of them - as 'stranded'
10 or 'transition' costs...." Do you see that?

11 A. Yes.

12 Q. Is that statement true as applied to
13 AEP Ohio?

14 A. Yes.

15 Q. And what are the billions of dollars that
16 were paid to AEP Ohio as stranded or transition
17 costs?

18 A. AEP Ohio recovered the regulatory assets.

19 Q. So what AEP Ohio recovered was not
20 stranded generation investment, correct?

21 A. That's correct.

22 Q. Thank you.

23 MR. RANDAZZO: Can I have that question
24 read back, please?

25 (Record read.)

1 MR. RANDAZZO: I'm sorry, what was the
2 answer?

3 MR. NOURSE: I believe the question was
4 already answered.

5 THE REPORTER: "That's correct."

6 Q. Okay, Mr. Hess, let's return to your
7 testimony, talk a bit more about Senate Bill 221,
8 your understanding as a nonlegal person that's been
9 involved with these issues for a number of years,
10 okay?

11 A. Yes.

12 Q. Now, do you agree that Senate Bill 221 --
13 let me back up.

14 Is it fair to characterize Senate Bill 3
15 as deregulation of retail?

16 A. No. Restructuring.

17 Q. Okay. Was there supposed to be
18 regulation of generation SSO rates after 2006, price
19 regulation?

20 A. It was to be -- the Commission had the
21 authority to approve or disapprove.

22 Q. And --

23 A. Based upon market rate.

24 Q. Okay. Is it fair, in your opinion, to
25 characterize Senate Bill 221 as exerting an

1 additional degree of regulation over generation
2 standard service pricing?

3 A. Could you be more specific what you're
4 referring to?

5 Q. Would you characterize Senate Bill 221 as
6 another stage of restructuring?

7 A. No.

8 Q. How would you characterize it?

9 A. It changed the Commission's ability to
10 value a market-based rate.

11 Q. Is the market-based rate language that
12 you referred to earlier from Senate Bill 3 still in
13 Senate Bill 221?

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

15 Q. Okay. And there are two options for
16 standard service offer rate plans, correct, a market
17 rate offer and an electric security plan?

18 A. Yes.

19 Q. Do you believe the market rate offer, or
20 MRO, is a fully competitive market rate?

21 A. Could you tell me what you mean by "fully
22 competitive market rate"?

23 Q. I'm asking your belief of whether a
24 market rate offer rate plan reflects a fully
25 competitive market rate.

1 MR. RANDAZZO: I'll object. He can't
2 respond to the question unless the counsel will
3 provide him with an indication of how he's using the
4 terms.

5 Q. I'm not using them in any special way,
6 Mr. Hess. I'm using plain English.

7 A. I don't understand the term and I can't
8 answer the question.

9 Q. You don't understand what "fully
10 competitive market rates" are?

11 A. I'm not sure that I can define the term
12 "market rate."

13 Q. Okay. Do you agree that an MRO plan
14 would involve another transition period of six to ten
15 years before getting to a fully auction-based
16 standard service offer?

17 A. I believe there are requirements about
18 how -- what the percentages of the standard service
19 offer that can be auctioned.

20 Q. And so the nonmarket part of the pricing
21 blend you referred to goes up from the maximum of
22 10 percent year 1; 20 percent year 2; 30 percent
23 year 3; 40 percent year 4; 50 percent in year 5; is
24 that your understanding?

25 A. Yes.

1 Q. And so to get to a hundred percent it
2 takes six years, does it not?

3 MR. RANDAZZO: Are you asking --

4 Q. At a minimum.

5 MR. RANDAZZO: Are you asking a legal
6 opinion or his understanding?

7 MR. NOURSE: No, I'm asking his
8 understanding. None of my questions are legal.

9 MR. RANDAZZO: Good.

10 A. No, I think at some point in time during
11 that period of time the Commission has discretion to
12 shift to a hundred percent prior to year 5. Or
13 actually to even change the percentage.

14 Q. So it's your opinion, your understanding,
15 that the Commission could go to a hundred percent
16 market under the MRO option in less than five years?

17 A. I believe that's correct, yes.

18 Q. Okay. Did Senate Bill 221 also implement
19 a significantly excessive earnings test?

20 A. Yes.

21 Q. And that applies to ESP plans?

22 A. Yes.

23 Q. And is it also your understanding that
24 ESP plans as a whole or in the aggregate have to
25 produce results that are more favorable than a market

1 rate offer, expected outcome of a market rate offer?

2 A. A market rate offer plan, yes.

3 Q. Okay. So it's fair to say that the
4 regulatory regime in 221 has changed substantively
5 and materially from what it was under Senate Bill 3;
6 would you agree?

7 A. I don't think I'm going to agree to the
8 "substantive and materially." But it did change. It
9 gave the Commission additional abilities to establish
10 the market rates.

11 Q. So it's your opinion that the changes
12 made in Senate Bill 221 were nonsubstantive?

13 A. I just said they were changes. I don't
14 have an opinion as to whether they're substantive or
15 not substantive.

16 Q. Is it your opinion that the changes were
17 nonmaterial associated with Senate Bill 221?

18 A. I don't have an opinion as to whether
19 they were material or nonmaterial.

20 Q. Okay, Mr. Hess, let's turn to page 15,
21 and here in question 23 you refer to above-market
22 generation costs. Do you see that?

23 A. Yes.

24 Q. Okay. And by that you mean costs that
25 are above the RPM capacity rate?

1 A. Yes, which I believe is to be a
2 market-based generation rate based upon how
3 Mr. Murray's described it.

4 Q. Would there -- okay, well, first of all,
5 that's the capacity charge that you discussed earlier
6 that is the wholesale charge paid by the CRES
7 provider to PJM, correct?

8 A. That's correct.

9 Q. Now, is it your opinion that ESP rates
10 can never be above market rates? Is that possible or
11 not possible?

12 A. No; they can be above market rates.

13 Q. Okay. In fact, even if you never charged
14 an SSO rate above market, there wouldn't be a whole
15 lot of competition, would there?

16 A. That's correct.

17 Q. Now, is it your opinion that the RPM
18 auction is the only indicator of a true market value
19 for capacity?

20 A. I don't have an opinion on that. That's
21 better asked of Mr. Murray.

22 Q. Okay. Are you aware of any other market
23 price indicators for capacity?

24 A. No.

25 Q. Okay. Have you done a long-term forward

1 view of RPM capacity pricing?

2 A. No.

3 MR. NOURSE: I think that's all the
4 questions I have, thank you, Mr. Hess.

5 THE WITNESS: Thank you.

6 EXAMINER SEE: Commissioner Porter?

7 COMMISSIONER PORTER: Just a few.

8 - - -

9 EXAMINATION

10 By Commissioner Porter:

11 Q. Mr. Hess, can you hear me?

12 A. Yes, sir, I can.

13 Q. Okay. We've used this term "stranded
14 costs" and I just want to clearly understand how you
15 understand this term, what you understand this term
16 to mean.

17 Is stranded costs the same thing as the
18 costs that you mention on page 5 of your -- actually
19 at the top of page 6 of your testimony, there are
20 four items at the top of page 6 of your testimony?

21 A. Yeah, it's been used interchangeably
22 throughout this hearing, but the statute did define
23 it as a transition cost.

24 Q. Okay. So these costs at the top of page
25 6 are what you refer to as transition costs?

1 A. These, yes, transition costs have to
2 qualify for these four items, yes.

3 Q. Are transition costs and stranded costs
4 the same thing?

5 A. They're used interchangeably.

6 Q. Is there anything within stranded costs
7 that would not be one of these four items at the top
8 of page 6 that you're aware of?

9 A. Not off the top of my head, no.

10 Q. Okay. And so the AEP ETP stipulation
11 that you referred to in your testimony as well
12 allowed for the full recovery or at least -- what's
13 your understanding of the recovery of transition
14 costs as part of the AEP ETP? Was it all of the
15 transition costs for AEP?

16 A. Were recovered, yes.

17 Q. All were recovered. And what total
18 dollar amount, if you know?

19 A. The regulatory assets were quantified at
20 about \$700 million, that's on I believe one of the
21 last pages of the settlement that's in that case.

22 Q. And if you recall in that settlement,
23 that \$700 million, was it a regulatory recovery? Was
24 it a recovery for all of the AEP Ohio plants in
25 existence at the time?

1 A. It was for regulatory assets associated
2 with Columbus Southern and Ohio Power, yes. And to
3 the extent there were uneconomic plant transition
4 costs, it would have been recovered through the
5 standard service offer.

6 Q. Okay. And so this \$700 million, I think
7 you either characterized Witness Kahn or Witness
8 Landon as describing the \$700 million as a cost-based
9 figure.

10 A. No, the \$700 million was not a part of
11 their study.

12 Q. Okay.

13 A. It was actually explicitly not included
14 in that. It was a -- they were the regulatory
15 assets. Utility companies have the unique ability to
16 create regulatory assets on their financial
17 statements.

18 If they can't collect an expense at some
19 point in time, the utility company -- the utility
20 commission can allow them to defer that expense to be
21 collected later. And it is unique to the utility
22 industry. It's you have to be in compliance with
23 FASB 71 to be able to create an asset like that.

24 Q. Okay. So these regulatory assets that
25 were created, were they regulatory assets for the

1 same timeframe of 2001 through 2030?

2 A. They were regulatory assets that were
3 existing on the financial statements of the utility
4 company at 12/31/00 that had been created prior to
5 that point in time.

6 Q. Okay. And so the cost, this regulatory
7 asset that was created was \$700 million and
8 ratepayers paid the total of \$700 million through a
9 stipulation that was approved which charge has
10 already been fully paid and recovered by the company?

11 A. Yes, sir. The mechanism to recover it
12 was the RTC rate.

13 Q. Okay. Tell me the difference between
14 these regulatory assets and what's your understanding
15 of the capacity costs that are being requested here
16 today.

17 A. Regulatory assets were just unique to the
18 assets themselves. Actually, they were defined by
19 the statute Senate Bill 3, 4928.1 I believe was the
20 Definition section, paragraph 26, I think, defined
21 what could be accounted for as a regulatory asset.

22 Q. So the generating capacity that the
23 company has today, you would agree that these are
24 power plants that run -- there's a cost associated
25 with keeping those plants running.

1 A. Yes.

2 Q. And is the capacity cost the company's
3 requesting the Commission to approve to support the
4 costs of keeping those plants running, the overhead
5 for keeping those plants in operation, separating out
6 the energy components of those plants?

7 MR. RANDAZZO: I object to the question.

8 COMMISSIONER PORTER: I'm not sure you
9 can.

10 MR. RANDAZZO: I'm not sure I can either,
11 and I know it's going to be overruled, but I don't
12 believe that's the basis for the claim here. It's a
13 differential of revenue.

14 Overruled? Sustained?

15 EXAMINER SEE: And the objection is
16 overruled.

17 MR. RANDAZZO: Yes, ma'am, thank you.

18 COMMISSIONER PORTER: If you can just
19 read it back and if you have an answer.

20 If you can answer.

21 THE WITNESS: Please, read it back.

22 (Record read.)

23 A. It's the cost associated with the
24 capacity portion of it, yes. My issue is that they
25 want a cost-based rate recovery mechanism for that

1 and I don't believe the state of Ohio can support a
2 cost-based rate recovery mechanism for that, given
3 that the generation service that's provided by the
4 generation function at AEP Ohio is under a
5 market-based paradigm.

6 Q. Okay. So am I correct in understanding
7 your testimony that the Ohio Commission cannot
8 approve the requested rate because the Ohio
9 Commission is limited by state law, rather than your
10 testimony being the Ohio Commission should not
11 approve the rate because it was previously recovered
12 through this regulatory charge?

13 A. I'm not trying to base my testimony on
14 law. It's based upon fairness. It was already
15 accounted for, transition costs were not to be
16 recovered in the future, and I think this is an
17 unfair request by AEP Ohio.

18 Q. Okay. So in your view -- well, let me
19 ask you this, are you opposed to the RPM payments as
20 well that would be received by the company if the
21 direction from the Commission were that capacity
22 should be at RPM? You're not opposed to that?

23 A. No; that's what we support.

24 Q. Okay. Let me just very quickly ask you,
25 you make several recommendations regarding

1 exclusions, this is beginning on page 16 of your
2 testimony, such that if there were a cost-based
3 capacity rate approved by the Commission, you suggest
4 that these items on page 16 should be excluded I
5 believe. Let me start with construction work in
6 progress, could you briefly explain why? This is the
7 first item.

8 A. First of all, I think it's very improper
9 to include a cost-based recovery mechanism for the
10 generating assets, but if you're going to approve a
11 revenue requirement calculation for the generating
12 assets, at a minimum it ought to be in compliance
13 with the state of Ohio's laws on revenue requirement
14 calculations.

15 Q. Okay. So that CWIP is inconsistent or
16 CWIP, for construction work in progress, is
17 inconsistent with state law.

18 A. That's correct, it has not been shown to
19 be 75 percent complete.

20 Q. Okay. And if there, for the second item,
21 if there were a mirroring component, it seems as if
22 your -- is it your testimony it's been unlawfully
23 omitted or just as a matter of fairness there should
24 have been a mirroring component included?

25 A. Well, that's what the state of Ohio

1 requires, that if you include CWIP in a revenue
2 requirement in a cost-based recovery mechanism, that
3 it must be mirrored back.

4 Q. At what level? Is there a dollar amount
5 that you'd attach to this mirroring component?

6 A. It's whatever level was collected.

7 Q. Okay. All right. Briefly explain the
8 impact of the lack of this lead-lag study, the
9 lead-lag study --

10 A. The Commission decided years ago to rely
11 upon a lead-lag study to determine a working capital
12 calculation. Years ago FERC used a formula-based
13 approach and then FERC got away from the formula,
14 said it was not a -- not a reliable calculation to
15 determine working capital and they went to a lead-lag
16 methodology and the state of Ohio followed.

17 No, I take that back. I don't think FERC
18 went to a lead-lag methodology.

19 The state of Ohio followed and insisted
20 on lead-lag studies if an allowance for working
21 capital was going to be requested.

22 Q. Okay. And, finally, you mentioned that
23 the fact that the -- that if the cost-based capacity
24 mechanism approved by -- requested by the company is
25 approved, that there would be an impact on CRES

1 suppliers and that there should be some risk.

2 There's some risk of the annual adjustments in the
3 cost inputs to this formula.

4 What level of risk should the Commission
5 account for when considering this rate? Do you
6 understand my question?

7 A. No, not at all.

8 Q. Okay. Let me go to your testimony, at
9 item No. 8 on page 18, maybe I'm misunderstanding
10 your testimony, but I believe that you're suggesting
11 that there needs to be some accounting for the fact
12 that there's risk to CRES suppliers based upon the
13 fact that there would be periodical adjustments in
14 the formula rate -- in the formula rate that's being
15 requested. Is that your testimony?

16 A. Yes.

17 Q. Okay. What should that -- how should the
18 Commission account for that?

19 A. Well, by reducing the equity return
20 that's included in the formula.

21 Q. Do you have any specific recommendations
22 regarding the amount of that reduction?

23 A. Well, I think if it's going to be a
24 formula-based rate that, you know, a debt rate would
25 probably, you know, if it's going to be adjusted to

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1 annually recover whatever costs they incur without an
2 audit on what the costs are, without a verification,
3 if there's no controls on whatever the costs are and
4 they're just allowed to pass them through, I think
5 that a debt rate is probably more than reasonable.

6 Q. Okay, you answering all the questions
7 today has been very helpful to my future
8 consideration of this.

9 COMMISSIONER PORTER: I have no further
10 questions, thank you.

11 EXAMINER SEE: Redirect?

12 MR. RANDAZZO: Just a couple of
13 questions. Commissioner Porter, you can object to
14 mine as well.

15 COMMISSIONER PORTER: I won't do that.

16 MR. RANDAZZO: All right.

17 COMMISSIONER PORTER: I wouldn't have the
18 guts to do that.

19 MR. RANDAZZO: I will accept that
20 observation.

21 - - -

22 REDIRECT EXAMINATION

23 By Mr. Randazzo:

24 Q. What's a lead-lag study, Mr. Hess?

25 A. It's a study that measures the leads and

1 lags of the revenues and expenses of an entity.

2 Q. How does it relate to the determination
3 of working capital?

4 A. The net value of the leads and the lags
5 are added to the rate base as a working capital
6 allowance.

7 Q. Is it possible to have negative working
8 capital?

9 MR. NOURSE: Your Honor, I object. I
10 mean, these questions don't relate to
11 cross-examination at all.

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

14 Q. What's a debt rate?

15 MR. NOURSE: Same objection, your Honor.

16 EXAMINER SEE: Overruled.

17 A. A debt rate would be whatever the company
18 could currently borrow long-term debt at.

19 Q. Okay. So that would be the interest rate
20 you're referring to on the debt?

21 A. Yes.

22 Q. You mentioned in response to several
23 questions by Mr. Nourse some history, you referred to
24 the ESP 1 increases as being 3 percent, 7 percent,
25 plus 4 percent. Do you recall that question and

1 answer?

2 A. If I said it was ESP 1, I was incorrect.
3 That should be RSP.

4 Q. Okay. You may have said the RSP, which
5 would be the rate stabilization plan, right?

6 A. Yes.

7 Q. Were those annual increases?

8 A. Yes.

9 Q. And so that would have been 7 percent a
10 year?

11 A. That's correct.

12 Q. Plus the 4 percent?

13 A. That's correct.

14 Q. Once we got beyond the rate stabilization
15 plan, were there also increases in ESP 1?

16 A. Yes.

17 Q. And, again, were these annual?

18 A. Yes.

19 Q. During that period of time, actually
20 since the beginning of Senate Bill -- the
21 implementation of Senate Bill 3 do you have a
22 recollection as to the return on common equity that
23 Columbus & Southern earned?

24 A. There was a, the SEET case provided an
25 awful lot of information to the Commission about that

1 and I believe Columbus & Southern's was determined in
2 that case to be excessively -- significantly
3 excessive for the period of 2009.

4 Q. And with regard to regulatory transition
5 charges and costs that you discussed with Mr. Nourse
6 and Commissioner Porter and the 700 million, were
7 those generation-related transition costs?

8 A. Yes.

9 Q. And were they continuing to recover those
10 costs into 2006 and 2007, and in Columbus &
11 Southern's case in 2008?

12 A. That's correct.

13 Q. Now --

14 A. Can I correct my answer earlier. They
15 were regulatory assets associated with providing
16 generation service.

17 Q. Now, as part of this history you talked
18 about the settlement in the ETP case, was that a
19 contested settlement?

20 A. Yes.

21 Q. Why was it contested?

22 A. Shell Energy believed that the -- that
23 there were stranded benefits and that those stranded
24 benefits should be used to offset the regulatory
25 asset recovery mechanism.

1 Q. And if Shell's position in that case
2 would have been sustained by the Commission, how
3 would it have impacted the regulatory asset
4 transition costs that the Commission authorized
5 pursuant to the settlement?

6 A. I believe it would have been eliminated.

7 Q. And how did stranded benefits factor into
8 the computation of allowable transition revenues?
9 Looking at the criteria that you have in your
10 testimony, please. Page 6.

11 Let me strike that question.

12 What does the concept of netting for
13 purposes of computing transition revenue allowance
14 mean to you?

15 A. I don't understand the question.

16 Q. All right. Fair enough.

17 Now, Mr. Nourse asked you some questions
18 about the testimony of Dr. Kahn and referred you to
19 pages -- I think one page actually, 16. Would you
20 turn to page -- do you have that, what's marked as
21 AEP Exhibit 107?

22 A. I have that.

23 Q. Turn to page 17.

24 A. I have that.

25 Q. Am I correct on page 17 at line 22 it

1 refers to AEP's likely market for AEP's capacity?

2 A. I see that.

3 Q. And on page 18 where the description of
4 the simulation occurs at line 16, can you tell me
5 what production costs are? Strike that.

6 Would production costs from an accounting
7 standpoint include both fixed and variable costs?

8 A. Yes.

9 Q. Is it possible to express both fixed and
10 variable cost recovery through an energy-based rate?
11 In other words, a megawatt-hour based rate or a
12 kilowatt-hour based rate.

13 A. Is it possible to do that? Yes.

14 Q. Yeah. You were asked some questions by
15 Mr. Nourse regarding the two options that were
16 provided as a result of Senate Bill 221. Do you
17 recall those questions?

18 A. Yes.

19 Q. Does the Commission have the ability to
20 impose an electric security plan on a electric
21 distribution utility? Your understanding.

22 A. Can the Commission force a -- no.

23 MR. RANDAZZO: I believe that's all I
24 have, your Honors. Thank you very much.

25 EXAMINER SEE: Recross, Ms. Kern?

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1 MS. KERN: No, thank you, your Honor.

2 EXAMINER SEE: Mr. Yurick?

3 MR. YURICK: No, thank you, your Honor.

4 EXAMINER SEE: Mr. Kurtz?

5 MR. KURTZ: No, your Honor.

6 EXAMINER SEE: Ms. Kingery?

7 MS. KINGERY: No questions, your Honor.

8 EXAMINER SEE: Mr. Hayden?

9 MR. HAYDEN: No, thank you.

10 EXAMINER SEE: Ms. Kaleps-Clark?

11 MS. KALEPS-CLARK: No questions, your
12 Honor.

13 EXAMINER SEE: Mr. Jones?

14 MR. JONES: No questions, your Honor.

15 EXAMINER SEE: Mr. Nourse?

16 MR. NOURSE: Thank you, your Honor.

17 - - -

18 RECROSS-EXAMINATION

19 By Mr. Nourse:

20 Q. Mr. Hess, your counsel referred you to
21 the RSP, again, rate stabilization plan annual
22 increases and the environmental 4 percent, do you
23 recall that?

24 A. Referred me to what? I'm sorry.

25 Q. The annual increases in the rate

1 stabilization plan.

2 A. Yes.

3 Q. 3 and 7 percent, and then he referred to
4 an additional 4 percent and then said something about
5 11 percent. Do you recall that?

6 A. Yes.

7 Q. Okay. Was the additional 4 percent under
8 the RSP an annual or an automatic increase or was it
9 a maximum increase for proven incremental
10 environmental costs?

11 A. Yes, the utility company had come in and
12 shown the needed increase.

13 Q. And showed by demonstrating they expended
14 the costs that support the increase, correct?

15 A. Yes.

16 Q. Incremental cost is not already reflected
17 in existing rates --

18 A. That's correct.

19 Q. -- correct?

20 Okay. And there was another reference by
21 your counsel to the 700 million regulatory assets
22 that were recovered through the ETP stipulation; do
23 you recall that?

24 A. Yes.

25 Q. And you stated they were related to

1 generation service, correct?

2 A. Yes.

3 Q. Just to clarify, again, the 700 million
4 regulatory assets that you're referring to there were
5 not uneconomic or stranded generation investment
6 costs, were they?

7 A. I know the distinction you're making,
8 but, yeah, they were not associated with the plant.
9 They were not plant -- they were not plant costs.

10 Q. Okay. And they met the four criteria you
11 referred to in your testimony on page 6, did they
12 not?

13 A. The regulatory assets?

14 Q. Yeah.

15 A. Yes.

16 Q. And did staff support the regulatory
17 asset recovery?

18 A. Yes. We signed the settlement.

19 Q. Did IEU support the regulatory asset
20 recovery?

21 MR. RANDAZZO: We'll stipulate we did.

22 MR. NOURSE: Your Honor, I'd appreciate
23 not being interrupted during examination by
24 Mr. Randazzo to offer stipulations.

25 Q. A simple answer will do, Mr. Hess.

1 A. Yeah, Mr. Nourse, I don't remember if
2 they signed the settlement or not.

3 Q. Thank you.

4 Finally, Mr. Hess, your counsel directed
5 you to discuss a couple passages in Dr. Kahn's
6 testimony, pages 17 and 18 --

7 A. Yes.

8 Q. -- do you recall that? And then he asked
9 you if it's possible to reflect capacity costs to the
10 dollar-per-megawatt-hour future energy projection.
11 Do you recall that?

12 A. Yes.

13 Q. And regardless of whether it's possible,
14 is it your understanding that Dr. Kahn and/or
15 Dr. Landon reflected capacity costs in their forward
16 prices?

17 A. Yeah, it was my understanding it was an
18 all-in price, yes.

19 Q. So your understanding was not what we
20 discussed earlier, that it was an energy-only
21 projection.

22 A. Well, it was an energy-only rate.

23 Q. So you're saying --

24 A. I'm sorry. It was a rate per
25 kilowatt-hour.

1 Q. You're saying the kilowatt-hour -- the
2 dollar-per-kilowatt-hour rate did reflect capacity
3 costs?

4 A. As I had stated, it was intended to
5 recover all costs associated with the generation.

6 Q. Well, what's your basis for saying "it
7 was intended to recover capacity costs"?

8 A. Page 18 as pointed out by Mr. Randazzo,
9 it states that "Also included are the production
10 costs of generation for OPCo and CSP, together with
11 the associated emission levels."

12 Q. So does that tell you that the full
13 capacity costs were included in the forward prices?

14 A. The capacity costs would have been a
15 portion of the production costs, yes.

16 Q. So even though we confirmed earlier when
17 we looked at Exhibit EPK-5, you confirmed that it was
18 an energy-only projection, you're changing your
19 testimony based on that reference on line 16 of page
20 18?

21 A. Again, I thought my testimony was that I
22 believed it covered all the production costs.

23 Q. And you don't recall discussing the table
24 on page 16 and concluding that it was an energy-only
25 projection?

1 A. I remember the discussion. I thought,
2 though, that I made it clear it was all -- it was for
3 all costs associated with the generation.

4 Q. Did you state earlier that there was not
5 a capacity market in 2000?

6 A. I don't think I stated that earlier. I
7 stated that there was not an RPM capacity market.

8 Q. That there was no capacity pricing
9 differentiated from energy pricing at that time?

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

11 MR. NOURSE: Thank you. Your Honor,
12 that's all I have.

13 EXAMINER SEE: Thank you, Mr. Hess.

14 THE WITNESS: Thank you.

15 EXAMINER SEE: Mr. Randazzo.

16 MR. RANDAZZO: No questions.

17 EXAMINER SEE: Do you want to --

18 MR. RANDAZZO: We will move the exhibit,
19 however.

20 EXAMINER SEE: IEU Exhibit 101.

21 MR. RANDAZZO: Yes, ma'am, thank you.

22 EXAMINER SEE: Are there any objections
23 to the admission of the direct testimony of Mr. Hess?

24 Hearing none, IEU Exhibit 101 is admitted
25 into the record.

1 (EXHIBIT ADMITTED INTO EVIDENCE.)

2 EXAMINER SEE: Mr. Nourse.

3 MR. NOURSE: Thank you, your Honor. AEP
4 moves for admission of Exhibits 106 through 109.

5 EXAMINER SEE: Are there any objections
6 to the admission of AEP Exhibits 106 through 109?

7 Hearing none, AEP Exhibit 106, 107, 108,
8 and 109 are admitted into the record.

9 (EXHIBITS ADMITTED INTO EVIDENCE.)

10 EXAMINER SEE: Mr. Nourse, did you intend
11 to mark and move into the record the prefiled
12 testimony of J. Edward Hess in ESP 1? You discussed
13 it in the record.

14 MR. NOURSE: No, your Honor, I had him
15 read the portion into the record we discussed and I
16 didn't mark it as an exhibit.

17 MR. RANDAZZO: I would ask that the
18 full -- either the full testimony be administratively
19 noticed so that the Commission has the benefit of the
20 complete context or that -- we'll mark it as an
21 exhibit and offer it.

22 MR. NOURSE: That's fine, I just didn't
23 bring enough copies. So I would be happy to submit
24 that as Exhibit 110, we'll just put it in the record
25 tomorrow.

1 EXAMINER SEE: Okay, thank you. We'll
2 take that up tomorrow, AEP Exhibit 110.

3 And with that --

4 MR. NOURSE: I'm sorry, your Honor.
5 Could we have a discussion off the record before we
6 adjourn?

7 EXAMINER SEE: Sure. Let's go off the
8 record.

9 (Discussion off the record.)

10 EXAMINER SEE: Let's go back on the
11 record briefly, and the representations that the
12 parties made as to the motion to compel and what's
13 been provided and what hasn't been provided and when
14 you expect to file your interlocutory appeals, I'd
15 prefer to see that information in the transcript. Do
16 you want to go first, well, Mr. Nourse, did you want
17 to make your statement there in the record?

18 MR. NOURSE: Yes, your Honor. I was just
19 inquiring off the record as to what the parties that
20 were ordered to compel discovery responses, when they
21 were going to complete that process, number one; and,
22 number two, whether it's accurate to say that
23 anything that's not provided in compliance with the
24 order compelling disclosure will be covered in their
25 interlocutory appeal; and, number three, when were

1 those steps going to be completed.

2 EXAMINER SEE: Mr. Hayden?

3 MR. HAYDEN: Yes, your Honor. As I
4 indicated on Friday of our intent, we plan to file
5 our interlocutory appeal tomorrow with respect to the
6 information that AEP is requesting which requests
7 that FES provide customer-specific information, which
8 is proprietary and trade secret having to do with
9 customer names and pricing, the contracts pursuant to
10 the Bench's order.

11 We have, however, provided thousands of
12 pages of customer contracts to AEP on Friday in
13 redacted form and in addition to that we have
14 supplemented all of our interrogatory responses set 1
15 through 4 to meet the Bench's order in that regard.

16 EXAMINER SEE: Did you indicate that
17 there were some responses that had not been provided?

18 MR. HAYDEN: The only responses, your
19 Honor, at this point that we have not provided,
20 interrogatory 1-7, 1-10, and 4-1 through 4-10, which
21 again seek customer-specific information. In our
22 mind we have complied with the Bench's order with
23 respect to all the noncustomer-specific information.

24 EXAMINER SEE: And as to Exelon,
25 Ms. Kaleps-Clark.

1 MR. NOURSE: I'm sorry, your Honor, could
2 I inquire, before we go to Exelon, briefly of FES.

3 When you say everything except the
4 customer-specific information that you provided which
5 were customer-specific information redacted, are you
6 including all rate information in that category?

7 MR. HAYDEN: All information that is
8 unique to that specific customer with respect to what
9 FES charges or the FES price to that customer has
10 been redacted.

11 MR. NOURSE: So all pricing has been
12 redacted.

13 MR. HAYDEN: All pricing has been
14 redacted.

15 MR. NOURSE: Okay. Thank you, your
16 Honor.

17 EXAMINER SEE: Ms. Kaleps-Clark.

18 MS. KALEPS-CLARK: Thank you, your Honor,
19 Exelon and Constellation, on behalf of them we intend
20 to serve supplemental responses tomorrow to the
21 motion to compel, in response to the motion to
22 compel, and we also intend to file an interlocutory
23 appeal as to that information which will not be
24 included in the supplemental response, which is
25 within the five-day deadline.

1 EXAMINER SEE: Any specifics as to which
2 of the discovery requests that Exelon has been
3 presented with that you do not intend to respond to?

4 MS. KALEPS-CLARK: At this point in time
5 I'm not exactly sure. I know that they are working
6 those details out now and they will be finalized and
7 that, we will know tomorrow.

8 EXAMINER SEE: I'm sorry, what was the
9 last part?

10 MS. KALEPS-CLARK: We will know tomorrow.

11 EXAMINER SEE: Okay. And with that
12 information, Mr. Nourse, were you expecting the
13 schedule to be reworked that we have thus far in the
14 proceeding?

15 MR. NOURSE: Well --

16 EXAMINER SEE: With FES's witnesses and
17 Exelon's witness.

18 MR. NOURSE: I mean, we just heard new
19 information, your Honor, about the scheduling from
20 FES witnesses but I don't think anything's changed,
21 your Honor, relative to the fact that the motion to
22 compel is done in order to prepare our case and
23 prepare our cross-examination and our arguments in
24 this case.

25 The parties have been ordered to disclose

1 the information and, you know, it hasn't happened
2 yet, and there's going to be an interlocutory appeal
3 process.

4 You know, the alternative that we had in
5 our motion to compel is a motion to strike that
6 affected, among other witnesses, Dr. Lesser, several
7 passages in his testimony, and I believe Mr. Banks as
8 well, and so, you know, since the motion to compel is
9 still in play in the interlocutory appeal process, I
10 think it's also fair to say that an alternative
11 motion to strike is in play, and both the testimony
12 submitted as well as the cross-examination could be
13 affected by both of those things.

14 So I'm not sure if you're asking us to
15 decide right now whether we're going forward without
16 seeing that process through and without receiving
17 information at all yet from Exelon, for example. You
18 know, I think for one thing Mr. Satterwhite has
19 handled a lot of the discovery, has been reviewing it
20 today as well as over the weekend, and I prefer that
21 he come in and talk about it if we're going to get
22 into the details of each request that's outstanding.

23 But I guess what I would suggest, your
24 Honor, is that we have a -- I believe we have a
25 schedule for tomorrow and that we can proceed with

1 that and see at the end of the day if we know
2 anything further if anything's changed about these
3 matters at that time.

4 MR. HAYDEN: Your Honor, I would just
5 note, since Mr. Nourse referred to the motion to
6 strike, it was only related to the third set of
7 discovery which we have provided all responses to.

8 MR. NOURSE: And I'm happy to check on
9 that with Mr. Satterwhite.

10 MR. LANG: Sorry, second set.

11 MR. HAYDEN: Second set, I'm sorry.

12 EXAMINER SEE: So the parties should --
13 Mr. Nourse, I was not implying that the Bench was
14 going to make a ruling at this time in light of the
15 motion to compel, and being aware of the fact that
16 the parties plan to file an interlocutory appeal,
17 given that we should be able to proceed with all
18 three of the witnesses that are scheduled for
19 tomorrow, we'll take the issue up about reworking, if
20 necessary, the current witness schedule at a later
21 time.

22 Is there anything else?

23 MR. JONES: Your Honor, I do want to
24 raise the issue of staff witnesses. Mr. Ryan Harter,
25 we do want to have him testify on Friday. He is

1 coming from Virginia and he has scheduled flight
2 plans to come here to be done on Friday. Now, there
3 might be some flexibility of Mr. Smith, we're
4 checking into that, but we at least want to have
5 Mr. Harter scheduled for Friday as a date certain.

6 EXAMINER SEE: Okay, Mr. Jones. The
7 Bench will make an effort to do so.

8 MR. JONES: Thank you.

9 EXAMINER SEE: Okay. Hearing is
10 adjourned until tomorrow at 9:00 a.m.

11 (Hearing adjourned at 6:41 p.m.)

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1 CERTIFICATE

2 I do hereby certify that the foregoing is a
3 true and correct transcript of the proceedings taken
4 by me in this matter on Monday, April 23, 2012, and
5 carefully compared with my original stenographic
6 notes.

7
8 Maria DiPaolo Jones, Registered
9 Diplomat Reporter and CRR and
Notary Public in and for the
State of Ohio.

10 My commission expires June 19, 2016.

11 (MDJ-3999)

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Summary: Transcript of Commission Review of the Capacity Charges of Ohio Power Company and Columbus Southern Power Company hearing held on 04/23/12 - Volume V electronically filed by Mrs. Jennifer Duffer on behalf of Armstrong & Okey, Inc. and Jones, Maria DiPaolo Mrs.