

**BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO**

In the Matter of the Application of)
The Cincinnati Gas & Electric Company)
to Modify Its Non-Residential Generation)
Rates to Provide for Market-Based) Case No. 03-93-EL-ATA
Standard Service Offer Pricing and to)
Establish an Alternative Competitively-Bid)
Service Rate Option Subsequent to Market)
Development Period.)

In the Matter of the Application of)
The Cincinnati Gas & Electric Company for)
Authority to Modify Current Accounting) Case No. 03-2079-EL-AAM
Procedures for Certain Costs Associated)
With the Midwest Independent Transmission)
System Operator.)

In the Matter of the Application of)
The Cincinnati Gas & Electric Company)
For Authority to Modify Current Accounting)
Procedures for Capital Investment in its)
Electric Transmission and Distribution) Case No. 03-2081-EL-AAM
System Case No. 03-2080-EL-ATA)
And to Establish a Capital Investment)
Reliability Rider to be Effective after the)
Market Development Period.)

PREPARED TESTIMONY

OF

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1 **I INTRODUCTION AND QUALIFICATIONS**

2 ***Q1. PLEASE STATE YOUR NAME, OCCUPATION AND ADDRESS.***

3 ***A1.*** My name is Neil H. Talbot. I am an economic and financial consultant affiliated
4 with Synapse Energy Economics, Inc. My business address is 22 Pearl Street,
5 Cambridge MA 02139.

6

7 ***Q2. WHAT ARE YOUR EDUCATIONAL QUALIFICATIONS?***

8 ***A2.*** In addition to earlier degrees in government and law from the University of Cape
9 Town, South Africa, I obtained a master's degree in economics from Cambridge
10 University, England in 1968, and a Master of Science in Finance (MSF) degree from
11 Boston College in 1992.

12

13 ***Q3. PLEASE OUTLINE YOUR WORK EXPERIENCE.***

14 ***A3.*** I have practiced as an economic consultant for the past 35 years. I was employed
15 from 1968 to 1972 by the Economist Intelligence Unit, London; from 1973 to 1979
16 by Arthur D. Little, Inc., Cambridge, MA; and from 1980 to 1994 by Tellus Institute
17 (formerly Energy Systems Research Group), Boston, MA. I then became affiliated
18 with Synapse Energy Economics, Inc.

19

1 **Q4. PLEASE OUTLINE YOUR EXPERIENCE WITH UTILITY CASES SUCH AS**
2 **THE PRESENT PROCEEDING.**

3 **A4.** Since 1973, my consulting work has focused on electric utility planning, rates,
4 regulation and finance, and for the past several years, I have concentrated on issues
5 related to the restructuring of the electric industry and the transition to competitive
6 wholesale and retail electricity markets. As will be readily apparent from a review of
7 my professional biography, attached as Attachment NHT-1, I have testified in many
8 regulatory proceedings and since 2000 I have testified on utility rate-making,
9 planning and procurement during the transition to competitive markets in a number
10 of cases. In January 2003 I submitted testimony on behalf of Staff before the New
11 Jersey Board of Public Utilities on the power purchases of Rockland Electric
12 Company for purposes of supplying standard offer customers. In May 2002 I
13 testified before the Arizona Corporation Commission on the restructuring of Arizona
14 Public Service Company in light of a survey that I undertook for the Commission
15 Staff of the state of deregulation and competition in a number of states around the
16 country. The survey included a review of the state of restructuring and competitive
17 markets in Ohio. For the Staff of the Arkansas Public Service Commission, I drafted
18 in 2000 a proposed rule on market power in deregulated electricity markets and was
19 an adviser to the Staff on electricity restructuring.

20
21 **Q5. ON WHOSE BEHALF ARE YOU TESTIFYING IN THIS PROCEEDING?**

22 **A5.** I am testifying on behalf of the Ohio Consumers' Counsel.
23

1 **Q6. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS CASE?**

2 **A6.** In my testimony I address a pair of proposals put forward by Cincinnati Gas &
3 Electric Company ("CG&E" or "the Company") in its January 10, 2003 Application.
4 My primary focus is on the Company's original Market Based Standard Service
5 Offer ("MBSSO"). This proposal has been presented again in January 2004. It is now
6 referred to as the Competitive Market Option ("CMO") MBSSO because it is one of
7 the two parts of the Company's CMO, the other part being a Competitive Bid
8 Process. For the sake of simplicity, I will refer to this offer as the MBSSO. I refer to
9 the *other* standard service offer, which the Company has developed this year in
10 response to the concern expressed by the Commission that pricing in the power
11 markets in Ohio is not yet sufficiently stable and competitive to be the basis of a
12 standard service offer, as the Electric Reliability and Rate Stabilization Plan
13 ("ERRSP" or "RSP").

14
15 The secondary matter that I address in my testimony is the Company's Competitive
16 Bid Process ("CBP"), as filed in January 2003, in light of the competitive bidding
17 rules subsequently promulgated by the Commission in Appendix B of its December
18 17, 2003 order in Case No. 01-2164-EL-ORD.

19
20 **Q7. PLEASE EXPLAIN HOW YOUR TESTIMONY IS ORGANIZED.**

21 **A7.** Section II presents a summary of the points made in my testimony and my
22 recommendations. The remainder of my testimony is presented into three sections,
23 as follows:

1 Section III is a critique of the proposed CMO MBSSO; Section IV covers CG&E's
2 proposed Non-Bypassable Provider of Last Resort ("POLR") Charge; and Section V
3 covers CG&E's CBP of the CMO.

4 **II SUMMARY AND RECOMMENDATIONS**

5 ***Q8. WHAT IS YOUR OVERALL ASSESSMENT OF THE COMPANY'S MBSSO?***

6 ***A8.*** I assess the MBSSO against the criteria established by the Commission in its
7 implementation of S.B. 3. These are "rate certainty, financial stability for the electric
8 distribution utilities and further competitive market development."¹ I will deal in
9 some detail with a number of specific problems that I have with the MBSSO as
10 proposed, but the general conclusion is that it is not well designed to achieve rate
11 stability consistent with further competitive market development. From a ratemaking
12 standpoint, the MBSSO is not anchored in the utility's actual costs in a traditional
13 manner. On the other hand, its attempt to construct a competitive price that is not in
14 fact determined in the competitive arena is complex, confusing, artificial and
15 unconvincing. My concerns with the MBSSO and recommendations are summarized
16 in the following discussion and presented in detail in Section III of this testimony.

17
18 ***Q9. IS THE MBSSO TRULY A MARKET-BASED RATE?***

19 ***A9.*** No. The Company tries to justify its MBSSO as an attempt to replicate the kind of
20 price that a Competitive Retail Electric Supplier (CRES) would build up from a
21 number of cost and risk components. To the base component, which is a market price
22 index, the Company adds several components reflecting the kinds of costs and risks

1 that it argues a CRES would seek to recover in its retail prices.

2 ***Q10. IS THIS AN UNREASONABLE APPROACH?***

3 ***A10.*** Under the present circumstances, I believe it is unreasonable. The problem is that the
4 components as estimated by CG&E are very imprecise measures of the costs and
5 risks faced by CRES providers, let alone those actually faced by CG&E itself as the
6 MBSSO provider. Some of the cost or risk items appear to be over-estimated, and
7 there may also be double-counting. Company witness Rose, who is sponsoring the
8 MBSSO proposal, acknowledges that it is novel, untested, and based upon a large
9 number of judgements as well as a number of estimates for which there is no firm
10 basis. My concern is that the prices constructed according to the MBSSO's proposed
11 methods are unlikely to correctly measure the actual costs and risks of providing
12 competitive retail service. The prices seem likely to be higher than justified by either
13 the Company's underlying cost of providing the service, or prices likely to be
14 determined in the competitive market. In my testimony, I address this concern in
15 relation to various specific price components. The general problem with the way the
16 Company has developed its proposed MBSSO rates is that it is complex, artificial
17 and imprecise. It is next to impossible to accurately simulate prices that would
18 prevail in the competitive retail market, as opposed to letting the market itself
19 determine what those prices will be.

20

¹ In FirstEnergy Case No. 03-1461-EL-UNC, Entry on Rehearing, October 22, 2003.

1 ***Q11. DOES IMPRECISION MATTER, AND WOULDN'T CUSTOMERS HAVE THE***
2 ***OPTION TO SWITCH COMPETITIVE SUPPLIERS IF A PROBLEM EXISTS***
3 ***WITH THE PROPOSED MBSSO?***

4 ***A11.*** Yes and no. If CG&E's MBSSO price is only somewhat higher than CRES prices,
5 customers are not likely to switch in large numbers. If CG&E uses non-price means
6 to exclude suppliers from the market, such as those described in OCC witness
7 Corbin's testimony, the MBSSO could be even higher without CG&E losing
8 customers to CRES providers.

9
10 ***Q12. IS THE COMPANY PROPOSING THE MBSSO FOR RESIDENTIAL***
11 ***CUSTOMERS AS WELL AS NON-RESIDENTIAL CUSTOMERS?***

12 ***A12.*** The answer to this question is not clear. In January 2003, the Company proposed the
13 MBSSO for only non-residential customers because the market development period
14 (MDP) for residential customers was not expected to end before December 31, 2005.
15 In its recent filing, however, the Company proposed that the MDP end for *all*
16 customers on December 31, 2004, and that the MBSSO be applied to all customers.

17
18 ***Q13 WHY IS THERE UNCERTAINTY ON THIS ISSUE?***

19 ***A13.*** When Mr. Rose, the architect of the MBSSO structure, was asked in his deposition
20 on May 3, 2004 if MBSSO was appropriate for residential customers, he first said he
21 had no comment. When pressed, he said he had no opinion. The Company's
22 approach needs to be clarified.

23

1 ***Q14. WHAT IS YOUR OPINION ON THIS ISSUE?***

2 ***A14.*** I believe the MBSSO, with its imprecision and possible overpricing, would be most
3 harmful to those customers like residential customers with limited willingness or
4 opportunities to switch generation suppliers. By contrast, MBSSO is least harmful to
5 those customers like large industrial and commercial customers that have the
6 resources to evaluate alternatives and switch if they are being overcharged.

7

8 ***Q15. HAS MR. ROSE'S PROPOSED MBSSO PRICING STRUCTURE BEEN***

9 ***APPLIED IN OTHER JURISDICTIONS?***

10 ***A15.*** No. Apparently, it is a completely novel structure. (Response to OCC-POD-04-050,
11 Attachment NHT-2) In answer to a data request about the acceptance of similar
12 proposals in other cases, Mr. Rose responded: "MDP or its equivalent has not ended
13 where the utility has implemented its obligation to provide retail Standard Service
14 Offer." (Response to OCC-INT-04-094, Attachment NHT-3) I take this response to
15 mean "no." It seems that this structure has not yet received a certificate of occupancy.

16

17 ***Q16. ARE THERE ANY SPECIFICALLY ANTI-COMPETITIVE FEATURES IN***

18 ***THE COMPANY'S PROPOSED MBSSO?***

19 ***A16.*** Yes, there is a rate flex-down provision that permits the Company to reduce rates
20 when it loses market share. The exercise of this provision would be unilaterally
21 determined by the Company itself. In other words, to the extent that competitive
22 marketers actually begin to achieve market share, they run the risk that the Company
23 will be able to undercut their offerings. This is directly anti-competitive and would

1 provide a significant deterrent to marketers trying to decide whether to enter the area
2 or to increase their sales effort. Since the flex-down provision would permit pricing
3 below the Company's cost estimates in response to loss of market share, this would
4 appear to be predatory pricing. This is defined in *The MIT Dictionary of Modern*
5 *Economics* as: "The practice of driving prices down to unprofitable levels for a
6 period in order to weaken or eliminate existing competitors."
7

8 ***Q17. ARE THE COMPANY'S FINANCIAL INTERESTS FURTHERED BY THESE***
9 ***VARIOUS PRICING PROVISIONS?***

10 ***A17.*** Yes. The Company, like all incumbent utilities in Ohio, has been provided with
11 financial protection during the transition to retail competition. However, I believe the
12 Company's proposals taken together are over-protective of its financial interests and
13 would be harmful to customers and competitive retail suppliers. For instance, there is
14 a considerable financial advantage in initially setting MBSSO prices somewhat high
15 (to maximize profit), but being able to reduce them (to protect revenue and market
16 share) if and when competitors succeed in undercutting them.
17

18 ***Q18. DO YOU BELIEVE THE LOCAL AND REGIONAL MARKETS WILL BE***
19 ***UNSTABLE IN THE FUTURE?***

20 ***A18.*** The risk of tight supply situations and severe price spikes has diminished, owing to
21 the construction of a number of power plants in the region. I believe that no new
22 generating capacity is required in the ECAR region until after 2010.

23 ***Q19. IS THERE A SOLUTION TO THE PROBLEM OF ERRORS AND***

1 ***UNCERTAINTY IN THE SIMULATED MBSSO RATE?***

2 ***A19.*** Yes, there is a solution that would set rates closer to competitive pricing and would,
3 avoid both over-charging and under-charging of CG&E's allocated retail costs. This
4 solution would base recovery on the utility's actual costs of buying electricity in the
5 generation market, to which would be added a retail adder estimated by appropriate
6 allocation of overhead administrative costs.

7

8 ***Q20. WOULD SUCH A RATE SATISFY THE COMMISSION'S THREE CRITERIA?***

9 ***A20.*** I believe it would. Clearly, the Company's financial stability would be assured. (Note
10 that by allowing for recovery of costs actually incurred, financial risk is reduced. No
11 compensation would be needed for risks other than those actually priced into costs.)
12 Such a mechanism could allow for smoothing of recovery to avoid seasonal variation
13 or other rate shocks, thus accommodating the Commission's goal of rate certainty. To
14 the extent that this rate would have to bear the full costs including overhead of the
15 utility, it should not undercut competitive offerings, provided that non-bypassable
16 charges are not so high as to stifle competition.

17

1 **Q21. WOULD A STANDARD SERVICE OFFER BASED ON COSTS BE "MARKET**
2 **BASED" AS REQUIRED BY S.B. 3?**

3 **A21.** I believe that it would be, because most of the costs incurred by the Company would
4 be for power acquired in the electricity market.

5
6 **Q22. WOULD IT BE POSSIBLE FOR THE COMPANY TO REBUILD A BETTER**
7 **MBSSO STRUCTURE BASED ON MARKET INDICES, OR IS THE**
8 **COMPANY'S WHOLE APPROACH FATALLY FLAWED?**

9 **A22.** I believe the Company's approach is fatally flawed. I have suggested that the
10 Company has made a number of specific errors and in some cases I have suggested
11 better alternatives. If these and other changes were made, I believe the Company's
12 proposed approach could be substantially improved. However, I would not
13 recommend that such a proceeding be initiated, since I believe the Company's whole
14 methodology is too complex and subject to too many subjective judgements and
15 estimates to be the basis for developing just and reasonable rates.

16
17 **Q23. DO YOU HAVE ANY FURTHER COMMENTS ON THE EFFECT OF THE**
18 **COMMISSION'S RULE ISSUED IN DECEMBER 2003?**

19 **A23.** Yes. My testimony regarding the Company's proposed MBSSO addresses the
20 Company's original filing in which the MBSSO would be the service to which an
21 EDU's full-service customers would automatically be assigned at the end of the
22 market development period, unless they affirmatively chose another supplier or
23 service. In this event, large numbers of CG&E's retail customers would be assigned

1 to that service. If, however, MBSSO is restricted only to returning customers whose
2 CRES providers have defaulted, it is likely, as I suggested earlier, that few if any
3 customers would be assigned to MBSSO service, and these would not return in one
4 large initial batch, but in uncertain numbers from time to time.

5
6 ***Q24. WHAT IS YOUR RECOMMENDATION REGARDING THE COMPETITIVE***
7 ***BID PROCESS?***

8 ***A24.*** The Company needs to re-file its CBP proposal with features that comply with the
9 competitive bidding rules recently promulgated by the Commission in Appendix B
10 of its December 17, 2003 order in Case No. 01-2164-EL-ORD. I discuss the CBP
11 proposal in Section V of this testimony. Also, OCC witness Corbin comments on a
12 preferred competitive bidding procedure in his testimony.

13 **III CRITIQUE OF THE PROPOSED MBSSO**

14
15 ***Q25. PLEASE DESCRIBE THE COMPANY'S PROPOSED MBSSO.***

16 ***A25.*** Let me first repeat that the MBSSO I will refer to in my testimony is the so-called
17 CMO MBSSO originally proposed by the Company in its Application filed January
18 10, 2003 and supported in some detail in Application Exhibit 1 prepared by Judah
19 Rose of ICF Consulting Group, Inc., as well as in Mr. Rose's recent pre-filed
20 testimony. A Competitive Bid Process (CBP) was also presented in the January 2003
21 filing. The MBSSO and CBP together constitute what CG&E calls its Competitive
22 Market Option (CMO). Both the MBSSO and CBP would take effect after the end of
23 the market development period. Originally, the Company's proposals applied only

1 to non-residential customers, but in its January 26, 2004 filing the Company said it
2 "would apply the same principles to develop a residential MBSSO and CBP after the
3 market development period ends for residential customers."
4

5 ***Q26. WHAT IS THE STRUCTURE OF THE PROPOSED MBSSO?***

6 ***A26.*** CG&E proposes a mostly fixed annual rate that would change at the end of each year
7 to reflect changes in wholesale market prices. The MBSSO proposal constructs a set
8 of prices for retail service. There are four principal features in the proposal:

- 9 A. An energy price index for the year ahead based on published forward market
10 price indices. This would vary from year to year according to changes in
11 those indices.
- 12 B. A number of energy cost adjustments are proposed to convert wholesale
13 price indices to retail prices.
- 14 C. Further price adders, including a Supply Management Fee, and an Operating
15 Risk Adjustment.
- 16 D. A rate flex-down provision.

17 In the following sections of my testimony, I will discuss each of these features in
18 turn.
19

20 ***Q27. DO YOU ADDRESS THE COMPANY'S POLR PROPOSALS?***

21 ***A27.*** Yes. The Company proposes a Provider of Last Resort (POLR) charge "to maintain
22 the physical reliability and availability of generation." This two-part charge is a
23 charge *to all customers*. I discuss these proposals in Section IV of my testimony.

1

2 **A. Energy Price Index**

3

4 ***Q28. WHAT ARE THE BASIC COMPONENTS OF THE PROPOSED PRICING***
5 ***STRUCTURE?***

6 ***A28.*** The foundation of the proposed pricing structure is a market index of electricity
7 prices. Prices obtained from this index are then adapted to match customers' retail
8 loads. The first question is whether the reported prices represent a sound starting
9 point for CG&E pricing.

10

11 1. Into Cinergy Forward Market Prices

12

13 ***Q29. WHAT REPORTED MARKET PRICES DOES THE COMPANY PROPOSE TO***
14 ***USE AS THE FOUNDATION FOR ITS MBSSO PRICING STRUCTURE?***

15 ***A29.*** Mr. Rose's response to OCC-INT-04-100 (Attachment NHT-4) indicates that "the
16 Into Cinergy (prices) from Megawatt Daily and ICE" would be used as the starting
17 point for determining the price of the MBSSO.

18

1 ***Q30. IS IT REASONABLE TO USE THIS SORT OF MARKET INFORMATION AS***
2 ***THE BASIS FOR PRICING POWER TO RETAIL CUSTOMERS?***

3 ***A30.*** I have reservations about the use of these reported prices. In my view, they do not
4 provide an appropriate basis for setting prices for retail service.

5
6 ***Q31. WHY DO YOU BELIEVE THAT THE PUBLISHED PRICE DATA ARE NOT***
7 ***APPROPRIATE FOR SETTING PRICES FOR RETAIL SERVICE?***

8 ***A31.*** There are several issues with the published price data for purposes of setting rates,
9 mainly having to do with the lack of available information about trading activity,
10 lack of information about market concentration and potential market power, lack of
11 authority for review and auditing the market data, and the lack of an organized
12 regional market with adequate market monitoring and market power mitigation.

13

14 ***Q32. PLEASE EXPLAIN.***

15 ***A32.*** Firstly, there is a legitimate concern that the “Into Cinergy” market may be thin.
16 There is some information available about the trading volume (see Mr. Rose's
17 Attachment JLR-5), but a worrisome lack of information about any details on the
18 volume of trading and number of transactions (see the response to OCC-INT-04-105,
19 Attachment NHT-5). There is also a lack of information about the concentration and
20 market shares of trading activity (see the response to OCC-INT-04-107, Attachment
21 NHT-6). Moreover, it is not possible for PUCO or other state agencies to review or
22 audit the market price indices (see the response to OCC-INT-04-102, Attachment
23 NHT-7).

1 **Q33. DOES THE DELAYED DEVELOPMENT OF THE MISO AFFECT YOUR**
2 **VIEWS?**

3 **A33.** Yes. The situation may be different when the MISO is up and running, with a fully
4 functional market monitoring unit, and market power mitigation rules and
5 procedures. Meanwhile, it would be premature to based retail rates upon the reported
6 prices for Into Cinergy trades.

7
8 **Q34. DIDN'T FERC ISSUE AN ORDER RECENTLY THAT WILL PROVIDE MORE**
9 **CONFIDENCE IN THE MARKET AND THE REPORTED MARKET DATA?**

10 **A34.** FERC issued an Order on November 17, 2003 in Docket Nos. EL01-118-000 and
11 EL01-118-001. That order adopts a set of market behavior rules, dealing with unit
12 operation, market manipulation, communications, reporting, record retention, and
13 related tariffs. These rules are welcome, and long overdue. They include some
14 requirements that I would think are rather obvious. For example on unit operation,
15 the new rules state that "Seller will operate and schedule generating facilities,
16 undertake maintenance, declare outages, and commit or otherwise bid supply in a
17 manner that complies with the Commission-approved rules and regulations of the
18 applicable power market." On market manipulation, the new rules state that "Actions
19 or transactions that are without a legitimate business purpose and that are intended to
20 or foreseeably could manipulate market prices, market condition, or market rules for
21 electric energy or electricity products are prohibited." The new rule on
22 communications states that "Seller will provide accurate and factual information and
23 not submit false or misleading information, or omit material information, in any

1 communication with the Commission, Commission-approved market monitors,
2 Commission-approved regional transmission organizations, or Commission-
3 approved independent system operators, or jurisdictional transmission providers,
4 unless Seller exercised due diligence to prevent such occurrences.” And the new rule
5 on reporting states that “To the extent Seller engages in reporting of transactions to
6 publishers of electricity or natural gas price indices, Seller shall provide accurate and
7 factual information, and not knowingly submit false or misleading information or
8 omit material information to any such publisher...”

9

10 ***Q35. WHAT IS THE OVERALL IMPORT OF THESE FERC RULES?***

11 ***A35.*** In plain language, the FERC order instructs electricity sellers to obey the market
12 rules, to not manipulate the market, and to not lie about their transactions to
13 regulators, grid operators, or entities in the business of compiling and reporting
14 market prices. This should, I suppose, shore up the level of market confidence,
15 following the Western market debacle and the collapse of Enron. But the need for a
16 set of what should be obvious rules may also be taken as a sign of some rather poor
17 behavior by electricity market participants. More to the point for the current case,
18 the new rules do not speak to the issues that I mentioned above having to do with the
19 volumes, market concentration , and auditability of indices like the Into Cinergy
20 indices. The rules state only that the data that is reported should not be bogus.

21

22 ***Q36. DO YOU AGREE WITH MR. ROSE THAT IT IS PRUDENT TO USE MORE***
23 ***THAN ONE INDEX?***

1 **A36.** Yes. However, I should note that this is not a perfect solution, because there is
2 apparently no historical data or analysis to support the consistency or convergence
3 of the indices. (CG&E response to OCC-POD-04-048, Attachment NHT-8)

4
5 **Q37. HOW DOES CG&E PROPOSE TO MERGE THE DATA WHEN IT HAS**
6 **FORWARDS FROM TWO SERVICES?**

7 **A37.** If the prices are within 10% of one another, CG&E would use a simple average of
8 the prices, but “where two or more sources diverge in value by more than 10%,
9 CG&E proposes to use the higher value as the index to mitigate price risk.”
10 (Application Exhibit 1 at 3)

11
12 **Q38. HAS CG&E OFFERED ANY JUSTIFICATION FOR USING THE HIGHER**
13 **OF THE AVAILABLE REPORTED VALUES?**

14 **A38.** No. The Company does not assert that the highest reported value would be the
15 more accurate value, let alone demonstrate that that would be the case. In
16 response to the question "Why does CG&E believe that the maximum reported
17 value is superior to the average of the reported values?" the Company refers to
18 another response, which reads as follows. "*If the higher price is more accurate,*
19 *and the average is used, there is the risk of overpaying for power. If this approach*
20 *is too conservative, consumers can purchase via CRES providers or the winner of*
21 *the CBP.*" (Response to OCC-INT-04-154, Attachment NHT-9 emphasis added).
22 On the face of it, the Company's price risk would be mitigated, but the retail
23 customer's price risk would not.

1

2 ***Q39. DOES THIS RESPONSE IMPLY A LACK OF CONCERN REGARDING***
3 ***POTENTIAL OVERPRICING?***

4 ***A39.*** I believe it does. Here and elsewhere the Company seems more concerned about
5 making sure that MBSSO prices are not too low, rather than not too high.

6

7 ***Q40. DO YOU AGREE WITH THE COMPANY'S BALANCE OF CONCERNS?***

8 ***A40.*** Under the circumstances, no. In a more fully developed retail market, it might not
9 matter if the standard service offer were over-priced. This is not the case for
10 residential and small commercial customers in CG&E's territory today.

11

12 2. No Assurance Of Price Stability

13 ***Q41. CAN PRICE STABILITY FOR CUSTOMERS, WHICH IS ONE OF THE***
14 ***COMMISSION'S CRITERIA, BE ASSURED IF THE MBSSO RESTS ON A***
15 ***FOUNDATION OF FORWARD MARKET PRICES?***

16 ***A41.*** No. Price stability cannot be assured. Mr. Rose presents annual average Into
17 Cinergy forward prices each year for the following year (Attachment JLR-10). I
18 reproduce the data below, together with the annual changes:

	<u>Year</u>	<u>Forward Prices for Next Year</u>	<u>Change from Previous Year</u>
1		Forward Prices	Change from
2			
3	1998	\$43.99/MWh	...
4	1999	43.93	(0.1%)
5	2000	47.26	7.6%
6	2001	39.04	(17.4%)
7	2002	30.70	(21.4%)
8	2003	37.39	21.8%

9

10 These changes, which affect the largest component of the Company's MBSSO

11 pricing structure, indicate that prices could vary considerably from one year to the

12 next.

13 ***Q42. IS THERE A SOLUTION TO THIS PROBLEM?***

14 ***A42.*** Yes. The pricing structure should represent a balanced portfolio of power supply

15 resources. These could include staggered contracts of different durations. I doubt

16 that the Company intends to provide MBSSO power from the forward market for

17 the next year; it doesn't make sense to price the service as if it did.

18

19 3. Market Price Tracker

20 ***Q43. WILL THERE BE NO ADJUSTMENT TO CONSUMER PRICES,***

21 ***REGARDLESS OF HOW HIGH MARKET PRICES ACTUALLY GO?***

22 ***A43.*** If prices go above certain levels, there is a Market Price Tracker that records the

23 excess prices above those levels and allows the Company to recover the excess over

24 the following nine months. The Company's concern is to protect itself financially

1 against price spikes. This provision does not reflect costs actually incurred by the
2 Company if and when there are price spikes. The Company may have contracts in
3 place at the time of any price spike in the spot market that protect it in whole or part
4 from exposure to the spot market.

5
6 4. Bid-Ask Adder

7 ***Q44. WHAT FURTHER ADJUSTMENTS DOES CG&E PROPOSE TO MAKE TO***
8 ***THE BASE PRICE?***

9 ***A44.*** CG&E proposes a 4% increase to the load-weighted index price for a bid-ask
10 adder.

11
12 ***Q45. HAS CG&E PROVIDED ANY JUSTIFICATION FOR THE ASK ADDER?***

13 ***A45.*** No. Without discussion or elaboration, the Application (Exhibit 1 at 9) asserts that
14 “the most appropriate reflection of [an energy purchaser’s] wholesale power costs
15 are the ask prices.” Mr. Rose provides no explanation other than “buying *can*
16 result in prices closer to the ask price or above the index” (Testimony at 19,
17 emphasis added). Moreover, CG&E failed to provide any historical analysis (e.g.,
18 describing differentials between actual settlement and index price, or between
19 average settlement price for net energy buyers versus settlement for all
20 participants) to justify this adder.

1 **Q46. DO YOU AGREE WITH THE PRINCIPLE OF THE ASK ADDER?**

2 **A46.** No. CG&E suggests that settlement prices are closer to ask than bid because of
3 additional costs, such as broker's fees. However, market participants adjust their
4 initial ask or bid to account for *known* transaction costs. Further, the seller who
5 bumps up the ask price for *unknown* costs will be unable to compete in a liquid
6 market.

7
8 **Q47. ASSUMING THAT THE MARKET IS NOT PERFECTLY LIQUID, IS IT**
9 **LIKELY THAT CG&E WOULD PAY MORE THAN THE INDEX PRICE**
10 **FOR WHOLESALE POWER PURCHASES ON AVERAGE?**

11 **A47.** It is highly unlikely. CG&E assumes that to meet MBSSO load it must settle for
12 whatever price power suppliers request. To the contrary, CG&E should be able to
13 obtain energy well below the asking price for a number of reasons:

14
15 1. Despite suggestions that being a large buyer weakens one's bargaining
16 position (Stevie Testimony at 12), CG&E has comparatively more bargaining
17 power than other, smaller market participants. Market power increases with
18 market share—regardless of whether the participant is a buyer or a seller. In a
19 market consisting of a large buyer and many small suppliers, sellers have
20 limited options to sell their goods; in contrast, the buyer can always go to the
21 next supplier to seek a better price. As the largest purchaser of power supply
22 in its market, CG&E can negotiate trades in its favor. CG&E clearly has an
23 advantage, not a disadvantage, in the wholesale power market.

- 1 2. In its initial comments filed on March 3, 2003 in the 03-93-EL-ATA case
2 (“CG&E Initial Comments”), CG&E states its plan to cover the majority of its
3 MBSSO obligations with its own generation, which comprises the bulk of the
4 generating capability in its territory. Energy transferred from CG&E’s
5 generation operations to cover MBSSO load should be valued at its
6 opportunity cost. With certainty, CG&E can sell excess power supply on the
7 market for the bid price (the opportunity cost). Therefore, rather than being
8 priced closer to ask prices, CG&E’s energy transfers should (if anything) be
9 priced closer to bid prices.
- 10 3. Barring differences in information, market power, inventory or transaction
11 costs for the market participants, the settlement price is most likely to be
12 between ask and bid, at or close to the middle of that range. Mr. Rose reports
13 that the indices are skewed towards the ask price (Attachment JLR-11). If the
14 indices are actually reporting prices higher than the average of bid and ask
15 prices, any adjustment to the index price should be downward.
- 16 4. CG&E states that, “from historical data, these percentile values equate to 4%
17 for asking prices (highs) and 6% for bidding prices (lows) as reported for the
18 MegaWatt Daily Into-Cinergy Index” (Exhibit 1 at 9). In fact, MegaWatt
19 Daily reports the range of completed transactions, not ask and bid prices.
20 CG&E appears to have erroneously interpreted that intra-day variability in
21 deals as if it were the difference between bid and asked. The Company’s
22 proposal to use the high end of the price is equivalent to assuming that CG&E

1 would strike the worst deal of the day, every day. That assumption seems
2 unlikely, and if it occurs, imprudent.

3 5. CG&E will presumably be acquiring power in large amounts (assuming
4 MBSSO is the primary service offered by the utility) and for considerable
5 periods of time, and in fact it will for the most part be committing its own
6 generating capacity. Such comparatively large and stable transactions would
7 appear to involve a smaller allowance (if any) for brokerage fees, transaction
8 costs and risks for traders.

9 5. A Different Price Offer Every Day?

10 ***Q48. ARE THERE OTHER PROBLEMATIC FEATURES OF THE COMPANY'S***
11 ***PRICING PROPOSAL?***

12 ***A48.*** Yes. For new customers that take service, the Company apparently intends to
13 price the annual MBSSO for the year ahead based upon forward prices for the
14 next 365 days. As stated on page 7 of the Application, “[t]he Energy Adjustment
15 is a customer variable component that may change daily based upon the
16 wholesale price index.”

17

18 ***Q49. HOW MANY FIXED-PRICE SUPPLY OPTIONS MIGHT CG&E HAVE***
19 ***OUTSTANDING AT ANY ONE TIME?***

20 ***A49.*** Even assuming pricing occurs only on business days, it appears that CG&E might
21 have as many as 250 annual market indices active at any given time, and a range

1 of load weightings, covariance factors and losses for each of those. This would
2 lead to confusion, not to mention a burden on the billing system.

3

4 ***Q50. IS THIS PROVISION NECESSARY TO REDUCE RISK TO THE***
5 ***COMPANY?***

6 ***A50.*** Periodic adjustment to the Company's MBSSO offer does reduce risk. However, a
7 simplified provision would be preferable.

8

9 **B. Energy Cost Adjustments**

10 1. Energy Losses

11 ***Q51. WHAT IS THE NEXT ADJUSTMENT CG&E PROPOSES TO MAKE?***

12 ***A51.*** CG&E proposes an adjustment for line losses to index price, as adjusted for the
13 items discussed above. This adder will be 7% for customers taking service off of
14 the distribution system and 3% for those taking service off of the transmission
15 system (Stevie Testimony at pages 12-13).

16

17 ***Q52. DO YOU FEEL THAT THE ADJUSTMENT FOR ENERGY LOSSES IS***
18 ***JUSTIFIED?***

19 ***A52.*** This adjustment is correct in principle. Competitive Retail Electric Service
20 suppliers must make a similar adjustment when computing their generation rates.
21 However, loss estimates should be reconciled to actual losses over time. Profit or
22 loss on line losses could alter CG&E's incentives to invest in its transmission and

1 distribution system. A sound factual basis for specific numbers, rather than the
2 use of round numbers, would be appropriate.

3

4 ***Q53. WHAT IS THE NEXT STEP IN CG&E'S CONSTRUCTION OF MBSSO***
5 ***PRICES?***

6 ***A53.*** Power is purchased on the wholesale market in standard blocks, such as 50
7 megawatts available during peak periods, 16 hours a day, 5 days a week. When
8 purchased to supply retail customers, the power must be shaped to fit the actual
9 load shapes of customers. Since retail customers are full-requirements customers,
10 moreover, their level of demand will vary owing to weather variations and other
11 uncertainties, so that the supplier must constantly schedule to meet changing
12 levels of consumption.

13

14 ***Q54. ARE THESE TASKS EASY?***

15 ***A54.*** No. These and other tasks discussed below are complex and will no doubt be
16 handled differently by different suppliers in terms of risk management and
17 pricing. The way in which suppliers manage these tasks is among the factors that
18 will determine which of them will survive in the competitive market. There is no
19 particular reason to believe that Mr. Rose's approach, risk assessment, and cost
20 estimates are the solutions that are most efficient and would prevail in the
21 competitive market.

22

1 **Q55. HOW DOES CG&E DIFFERENTIATE THE SUPPLY OF GENERATION**
2 **SERVICES FOR RETAIL LOAD FROM STANDARD WHOLESAL**
3 **BLOCKS OF POWER?**

4 **A55.** CG&E provides a complex set of procedures for shaping generation to customer
5 loads, and dealing with unpredictable variations in loads.

6

7 2. Load Weighting

8 **Q56. IS CG&E'S PROPOSAL TO LOAD-WEIGHT THE FORWARD PRICES FOR**
9 **ENERGY APPROPRIATE?**

10 **A56.** The proposal is correct in principle: the energy mix used in a typical year to serve
11 a customer will generally be more expensive than the energy to serve a load shape
12 that corresponds with the blocks in which wholesale power is traded.

13

14 **Q57. HAS CG&E ADEQUATELY EXPLAINED HOW IT WOULD WEIGHT**
15 **FORWARD PRICES BY LOAD?**

16 **A57.** No. The Company's approach to setting rates requires hourly market-price and
17 load data for the next year. The hourly prices for the next year would be
18 synthesized in some manner from historical data. (Rose Testimony at 17) The
19 Company does not provide (or even describe):

- 20
- 21 ■ the historical data (which year, actual or normalized, or other factors),
 - 22 ■ the algorithm (or "statistical method" -- see Rose Testimony at 17) for turning historical into future hourly prices,

- 1 ▪ the extent to which monthly on- and off-peak prices will be used in the
2 computation.

3 Similarly, the Company’s Application, tariffs and testimony do not provide (or even
4 describe) the load data that would be used for each class: the year(s) from which the
5 data would be taken, or whether the data will be actual, normalized, or synthesized.

6
7 ***Q58. HAVE SOME EXPLANATIONS BEEN PROVIDED?***

8 ***A58.*** Yes. However, the explanations of load-weighting are varied and contradictory:

- 9 ▪ The Application (Exhibit 1 at 10) describes using 2 or 3 years of recent
10 data, and that “additional years of historical weather [would be] simulated
11 to estimate what loads and prices would have occurred under varying
12 weather conditions.” The Application states that CG&E would derive “the
13 distributions of load and price via simulation through past weather
14 patterns (e.g., 30 years).” “Modeling methods used for this estimation can
15 include regression, ARIMA, GARCH, and other types of stochastic
16 modeling.”
- 17 ▪ The CG&E Initial Comments filed in March of 2003 (page 5-6) state that
18 the loads and prices would be simulated or modeled solely using GARCH,
19 incorporating all the variability in “available weather data since 1968, to
20 simulate a range of likely daily average prices....”
- 21 ▪ In his 2003 technical conference presentation on rates, Mr. Rose’s
22 background materials state that “actual rates will be based on average

1 historical load data.” That appears to contradict both of the other
2 descriptions.

3 In short, CG&E appears to describe an enormous effort, which it has not even
4 designed, let alone implemented. The types of statistical methods mentioned as
5 candidates for this purpose involve considerable professional judgment in their
6 application; their implementation should not be regarded as mere detail.

7 Regulatory review of this effort should involve extensive investigation, including
8 the use of technical conferences and stakeholder meetings. In my opinion, this
9 matter and other matters that should be reviewed would require another regulatory
10 proceeding to resolve important issues.

11

12 ***Q59. IS IT CLEAR WHETHER CG&E INTENDS TO PERFORM THE LOAD-***
13 ***WEIGHTING COMPUTATION BY CLASS OR CUSTOMER?***

14 ***A59.*** It appears that CG&E expects to use hourly meter data for all customers with
15 interval meters, but it is not clear whether this is mandatory or discretionary.

16 “Load [is] estimated from profile group if customer lacks hourly meter.”

17 (Application, Exhibit 2, Sheet 101, page 1 and Sheet 102, page 1) The situation is
18 clearer for the larger customers. The Company will install interval meters at all
19 facilities with demand exceeding 500 kW. Meters would be installed for
20 customers on rates SEP-HP and SEP-HPF, but accounts with less than 500 kW
21 would pay the incremental cost of installation.

22

1 Nowhere does the Company specify which actual customer data would be used in
2 determining the load-weighted price. Nor is it clear when or how CG&E would
3 reflect changes in customers' operations or equipment that shifts load.

4 The Company has not explained the "principles" that would guide its
5 development of MBSSO rates for residential customers.

6

7 ***Q60. DOES CG&E PROPOSE TO USE ALL THE ACTUAL METERING DATA***
8 ***AVAILABLE WHEN THE CUSTOMER IS BILLED?***

9 ***A60.*** No. The Company claims that:

10 CG&E would begin to transition customers from prices based on
11 broadly-averaged load profiles... to prices that more appropriately
12 reflect each customer's specific load pattern, either using hourly
13 usage (for interval meter customers) or monthly usage (for non-
14 interval meter customers). (Application Exhibit 1 at 5-6)

15 But other portions of the Application and testimony indicate that CG&E does not
16 intend to use actual billing data to inform its computation of customer load. The
17 price CG&E would charge through the entire year (in rate FPY), for the contract
18 period (in rate FPV) or for each day (in HP and HPF) would depend on the
19 customer's, or class's previous or estimated or simulated pattern of monthly usage.

20

1 ***Q61. DOES CG&E CONSISTENTLY ASSERT THAT ITS ESTIMATE OF LOAD-***
2 ***WEIGHTED MARKET PRICES WILL BE BEST ESTIMATES?***

3 ***A61.*** No. In his testimony (page 44, Exhibit JLR-36) Mr. Rose claims (in defending the
4 flex-down) that the prices will be computed for “block on-peak load shapes” and
5 that the use of actual load shape "lowers the CMO MBSSO offering by 5%–25%.
6 This occurs as the supplier bids for an actual on-peak load shape rather than a
7 block of on-peak load shape." It is worth referring at some length to the relevant
8 portion of the Application (page 10, first full paragraph), in an attempt to clarify
9 this point:

10 Where hourly level estimation is not able to produce adequate
11 models...or where data is insufficient, simpler methods can
12 produce reasonable approximations of the load-weighted energy
13 risk. For example, a commonly used blocking approach values
14 peak vs. off-peak load blocks where a peak block is created by
15 using the peak load that occurs during peak hours and multiplying
16 it by the peak price for that period (usually a month), creating a
17 block load of peak power. To this, we add the off-peak block
18 cost...In essence, this approach assumes that a customers load
19 shape is a series of peak and off-peak load blocks.

20

1 **Q62. WHAT DOES THIS STATEMENT MEAN?**

2 **A62.** Like much of the technical discussion in the Application and in Mr. Rose's
3 testimony, the meaning is at best complicated and at worst confusing. That being
4 said, what I take this statement to mean is that where customers' patterns of
5 energy use are for some reason unknown, their peak period energy usage for the
6 peak period in a month) is *assumed* to be equal to their peak *hour* usage
7 multiplied by the number of peak hours in the month. (5 X 16 times the number of
8 weekdays in the month). This would only be correct in the extreme circumstance
9 in which these customers' load during that period was flat. Accordingly, as
10 information becomes available regarding the degree of variability of customer
11 loads, the MBSSO energy prices are shown to be too high and can be reduced.
12 The mechanism through which this would occur is a reduction in the weight
13 assigned to (more expensive) on-price usage and a corresponding increase in the
14 weight assigned to (less expensive) off-price usage.

15

16 **Q63. WHAT CONCLUSION DO YOU DRAW REGARDING THIS PRICING**
17 **FEATURE?**

18 **A63.** Mr. Rose's testimony, which shows that prices will be above costs for certain
19 groups of customers and can therefore be reduced to some extent before pricing
20 becomes predatory, confirms that CG&E intends to initially err on the side of
21 overcharging customers.

1 3. Covariance

2 ***Q64. IS THE COVARIANCE OF LOAD AND PRICE AN APPROPRIATE***
3 ***ADJUSTMENT TO RETAIL SERVICE PRICES?***

4 ***A64.*** It can be, depending on the manner in which the load-weighting is computed. For
5 example, if the load-weighted prices are computed for normal load shape, using
6 one typical week for each month, the load weights would not include the
7 additional covariance of load and price among the on-peak hours of April, or
8 among the off-peak hours of August.

9
10 ***Q65. IS THIS HOW CG&E PROPOSES TO USE A COVARIANCE***
11 ***COMPUTATION?***

12 ***A65.*** No. CG&E appears to be double-counting, given the extensive analysis of
13 covariance of load and market price in its discussion of load-weighting. CG&E’s
14 description of covariance is indistinguishable from that of load-weighting
15 (Application Exhibit 1 at 10; Rose Testimony at 18) The Company proposes to
16 compute covariance “over varying weather conditions” (Exhibit 1, 10), while the
17 load-weighting is supposed to reflect all the variability in weather conditions
18 since 1968. SEP-FPY and SEP-FPV tariffs provide that the hourly price will be
19 computed from the forward on- and off-peak prices with an hourly shaping
20 adjustment, so a large amount of covariance of load and prices are already
21 captured in the load-weighted hourly forward price.

22

1 **Q66. HOW DOES CG&E PROPOSE TO COMPUTE COVARIANCE?**

2 **A66.** The Company intends to compute covariance for some customers, but does not
3 exactly describe which customers or how the computation would be conducted.

4 For example, it is not clear:

- 5 • Whether covariance would be computed for all customers with interval
6 meters.
- 7 • Whether covariance would be computed for any customers without interval
8 meters.
- 9 • For what historical period the computation would be conducted, or what the
10 Application means by “insufficient hourly or monthly data.” (Exhibit 1, 10).
- 11 • Whether all available load data will be used to compute the covariance.

12

13 **Q67. WHAT IS THE BASIS FOR THE 10% DEFAULT COVARIANCE FACTOR**

14 **PROPOSED BY THE COMPANY?**

15 **A67.** Mr. Rose states (Testimony at 18) that the default covariance factor of 10% is
16 “based on experience,” but the Company has not provided any description of such
17 an experience, data or computations, or even the period of the experience or the
18 type of analysis the Company claims to have undertaken.

19

1 **Q68. IS THE COMPANY'S APPROACH OF COMPUTING COVARIANCE ON AN**
2 **ANNUAL (OR CONTRACT-LONG) BASIS APPROPRIATE?**

3 **A68.** No. If the Company were to go to all the trouble it proposes in load-weighting
4 prices and estimating covariance, it should retain as much data as possible, rather
5 than averaging out effects over a year. Covariance almost certainly differs across
6 months, and between peak and off-peak hours. Once CG&E computes a load-
7 weighted cost for the on-peak and off-peak periods in each month (and assuming
8 that does not include so much load variability as to subsume the covariance
9 computation), CG&E should compute and apply covariance separately for each of
10 those pricing periods. If the ratios of monthly on-peak and off-peak prices in the
11 forward price curve is similar to the historical ratios, this approach would produce
12 results much like those in CG&E's approach. But since seasonal and period prices
13 may move separately, assuming the same covariance for the entire contract period
14 may over- or under-estimate CG&E's expected cost. For example, if gas prices
15 are low and load is soft, the high-covariance peak-period prices are likely to fall
16 more than the off-peak prices, resulting in an overall decline in covariance.

17
18 **Q69. HAS A COVARIANCE FACTOR BEEN PREVIOUSLY INCORPORATED IN**
19 **REGULATORY DECISIONS?**

20 **A69.** Not to my knowledge. Nor is the Company aware of any regulatory precedent for
21 this procedure. (Response to OCC-INT-04-160, Attachment NHT-10)

1 **C. Proposed Adders to the Adjusted Market Prices**

2

3 ***Q70. IS THE COMPANY PROPOSING FURTHER ADDERS TO THE ADJUSTED***
4 ***MARKET PRICES?***

5 ***A70.*** Yes. While the previous items were adjustments intended to convert market
6 indices into relevant retail market prices, the Company has also proposed other
7 adders. I will discuss these in turn.

8

9 1. Supply Management

10 ***Q71. WHAT COSTS DOES CG&E PROPOSE TO COLLECT THROUGH THE***
11 ***SUPPLY MANAGEMENT ADDER?***

12 ***A71.*** That is unclear. The Company provides only a rambling description of a vague
13 and ill-defined category of costs, including:

- 14 • “costs related to supply, procurement and risk management”
- 15 • risk of floating prices to customers
- 16 • odd-lot premiums
- 17 • liquidity risk when the MDP ends

18

1 **Q72. WHAT ARE THE “COSTS RELATED TO SUPPLY, PROCUREMENT AND**
2 **RISK MANAGEMENT”?**

3 **A72.** The Company does not provide the details. Without details these costs cannot be
4 justified.

5

6 **Q73. HAS THE COMPANY PROVIDED ANY QUANTITATIVE ESTIMATE OF**
7 **SUPPLY MANAGEMENT COSTS?**

8 **A73.** The Company is claiming 10% of generation costs, based on "FERC's past
9 practice on 'difficult to quantify' parameters of 10% regarding third party
10 wholesale transactions." (Application Exhibit 1 at 18). This is hardly a specific
11 cost estimate. It does not reflect FERC's *current* practice, and the Company
12 cannot provide any guidance as to FERC's current views. (Response to OCC-
13 POD-04-026, Attachment NHT-11) Nor can the Company provide any evidence
14 that supply management risks impose costs of 10%, 5% or even 1%. (Responses
15 to OCC-POD-04-023/4/5, Attachment NHT-12)

16

17 **Q74. DOES CG&E EXPAND ON ITS ASSERTED RISK OF FLOATING PRICES**
18 **TO CUSTOMERS?**

19 **A74.** Not much. In Application Exhibit 1 at 18, CG&E asserts that the “price float is
20 assumed to be necessary to minimize customer confusion and provide customers
21 with ample opportunity to make reasoned choices between CG&E and other
22 market suppliers.” In this quote, CG&E suggests (but does not affirmatively state)
23 that it will honor price quotes that the Company makes to customers.

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The Company has not even been able to decide how long it would be “floating” those risks. The Application says that “CG&E incurs risk by floating prices to customers 30 days between billing cycles” (Exhibit 1 at 18), while Mr. Stevie claims CG&E would be floating prices for 45 days (Testimony, page 13). It is not clear what billing cycles CG&E thinks it will float prices between.

Q75. HOW LONG WOULD THE COMPANY KEEP PRICE OFFERS OPEN, IF THAT IS WHAT THE COMPANY MEANS BY “FLOAT”?

A75. The Company does not appear to have proposed any float. Some new customers would pay a price as that is determined daily. The Company has no quantification or monetary valuation of the risk imposed by floating prices to customers. (Response to OCC-POD-04-021, Attachment NHT-13)

Q76. WHAT ARE ODD-LOT PREMIUMS?

A76. The Company states that, “As customers leave, CG&E must put load back to the market...in blocks that are usually much less than 50 MW.” (Application Exhibit 1 at 18). However, 50 MW is just a few percent of MBSSO load, assuming MBSSO service is the primary standard service offer. It is unlikely that CG&E would try to match forecasted load so closely. Rather, it would buy and sell in the spot market to balance. Any one customer returning is as likely to reduce the size of an hourly odd-lot surplus as to increase the size of an hourly odd-lot deficit. CG&E may lose some customers and gain new ones, existing customer loads may

1 change, and weather may be more or less extreme than forecasted. Any one
2 change may simply offset others. CRES providers that gain CG&E customers will
3 need to buy small amounts that match the small amounts of excess CG&E will
4 have for sale. The Company does not have any data supporting higher prices for
5 odd lots. (Response to OCC-POD-04-020, Attachment NHT-14) In my opinion,
6 there should not be any significant adder for odd lots.

7

8 ***Q77. DOES CG&E FACE “LIQUIDITY RISK” (APPLICATION EXHIBIT 1 AT***
9 ***18)?***

10 ***A77.*** CG&E provides no evidence that the problem CG&E anticipates “when the MDP
11 ends and CG&E goes to market” actually occurred in any state other than
12 California for any utility for which initial power supply arrangement in the
13 restructuring process has ended (e.g., Pennsylvania, New Jersey, Maryland). At
14 the end of the MDP, CG&E will be selling into (or releasing to) the market all the
15 generation that has been serving its generation customers. It could then be
16 purchasing the same amount of power (some directly transferred from its own
17 generation and some from the market) to serve MBSSO. So there does not appear
18 to be a liquidity problem. The party most likely to become aware of the timing
19 and need for CG&E’s MBSSO load, and likely to sell CG&E most of the power
20 for MBSSO, is its own generation operation. If CG&E overcharges itself for
21 generation to serve MBSSO load, CG&E is not disadvantaged. Customers are,
22 however, penalized.

23

2. Operating Risk

Q78. PLEASE ADDRESS THIS PROPOSED COST COMPONENT.

A78. The Company provides only a rambling discussion of a vague category, including (Application Exhibit 1 at 18–19, line 2), booking and settlement error, modeling error, forecasting/methods risk, contract risks, delivery risk, security risk, personnel risk, programming error, faulty data, meter read error, information system risk, telecommunications failure, legal risk, regulatory risk, natural disasters, economic downturns, political disruption, and other unexpected events.

Q79. IS IT POSSIBLE TO ASSESS AND QUANTIFY ALL THESE FACTORS?

A79. No. CG&E does not explain the nature of each factor, explain how they differ from one another (e.g., modeling versus forecasting), explain how each arises, explain how the factor imposes costs on CG&E, explain why variations in the factor do not tend to balance out (e.g. overestimating for one customer, underestimating for another; buying too much energy one day, too little another), or quantify or value the risk. Many of these categories appear to be drawn from contract boilerplate, and don't appear likely to be real risks for CG&E: for example "political disruption," "economic downturns" (within a one-year contract?), "natural disasters" (what natural disasters would affect MBSSO, and how?), "regulatory risk" (what is CG&E asking for compensation for?).

1 **Q80. IS THERE POTENTIAL DOUBLE-COUNTING HERE?**

2 **A80.** Yes. There is, for example, potential double counting of provisions for legal costs
3 in existing rates and *legal risk, contract risk, delivery risk*. There may be double-
4 counting in some of the other items, depending on what they mean. Covariance
5 and load weighting; *economic downturns; booking and settlement error* and
6 “costs related to supply, procurement and risk management” in supply
7 management; and *contract risk* with uncollectibles.

8

9 **Q81. SHOULD SOME OF THESE RISKS BE AVOIDABLE?**

10 **A81.** Yes. CG&E (App Exhibit 1 at 18-19) asks ratepayers to pay for CG&E’s errors in
11 booking, settlement, modeling, and programming. This is entirely inappropriate.

12

13 **Q82. DOES CUSTOMER MIGRATION IMPOSE COSTS ON CG&E?**

14 **A82.** CG&E provides no evidence demonstrating that the net effect of customer
15 migration is a cost to CG&E, let alone quantifying that supposed cost.

16

1 ***Q83. ARE THE VALUE LINE DATA ON OPERATING MARGINS RELEVANT***
2 ***TO CG&E?***

3 ***A83.*** No. Operating margin covers such items as cost of capital (interest on debt and
4 return on equity), taxes, depreciation and amortization, and other fixed cost items.
5 The Value Line data (Application Exhibit 1 at 19) are not applicable to CG&E as
6 a retail generation provider. The data on which the 13.4% adjustment is based is
7 an (updated) ten-year average of 16.5% for all industries less 3.1% sales, general
8 and administrative costs for electric utilities – central (Value Line reports
9 separately on industries in the west, central region, and east.) This is a mismatch
10 of industry coverage – all-industry data and electric utility data being used
11 together. Moreover, the utility data is for utilities that are still mostly integrated,
12 and does not refer to utility-provided retail generation. Nor does it reflect the cost
13 and margin structure of competitive retailers. Finally, inspection of the data
14 shows that it is totally unreliable. (Response to OCC-POD-03-002, Attachment
15 NHT-15) For example, the ratio of sales, general and administrative costs to sales
16 revenues is given as 3.06% (rounded to 3.1% by Mr. Stevie) for electric utilities -
17 central, but only 0.39% for central utilities-east and 1.06% for electric utilities –
18 west. There is no way that utilities in the central and eastern regions should have
19 SG&A ratios that vary by a factor of nearly 8:1. The data on electric utility
20 operating margins also varies considerably by year and region. Mr. Rose lists the
21 cost components (Testimony at 20), but doesn't give any details, and offers no
22 other empirical basis for the 13.4% adder.

23

1 **Q84. WHAT IS YOUR CONCLUSION REGARDING THE PROPOSED**
2 **OPERATING RISK ADJUSTMENT?**

3 **A84.** Since the Value Line data are relevant to neither the operating margin of CG&E's
4 retail generation service nor that of a competitive retail supplier, there is no
5 reliable quantitative basis for the Company's proposed adjustment.

6
7 3. Credit Adder

8 **Q85. WHAT IS THE NEXT ADJUSTMENT CG&E PROPOSES TO MAKE?**

9 **A85.** CG&E proposes a 1.5% increase to the cumulative charge for bad debt. As stated
10 in the CG&E Initial Comments (page 4), this charge would be assessed to all
11 MBSSO ratepayers because the entire generation bill is supposedly subject to
12 credit risk.

13
14 **Q86. HAS CG&E DESCRIBED THE CALCULATION OF THIS FIGURE?**

15 **A86.** To an extent, Mr. Stevie states that “the expense is calculated as the net charge-
16 off dollars (net of taxes) for the month divided by the 12-month total CG&E gas
17 and electric revenue as of nine months ago (i.e., with a nine month lag)” (Stevie
18 Testimony at 14). However, it is unclear whether Mr. Stevie’s statement describes
19 how frequently the percentage adder will change going forward, or how the fixed
20 1.5% adder—as set forth in the Application—was calculated. The former
21 interpretation conflicts with the Application, in which CG&E suggests that it
22 intends to update this adjustment intermittently: “as actual costs for uncollectible
23 accounts change” (Application, Exhibit 1 at 19). If this statement refers to the

1 method used to calculate a fixed percentage adder, CG&E should provide
2 information about the data used in calculation (e.g., which twelve months of data)
3 and the data itself to verify the accuracy of this charge.

4
5 ***Q87. DO YOU HAVE ANY CONCERNS REGARDING THE APPLICATION OF***
6 ***THIS CHARGE?***

7 ***A87.*** Yes. As CG&E points out, returning customers are more likely to have credit
8 problems (Application, Exhibit 1 at 19). Should CRES suppliers put consumers
9 with poor credit histories or uncollectible accounts back on the MBSSO, the
10 charge will undoubtedly increase over time, as nonpayment rates rise. Applying
11 this charge to MBSSO customers exclusively places a higher burden on those
12 with the least ability to pay.

13 **D. Rate Flex-Down Provision**

14 ***Q88. PLEASE DESCRIBE THE PROPOSED RATE FLEX-DOWN PROVISION.***

15 ***A88.*** The proposed rate flex-down provision is listed in the Company's January 10,
16 2003 Application (at 8, Item No. 9), and is described in more detail in Mr. Rose's
17 Application Exhibit 1(at 21-22). This proposal seems to me so wholly
18 unacceptable in any form that I will describe it general terms, rather than getting
19 into details.

20

1 **Q89. PLEASE PROCEED.**

2 **A89.** In general terms, the provision would give the Company the option to reduce its
3 MBSSO prices if and when it loses market share in the retail market. The greater
4 the share it loses, the more it may reduce its prices. Under no circumstances,
5 however, may it reduce prices below the marginal wholesale purchased cost of
6 power.

7

8 **Q90. WHY IS THIS PROVISION WHOLLY UNACCEPTABLE?**

9 **A90.** The rate flex-down provision is based on a completely erroneous view of the role
10 of an electric distribution utility (EDU), like CG&E, as a competitor in the retail
11 marketplace, rather than a provider of last resort in an otherwise competitive
12 marketplace. While a CRES might legitimately seek to maintain or regain market
13 share by reducing prices or refining its offer, an EDU, as a provider of last resort,
14 is or should be in a wholly different situation. One of the criteria for success in
15 the transition to retail competition is the proportion of customers who, over time,
16 switch from utility service to competitive suppliers. As noted earlier, one of the
17 Commission's stated objectives is "further competitive market development." A
18 rate flex-down option, being clearly aimed at maintaining or regaining the EDU's
19 retail market share, threatens to undermine the development of the competitive
20 market and is a violation of the corporate flex-down requirements.

21

1 **Q91. FROM AN ECONOMICS STANDPOINT, HOW WOULD THIS TYPE OF**
2 **PRICING BE CHARACTERIZED?**

3 **A91.** It would be characterized as predatory pricing, which I defined earlier.

4

5 **Q92. WOULD CG&E'S PRICES BE AT "UNPROFITABLE LEVELS" IF IT**
6 **EXERCISED ITS FLEX-DOWN OPTION?**

7 **A92.** Yes. The Company's construction of MBSSO prices are, or should be, aimed at
8 producing price levels that are fully costed. Reduction of prices below these
9 levels would be *prima facie* unprofitable. This is clear if you consider the lower
10 limit to prices under the flex-down option, which is the wholesale price of
11 electricity. Since at this level there is no margin whatsoever to cover the costs and
12 risks of providing retail service (i.e., there is no retail price adder), this level
13 would be unprofitable to CG&E. No doubt, once competitors had been driven
14 back, CG&E would raise its prices again to profitable levels. This fits the
15 definition of predatory pricing behavior.

16

17 **Q93. SO WOULD COMPETITION BE HARMED, NOT "ENHANCED," BY THIS**
18 **PROVISION?**

19 **A93.** Yes. Competition would be impeded in two ways. Clearly, by reducing prices if
20 and when competitors succeed in increasing their market shares, the flex-down
21 option gives the EDU an opportunity to maintain or increase its market share at
22 the expense of the shares of the competitors. However, there is another problem --

1 potential market entrants would be deterred from entering the market in these
2 circumstances. Not only would they be facing an incumbent monopolist with 80%
3 or 95% market share (CG&E has these shares in non-residential and residential
4 markets respectively today), they would be facing one that has the ability to
5 undercut their offerings just when they were beginning to reduce the degree of
6 monopoly.

7

8 ***Q94. MR. ROSE CLAIMS THAT "THIS ENHANCED COMPETITION***
9 ***GENERATES MARKET EFFICIENCIES, PROVIDES MORE CHOICES TO***
10 ***CUSTOMERS, AND PROTECTS AGAINST CRES PROVIDERS***
11 ***POTENTIALLY OVER-CHARGING CUSTOMERS, PARTICULARLY***
12 ***WHEN ONE OR TWO SUPPLIERS DOMINATE A MARKET OR SECTOR."***
13 ***(APPLICATION EXHIBIT 1 AT 21) DO YOU AGREE?***

14 ***A94.*** No. Standard service offer is or should be designed to provide customers with a
15 fall-back service during the transition to competition. Of course, it should not be
16 over-priced, particularly during periods when "one or two [retail] suppliers
17 dominate a market or sector" and the retail market is therefore only semi-
18 competitive. The solution to the problem of over-pricing is to carefully set the
19 MBSSO price close to a competitive level of costs. If, despite the appeal that is
20 inherent in standard service, the market shares of competitive providers increase
21 over time, this should be welcomed and not undermined. An increase in the
22 number of competitors is ultimately the answer to the problem of having only one
23 or two suppliers dominating the market, not a move back toward bolstering the

1 position of an incumbent monopolist and thereby reducing competition. An
2 increase in the number of competitors is also the best way to increase the range of
3 choices open to customers.

4

5 ***Q95. IS YOUR APPROACH CONSISTENT WITH THE COMMISSION'S VIEWS***
6 ***REGARDING THE NATURE OF THE MBSSO?***

7 ***A95.*** I believe it is. In its December 17, 2003, Order with reference to CG&E's
8 preference for flexible rates, the Commission stated that both the MBSSO and
9 CBP should be on a "revenue-neutral basis and not on a for-profit basis." I take
10 this to mean that the Company should cover its reasonable costs of providing
11 these services, but should not have any incentive to maximize profits.

12

13 ***Q96. DO YOU HAVE ANY FURTHER COMMENTS ON CG&E'S PROPOSED***
14 ***FLEX-DOWN OPTION?***

15 ***A96.*** Yes. Mr. Rose has considered refining flex-down, saying, for example, that it
16 might be "based on actual load shape." (Rose Testimony at 44) I believe that
17 attempts of this kind to fine-tune MBSSO pricing are inappropriate. In my
18 opinion it would be more appropriate to design MBSSO as a plain vanilla
19 alternative to competitive market offerings. One of the ways in that competitors
20 would be able to gain market share over time would be for them to fine-tune their
21 pricing and service offerings. This would be a favorable development that should
22 not be impeded.

1 A rate flex-down provision, if applied differentially between customers, could
2 also be regarded as discriminatory pricing.

3

4 Finally, since MBSSO would on the face of it be unprofitable, it is not clear who
5 would absorb the lost profits -- the Company's shareholders or, in some manner,
6 ratepayers. Either way, the loss of profits would be problematic.

7

8 ***Q97. DOES ALL THIS MEAN THAT UTILITIES SHOULD NOT BE ALLOWED***
9 ***TO COMPETE IN THE RETAIL ELECTRICITY MARKET IN THEIR***
10 ***DISTRIBUTION SERVICE TERRITORIES?***

11 ***A97.*** No. S.B. 3 permits utility holding companies like CG&E's parent Cinergy to
12 compete in the retail market through marketing subsidiaries, provided they meet
13 the requirements of corporate separation from their affiliate EDU and abide by an
14 appropriate code of conduct. What is not envisioned in the legislation is that the
15 EDU itself would participate in the retail electricity market in its service territory,
16 apart from its roles as a distribution entity and as provider of last resort.

17

18 1. Outline Of A Better MBSSO Structure

19

20 ***Q98. IS THERE A SOLUTION TO THE PROBLEM OF ERRORS AND***
21 ***UNCERTAINTY IN THE SIMULATED MBSSO RATE IN ORDER TO***
22 ***PROVIDE RESIDENTIAL CUSTOMERS WITH A STANDARD SERVICE***
23 ***OFFERING?***

1 **A98.** Yes, there is a solution that would set rates closer to competitive pricing and would
2 avoid both over-charging and under-charging of CG&E's allocated retail costs. This
3 solution would base recovery on the utility's actual costs of buying wholesale
4 electricity in the generation market, to which would be added a retail adder for an
5 appropriate allocation of overhead administrative costs. A true-up to reconcile any
6 over or under collections could occur twice a year at the conclusion of summer and
7 winter periods. A mechanism such as a traditional fuel and purchased power
8 adjustment clause could be used. Like such traditional mechanisms, the process
9 should be subject to oversight as a check on the reasonableness of the utility's
10 administration of the process.

11

12 ***Q99. DO ANY CONDITIONS NEED TO BE PRESENT IN ORDER TO***
13 ***EFFECTIVELY IMPLEMENT YOUR PROPOSED SOLUTION?***

14 **A99** Yes. I believe those conditions are consistent with the Commission's ETP Order and
15 Commission's existing rules on the subject of post-MDP service options. My
16 proposal would work best under conditions where CG&E's distribution operations
17 are separated from their generation operations and where customers who do not
18 choose a competitive provider of generation service are provided service at prices
19 determined through the competitive bidding process. These conditions are consistent
20 with my understanding of Revised Code Section 4928.14 and the provision in the
21 Commission's rules concerning service in the post-MDP period (stated in an
22 attachment to a December 17, 2003 Order in Case No. 01-2164-EL-ORD) that the
23 bid pool must include "residential and small general service customers who have not

1 chosen” such a provider of generation service. Also, the Commission’s ETP Order
2 (August 31, 2000 in Case No. 99-1658-EL-ETP at page 46) states that transfer of the
3 Company’s generating assets to an EWG should take place “as proposed by the
4 company ...by December 31, 2004.”

5
6 ***Q100. HOW ARE THESE CONDITIONS IMPORTANT TO YOUR PROPOSED***
7 ***SOLUTION?***

8 ***A100.*** The oversight task would be greatly complicated if these conditions do not exist. If
9 CG&E supplied large blocks of generation to implement its MBSSO by means of
10 self supply (i.e. in the absence of arm’s-length negotiations), the resulting pricing
11 may not be “market-based.” Considerable effort would be needed to determine the
12 appropriateness of the Company’s results.

13
14 ***Q101. DO YOU HAVE ANY OTHER RECOMMENDATIONS CONCERNING THE***
15 ***DEVELOPMENT OF A MBSSO FOR RESIDENTIAL CUSTOMERS?***

16 ***A101.*** Yes. The solution that I have described is based upon use of actual markets to
17 provide a “market based” MBSSO. Alternatives that are based on arm’s-length
18 bargaining in a market may present themselves over time, such as the availability of
19 pricing information related to market development for the Midwest Independent
20 System Operator. Improvements to CG&E’s MBSSO might be possible over time,
21 and the Commission should remain open to adjustments to take advantage of
22 developments in the market for generation services.

1 ***Q102. WOULD SUCH A RATE SATISFY THE COMMISSION'S THREE CRITERIA?***

2 ***A102.*** I believe it would. Clearly, the Company's financial stability would be assured. (Note

3 that by allowing for recovery of costs actually incurred, financial risk is reduced. No

4 compensation would be needed for risks other than those actually reflected in costs.)

5 Rate certainty is provided by implementing an effective competitive bidding plan

6 that would serve most customers who do not choose a generation provider,

7 supplemented by my proposed MBSSO that could include a smoothing mechanism

8 to reduce rate volatility for the remainder of the customers who are not served by a

9 competitive retail electric supplier. Since the MBSSO rate would have to bear the

10 full costs of supply, including the overhead of the utility, it would not undercut

11 competitive offerings that may be available if non-bypassable charges are not

12 instituted so as to stifle competition.

13

14 ***Q103. WOULD A STANDARD SERVICE OFFER BASED ON ACTUAL MARKET***

15 ***COSTS BE "MARKET BASED" AS REQUIRED BY S.B. 3?***

16 ***A103.*** I believe that it would be, because most of the costs incurred by the Company

17 would be competitively acquired in the electricity market. My proposal

18 emphasizes the need to base pricing on transactions that occur at arm's-length

19 between market participants.

20

1 ***Q104. HAS THE COMPANY EXPRESSED AN OPINION REGARDING A***
2 ***MECHANISM SUCH AS THE ONE YOU HAVE DESCRIBED?***

3 ***A104.*** Yes. Mr. Rose states that "The Company is opposed to a mechanism that would
4 reconcile recoveries and actual costs, like a fuel adjustment mechanism, under the
5 CMO MBSSO. This is a benefit that is not available to CRES providers and
6 would not create a level playing field." (Response to OCC-INT-04-129,
7 Attachment NHT-16)

8 ***Q105. IS MR. ROSE'S OBSERVATION REGARDING A LEVEL PLAYING FIELD***
9 ***VALID?***

10 ***A105.*** In the circumstances, no. Other factors would offset the reduction in risk to the
11 Company, including full allocation of administrative and overhead costs
12 (administration might not be as efficiently organized as it is by some CRES
13 providers), and limitation of the MBSSO to plain vanilla offerings. Meanwhile,
14 retail customers would be protected by MBSSO pricing that does not have a
15 number of uncertain adders in it. Contrast this with the Company's approach,
16 which is exemplified in the follow exchange (OCC-INT-04-137, Attachment
17 NHT-17):

18 Is the Company claiming that risk-related costs should be included
19 even if they are not actually incurred, in order to boost the price of
20 MBSSO so as not to undermine competitors?

1 Yes, in part. The Company also must be compensated for the
2 entrepreneurial effort involved in making the CMO MBSSO work,
3 just like energy marketers try to obtain an operating margin.

4 And again, "The operating margin covers the entrepreneurial margin." (Response
5 to OCC-INT-04-190, Attachment NHT-18) I don't think the quality of
6 entrepreneurial effort or risk is the same for CG&E as it is for a CRES, which
7 stands to lose its entire investment in a market. Besides, the margin is not
8 reasonably measurable. The Company admits: "There are no quantifications of
9 the individual risks." (Response to OCC-INT-04-191, Attachment NHT-19)

11 **IV NON-BYPASSABLE POLR CHARGE**

12 ***Q106. PLEASE DESCRIBE CG&E'S PROPOSED PROVIDER OF LAST RESORT*** 13 ***CHARGE.***

14 ***A106.*** This proposed charge would be non-bypassable and accordingly would be paid by
15 all customers including those that have switched to competitive electricity
16 providers. As described by Mr. Rose (Application Exhibit 1 at 11),

17 The need for tariffs to reflect the cost of reserves arises from two
18 sources:

- 19 1. Traditional factors of spinning reserves, forced outages and
20 weather uncertainty,
- 21 2. New factors related to the risk of CRES provider or bilateral
22 contract provider default, withdrawal from the market, or of

1 CRES provider "gaming" of regulatory rules by encouraging
2 customers to return to POLR service during high price times.

3
4 **A. FIXED CHARGE FOR TRADITIONAL RESERVE MARGIN**
5 **REQUIREMENTS**

6
7 ***Q107. PLEASE DISCUSS THE TRADITIONAL FACTORS FIRST.***

8 ***A107.*** Clearly, the problem of reliability is an inescapable one for the electricity system.
9 Reliability at the distribution level is the responsibility of the EDU. Reliability of
10 the bulk power system is assured by coordinated operation and development of
11 transmission and generation. The blackout of August 14, 2003 reflected primarily
12 failures in the operation of the transmission system. The responsibility for
13 coordinating the regional transmission system is being given to the Midwest
14 Independent System Operator (MISO), which will sooner or later have the means
15 to ensure that transmission-owning utilities do what needs to be done to maintain
16 reliability. What CG&E's proposed Rider POLR addresses is the need for
17 adequate regional *generation* reserves.

18
19 ***Q108. WHY DO YOU REFER TO REGIONAL GENERATION RESERVES***
20 ***RATHER THAN CG&E'S RESERVES?***

21 ***A108.*** When it comes to the reliability of the bulk power system, the regional system
22 stands or falls together. When reliability is threatened, normal commercial
23 considerations are overridden by the emergency requirements of the system.

1 ***Q109. WHICH ENTITY OR ENTITIES ARE RESPONSIBLE FOR MAINTAINING***
2 ***ADEQUATE GENERATION RESERVES?***

3 ***A109.*** The region is in a transitional period during which responsibility is being shifted
4 from utilities loosely coordinated by ECAR to new arrangements under the
5 auspices of MISO. It seems certain that MISO will take steps to ensure that there
6 are sufficient generation reserves in the region. Exactly *when* it will do this is not
7 clear, but it seems likely that measures will be in place by sometime in 2005. The
8 most likely step MISO will take is to require that all load-serving entities,
9 including CRES providers, will have to maintain or contract for reserve margins
10 to cover their customers' loads.

11 ***Q110. PENDING THE DEVELOPMENT OF MISO RULES REGARDING***
12 ***GENERATION RESERVES, IS CG&E'S PROPOSAL THE RIGHT WAY TO***
13 ***GO?***

14 ***A110.*** It is certainly a feasible way to go. And, by holding reserves for all the retail load
15 in its area, it would provide a high degree of certainty that there will be sufficient
16 generating capacity. However, I am skeptical about the proposal. It seems to me
17 retrograde and partially duplicative, and it appears to involve overkill in the
18 current factual circumstances of MISO and ECAR.

19

1 ***Q111. WHY DO YOU REGARD CG&E'S PROPOSAL AS RETROGRADE?***

2 ***A111.*** It proposes to make CG&E solely responsible for generating reserves in its area,
3 just when alternative approaches based on the new competitive generation market
4 are under consideration.

5
6 ***Q112. WHY DO YOU REGARD CG&E'S PROPOSAL AS PARTLY DUPLICATIVE?***

7 ***A112.*** To the extent that CRES providers themselves provide for generating reserves
8 (which they either own or contract for), CG&E's reserves would be duplicative.
9 They would also result in overlapping charges for those customers who had
10 switched to the CRES providers in question.

11
12 ***Q113. WHY DO YOU SAY THE PROPOSAL APPEARS TO INVOLVE OVERKILL***
13 ***IN THE CURRENT FACTUAL CIRCUMSTANCES OF MISO AND ECAR?***

14 ***A113.*** The Company seems to assume that there is a danger of inadequate generating
15 reserves in the ECAR or MISO area during the interim period until new rules are
16 established. That period is likely to end by December 2004 or sometime during
17 2005. That assumption does not appear to be founded in fact. ECAR projects
18 reserve margins over 38% through 2008. No new generating capacity will likely
19 be required until 2010 or after. Mr. Rose acknowledges that,

20 "Reserve margins in Ohio, the Midwest and in most areas of the U.S. are
21 currently high. This means the chances for shortages at the system peak in

1 the immediate term are low. Also, the market has demonstrated its ability
2 to increase supply in response to high prices. (Testimony at 33)

3
4 ***Q114. HOW WOULD YOU PROPOSE THAT THE ISSUE OF GENERATING***
5 ***RESERVES BE DEALT WITH IN THE PRESENT MATTER?***

6 ***A114.*** CG&E should be required to have generating reserves for its own retail load,
7 period. And the general adequacy or otherwise of the bulk power system should
8 be monitored by the utilities and the Commission during the interim period until
9 new MISO rules are adopted. Finally, to the extent that reserve capacity is held by
10 CG&E, its sales of power or energy from that capacity should be netted out
11 against the costs incurred.

12
13 **B. VARIABLE CHARGE RELATED TO POTENTIAL CUSTOMER**
14 **MIGRATION**

15
16 ***Q115. PLEASE DESCRIBE THIS PROPOSED CHARGE IN MORE DETAIL.***

17 ***A115.*** The Company proposes to acquire call options (rights to buy power in the future
18 if needed at agreed-upon prices, but no obligation to buy it if it is not needed) to
19 cover certain percentages of switched load, in case that load returns. "(T)here are
20 real risks of supply shortfalls in the case of massive customer migration to the
21 default provider. CRES providers cannot be assumed to be unerringly certain to
22 have contracted for their customers' needs, nor certain that those supplies are both
23 reliable and deliverable to the market (i.e. without transmission constraints). Also,

1 the index price might not properly measure the actual cost of obtaining supply
2 and this could lead to default supplier financial default." (Application Exhibit 1 at
3 15)

4

5 ***Q116. SPECIFICALLY, WHAT FORMULA IS CG&E PROPOSING?***

6 ***A116.*** The Company states: "The formula that CG&E proposes is to use the higher of
7 the following two numbers: a) the MWA provided by the three largest CRES
8 providers, with an upper limit of 80% of the number of MW that have switched;
9 or b) 50% of the MW that have switched." In other words, depending upon the
10 particular circumstances, between 50% and 80% of switched load would be
11 covered by these options.

12

13 ***Q117. IS THIS A REASONABLE PROPOSAL?***

14 ***A117.*** No. Mr. Rose defends it on the grounds that "this 'call' option is designed to
15 match the 'put' option that CRES providers have" (Rose Testimony at 27). In
16 fact, CRES providers have contracts with customers and may not easily be able to
17 'put' them to the Company. Secondly, these options would probably be needed
18 only if there is a crisis in the regional electricity market. Mr. Rose says that "there
19 might be a lack of supply." (Rose Testimony at 26) This would be the situation if
20 there was a generation shortage, which "could occur under extreme and stressful
21 circumstances." (Response to OEG-DR-01-020) But, as noted earlier, there are
22 high reserve margins in the ECAR area, making a crisis highly unlikely.
23 Furthermore, the probability of multiple supplier defaults is low.

1

2 ***Q118. WHAT DO THESE CONSIDERATIONS SUGGEST?***

3 ***A118.*** The amount of options being proposed seems excessive. Note that according to
4 the formula, options would be purchased for 50%–80% of shopping load. Despite
5 the fact that CG&E will cover the cost of power only at peak hours, the proposal
6 is likely to be unnecessarily expensive, particularly since the Company proposes
7 to buy at-the-money options.

8

9 ***Q119. WHAT MIGHT AN APPROPRIATE LEVEL OF COVERAGE BE?***

10 ***A119.*** The fundamental problem here is that the level of risk is so uncertain that it is
11 hard to justify any particular level of coverage. Mr. Rose admits that, "The extent
12 of this risk is hard to judge." (Rose Testimony at 26) This observation, which is
13 an understatement, supports my overall conclusion that the price components of
14 the proposed MBSSO are based on costs and risks that are extremely difficult to
15 quantify and put a price tag on. Mr. Rose proposes "Approach #4" to setting the
16 amount of reserves that CG&E should acquire call options for (Application
17 Exhibit 1 at 16) because it "would require less reliance of CG&E judgement."
18 However, the Company acknowledges that there is no documentation or other
19 quantitative or empirical basis for the assumptions and estimates that it would still
20 have to make. (Response to OCC-POD-04-022, Attachment NHT-20)

21

1 ***Q120. ARE THERE OTHER PROBLEMS WITH THIS PROPOSAL?***

2 ***A120.*** Yes. The proposal may complicate claims for damages for breach of contract
3 against CRES providers in the event of default, since the utility is in effect
4 absorbing that risk.

5
6 ***Q121. WHO WOULD PAY THIS PROPOSED CHARGE?***

7 ***A121.*** All customers would pay, whether they have switched or not. The question of
8 who would pay raises a dilemma. On the one hand, "the most appropriate way to
9 capture this risk would be to assess a charge that would apply only to customers
10 who have switched from CG&E, since it is the potential return of those customers
11 that gives rise to the need for the utility to hold some insurance against their doing
12 so." (Application Exhibit 1 at 14). On the other hand, "that could cause the cost of
13 switching to rise" which is an undesirable outcome. The peculiar nature of this
14 charge is highlighted by this dilemma.

15
16 ***Q122. TO THE EXTENT RETURNING CUSTOMERS DO REPRESENT A***
17 ***POTENTIAL PROBLEM FOR CG&E, ARE BETTER WAYS TO DEAL***
18 ***WITH IT AVAILABLE?***

19 ***A122.*** Yes, I believe there are. A requirement that CRES providers must meet certain
20 financial and technical criteria would substantially reduce the risk of default.
21 Second, to the extent that the Company can show that it is prudent to hold some
22 amount of call options to supply returning customers, only customers on MBSSO

1 service should foot the bill, on the grounds of cost causation – it is they who have
2 occasioned the cost.

3

4 **V CG&E'S PROPOSED COMPETITIVE BID PROCESS**

5

6 ***Q123. WHEN WAS THE COMPANY'S COMPETITIVE BIDDING PROCESS PLAN***
7 ***FIRST PROPOSED?***

8 ***A123.*** The CBP plan was proposed by CG&E in its application, as filed on January 10,
9 2003 in case 01-2164-EL-ORD.

10

11 ***Q124. HAS ANYTHING HAPPENED SINCE THAT TIME THAT WOULD HAVE AN***
12 ***IMPACT ON THE ORIGINAL PROPOSAL?***

13 ***A124.*** Yes. Requirements of the Commission's competitive bidding rules were adopted
14 and filed on December 12, 2003. It is clear that some components of the initial
15 proposal must be revised in order to satisfy the newly established rules.

16

17 ***Q125. WHAT IS THE CONTEXT OF THE REMAINING DISCUSSION ON CBP?***

18 ***A125.*** The remaining discussion describes the Commission's requirements for CBP and the
19 ways in which the original CG&E proposal does not conform to these rules.

20

21 ***Q126. WHAT IS YOUR UNDERSTANDING OF THE COMPETITIVE BIDDING***
22 ***PROCESS (CBP) PLAN RULES FOR RESIDENTIAL AND SMALL NON-***
23 ***RESIDENTIAL CUSTOMERS?***

1 **A126.** The CBP was designed to serve as a market-based, fixed-rate retail electric supply
2 service for residential and small non-residential customers who do not make a
3 choice. In other words, residential and small non-residential customers would
4 automatically be placed on the CBP plan unless they explicitly chose another option.
5 Therefore, at the end of the transition period, all current residential and small non-
6 residential customers who have not gone to a competitor would automatically be
7 placed on this plan. As such, the CBP would likely serve a large share of small
8 customers.

9

10 ***Q127. WHAT IS YOUR UNDERSTANDING OF THE COMPETITIVE BIDDING***
11 ***PROCESS (CBP) PLAN RULES FOR OTHER CUSTOMERS?***

12 **A127.** In the CBP plan, there would be a fixed-rate offering available to large general
13 service customers and other customer classes. The bidding process for these types of
14 customers would be separate from those of residential and small non-residential
15 customers.

16

17 ***Q128. DO THE RULES DIFFER FROM CG&E'S ORIGINAL PROPOSAL?***

18 **A128.** Yes, they differ in several respects. In CG&E's original proposal, customers who did
19 not choose would *not* automatically be placed on the CBP plan, as they would be in
20 the rules. Customers would have to affirmatively choose between CBP, MBSSO, a
21 municipal aggregator, or a competitive supplier. In addition, when the original
22 proposal was filed, plans were not being made for residential customers. In the new
23 rules, residential customers are included in the CBP plan. Thus, the original proposal

1 should be revised to address the CBP plan in terms of residential customers and the
2 process by which they are placed onto the CBP plan.

3

4 ***Q129. WHAT FEATURES OF THE CBP RULES WOULD BE ADVANTAGEOUS***
5 ***FOR CONSUMERS?***

6 ***A129.*** The CBP would have a fixed rate for between one and three years, and it would be
7 competitively bid. Both of these features would likely serve customers well.

8

9 ***Q130. WHAT OTHER FEATURES SHOULD CG&E'S CBP PROPOSAL INCLUDE?***

10 ***A130.*** Because CBP would likely be the plan for the majority of residential and small non-
11 residential customers, the proposed plan should be easy to understand. The plan
12 should be thought of as the main service option for customers who do not choose a
13 generation service provider.

14

15 ***Q131. HAVE OTHER STATES ADOPTED PLANS SIMILAR TO CBP?***

16 ***A131.*** Yes. For example, New Jersey's CBP plan, which is called basic generation service
17 (BGS), is similar. Under that plan, customers pay rates determined on the basis of an
18 auction. (In the first three years of restructuring, customers continued to pay pre-
19 established rates. They now pay rates based on auction prices.) There is one auction
20 to procure supply for larger customers and another for smaller customers.

21

1 ***Q132. WHAT IS THE COVERAGE OF BIDS UNDER NEW JERSEY'S BGS***
2 ***AUCTION PLAN?***

3 ***A132.*** In New Jersey, BGS is auctioned off in tranches (i.e. portions). In each auction, a
4 descending clock auction procedure is followed. In a given round, bidders state how
5 many tranches they wish to supply of a product at the price in that round. In the 2002
6 auction, fifteen energy suppliers won bids to sell a total of 18,000 MW for one year.
7 By contrast, if only one supplier is chosen to serve an entire class of customers,
8 bidders with smaller resources cannot offer service to some portion of the group.

9
10 ***Q133. IN NEW JERSEY, ARE THERE PROVISIONS TO GUARANTEE THE***
11 ***ADEQUACY OF SUPPLY?***

12 ***A133.*** Yes. By participating in the auction, suppliers assume a basic generation service
13 capacity obligation for their customers.

14
15 ***Q134. WHAT SELECTION PROCESS IS FOLLOWED IN NEW JERSEY?***

16 ***A134.*** In New Jersey, there is a straight-out auction in which the bidder with the lowest bid
17 for each tranche wins.

18
19 ***Q135. WHAT DO THE ADOPTED RULES SAY ABOUT THIS?***

20 ***A135.*** The rules say: "The bidding methodology is to be chosen by the applicant and
21 approved by the Commission as a part of the application process. The bidding
22 process must include an independent third-party auctioneer in order to provide
23 confidence in the impartiality of the auction process. The application will specify the

1 process by which an independent third-party auctioneer will be selected and by
2 which the auction will be conducted. However, if the EDU believes that some
3 method other than an independent third-party auctioneer is warranted, the application
4 must provide an analysis of the rationale, a description of the alternative method, and
5 a discussion which addresses the issue of providing confidence in the impartiality of
6 the process.”

7

8 ***Q136. WHAT IS THE TERM OF THE BIDS?***

9 ***A136.*** In the rules, the accepted bid contracts would be no less than one year and no more
10 than three years.

11

12 ***Q137. WHAT HAVE OTHER STATES DONE IN THIS REGARD?***

13 ***A137.*** Some states, such as New Jersey, initially bid out portions of the load for different
14 terms and now have staggered terms with only one third of the load being re-bid each
15 year, in order to smooth out yearly volatility. Still other states, such as Maine, are
16 currently considering a financial laddering approach for their contracts for standard
17 offer service. The duration of contracts within the ladder might be longer-term than
18 those in New Jersey.

19

20 ***Q138. ARE THERE EXAMPLES FROM STATES OTHER THAN NEW JERSEY?***

21 ***A138.*** Yes. In Massachusetts, customers who do not make an explicit choice of provider
22 are automatically placed on standard offer service, which is similar to CBP. Their
23 rate is fixed for six-month periods. Customers in Massachusetts who choose to go to

1 a competitor cannot decide to return to the standard offer service plan. Instead, they
2 can choose the default service option, which is similar to the standard service offer.
3 Thus, the overall plan envisioned by Ohio's rules is similar to that of Massachusetts,
4 where there is one plan for customers that have never left and another plan for those
5 who leave and then return to their electric distribution utility. If CG&E's customers
6 follow similar trends to those in Massachusetts, the majority will remain on the CBP
7 plan during at least the first several years.

8

9 ***Q139. WHOSE CUSTOMER IS THE CBP CUSTOMER?***

10 ***A139.*** The newly adopted rules state that customers who are on the CBP plan remain
11 customers of CG&E. They do not become customers of the winning bidder of the
12 CBP. However, in the Company's original proposal, CBP service would be offered
13 by the winning bidder.

14

15 ***Q140. IS IT NECESSARY FOR A CUSTOMER WITHIN THE CBP PLAN TO KNOW***
16 ***THE NAME OF THE WINNING BIDDER WHO SERVES THE CBP***
17 ***CUSTOMERS?***

18 ***A140.*** While CG&E will remain the retail supplier to individual customers, CG&E should
19 include the name of the winning wholesale suppliers on the bill. This will increase
20 the name recognition of suppliers and would be especially valuable to wholesale
21 suppliers who have retail affiliates that would benefit from customer recognition.

22

1 ***Q141. WHAT DO YOU THINK SHOULD BE DONE TO FIX THESE AND OTHER***
2 ***RELATED PROBLEMS WITH THE ORIGINAL PROPOSAL?***

3 ***A141.*** I recommend that the Commission order CG&E to revise its original proposal such
4 that it meets all of the rules adopted by the Commission relating to the CBP plan.

5

6 ***Q142. DO YOU HAVE CONCLUSIONS AND RECOMMENDATIONS?***

7 ***A142.*** My conclusions and recommendations are contained in Section II above.

1 *Q142. DOES THAT CONCLUDE YOUR TESTIMONY?*

2 *A142.* Yes.

Ohio Consumers' Counsel Fourth Set Production of Documents
CG&E Case No. 03-93-EL-ATA
Date Received: April 16, 2004
Response Due: April 26, 2004

OCC-POD-04-050

REQUEST:

50. Please provide copies of any reports, studies, memoranda or other communications by Mr. Rose or ICF that contain proposals similar, in whole or part, to the methodology contained in Application Exhibit 1 or any component thereof.

RESPONSE: None.

WITNESS RESPONSIBLE: Judah L. Rose

Attachment

Ohio Consumers' Counsel Fourth
CG&E Case
Date Received
Response

WHT-3

OCC-INT-04-094

REQUEST:

94. Referring to Mr. Rose's or IDF's proposals provided in the Company's response to OCC Interrogatory No. A, for any such proposals that have been accepted by a commission or other regulatory authority, what is the case docket name and number in which each proposal has been accepted

RESPONSE: MDP or its equivalent has not ended where the utility has implemented its obligation to provide retail Standard Service Offer.

WITNESS RESPONSIBLE: Judah L. Rose

ATTACHMENT

NHT-4

Ohio Consumers' Counsel

CG&

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Response Due. ...

OCC-INT-04-100

REQUEST:

100. The Company's Application Exhibit 1 at page 8 states, "The price index model will be the average of independently reported indices such as Megawatt Daily and ICE, adjusted to represent an ask price":
- a. What is each of the "independently reported indices" that would be used?
 - b. What is the actual price data for each of the indices for January 2000 to the present?
 - c. For each of indices, what is the method used to collect and report the price data?

RESPONSE:

- a. The Into Cinergy piece from Megawatt Daily and ICE.
- b. This data is available from Megawatt Daily and ICE for a subscription fee. CG&E is prohibited from providing copies of these publications, due to copyright and licensing considerations. This information can be viewed at CG&E's offices at a mutually agreeable date.
- c. ICE provides information on actual transactions that are transacted through the ICE exchange. Megawatt Daily is a survey of market participants of the weighted price for transactions.

WITNESS RESPONSIBLE:

Judah L. Rose

ATTACHMENT

247-5

Ohio Consumers' Counsel For
CG&E
Date
Resp

OCC-INT-04-105

REQUEST:

105. What is the trading volume and number of transactions for the Cinergy hub, by month from January 2000 to the present, for transactions of different durations (e.g., hourly, daily, month) both spot and forward?

RESPONSE: Cinergy does not know the trading volume and number of transactions for the Cinergy hub because Cinergy is not the only entity that transacts at the Cinergy hub. An estimate of the total volume could be obtained from entities, such as over-the-counter brokers or electronic trading platforms, however, the information would not include transactions done directly between counterparties without the use of a broker or electronic trading platform. An effort is currently underway by the FERC and a group of industry participants including marketers, brokers, electronic trading platforms and index publishers to estimate the total size of the power trading market for day ahead trading at various locations, including the Cinergy hub. This analysis is not complete and will only contain data for a single month of transactions. When complete, the results of this study may be available from the FERC under Docket PL03-3, however, the decision whether to enter the results into said Docket has not been finalized.

WITNESS RESPONSIBLE: NA

Ohio Consumers' Counsel Fourth S
CG&E Case N
Date Receiv
Response D

ATTACHMENT

WHT-6

REQUEST:

107. What is the concentration for the companies trading at the Cinergy hub (e.g., the number of firms, the market shares or HHI for various time periods and products)?

RESPONSE: Not available.

WITNESS RESPONSIBLE: Richard G. Stevie

ATT

WHT-7

Ohio Consumers' Counsel Fou
CG&E C
Date R
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OCC-INT-04-102

REQUEST:

102. Referring to the "independently reported indices" in the Company's Application Exhibit 1 at page 8:
- a. Does the Company believe the Public Utility Commission of Ohio, or any other state agencies, have the authority and ability to review and audit the "independently reported indices?"
 - b. If the response to part (a) is affirmative, what is the basis for any such authority and ability?

RESPONSE:

- a. No.
- b. NA.

WITNESS RESPONSIBLE: Judah L. Rose

ATTACHMENT
NHT-8

Ohio Consumers' Counsel Fourth Set Prod

CG&E Cas

Date Recd

Response Due: April 20, 2011

OCC-POD-04-048

REQUEST:

48. Please provide any historical data and analyses that support the consistency or convergence of the MegaWatt Daily, ICE or other indexes that CG&E proposes to use (Application Exhibit 1 at 3, third bullet)

RESPONSE: None.

WITNESS RESPONSIBLE: Judah L. Rose

ATTACHMENT

WHT-9

Ohio Consumers' Counsel Fourth Set Int

CG&E Case No. 03

Date Received: A

Response Due: April 20, 2007

OCC-INT-04-154

REQUEST:

154. Why does CG&E believe "where two or more sources diverge in value by more than 10%, CG&E should to (sic) use the higher value as the index to mitigate price risk?"

RESPONSE: If the higher price is more accurate, and the average is used, there is the risk of overpaying for power. If this approach is too conservative, consumers can purchase via CRES providers or the winner of the CBP.

WITNESS RESPONSIBLE: Judah L. Rose

Ohio Consumers' Counsel Four
CG&E Ca
Date Re
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ATTACHMENT

10 HT - 3 10

000 11 -

REQUEST:

160. What regulatory decisions that have incorporated a "covariance" factor in determining prices.

RESPONSE: CG&E is unaware of regulatory decisions incorporating a covariance factor in determining prices.

WITNESS RESPONSIBLE: Judah L. Rose

ATTACHMENT

PHT-11

Ohio Consumers' Counsel Fourth Set P
CG&E ()
Date R
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OCC-POD-04-026

REQUEST:

26. Please provide the FERC's current views on adding 10% or any other arbitrary number to reflect the costs or risks of supply management. (Application Exhibit 1 at 18, para 4)

RESPONSE: Unknown.

WITNESS RESPONSIBLE: Judah L. Rose

ATTACHMENT
WHT - 12

Ohio Consumers' Counsel

Pg 1 of 3

Documents
EL-ATA
16, 2004
26, 2004

OCC-POD-04-023

REQUEST:

23. Please provide any evidence that the supply management risks identified by CG&E (Application Exhibit 1 at 18) impose costs of 10%?

RESPONSE: None.

WITNESS RESPONSIBLE: Judah L. Rose/Richard G. Stevie

ATTACHMENT
WHT-12

Ohio Consumers' Counsel Second

CG
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R

pg 2 of 3

OCC-POD-04-004

REQUEST:

4. Please provide a copy of the terms that will apply to customer leaving the residential tariff Rate TD.

RESPONSE:

Following are the terms and conditions contained in Rate TD (P.U.C.O. Electric No. 19, Sheet No. 33.5):

TERMS AND CONDITIONS

This rate is available upon application in accordance with the Company's Service Regulations.

The initial term of service under this rate is three (3) years. If the customer desires to cancel service under this tariff within three (3) years, a termination fee may be charged by the Company. The termination fee will be determined by applying the above Customer Charge times the remaining months of the initial service agreement.

Where the Company is denied access to read the customer's time-of-day meter for more than two consecutive months, the Company may, after notifying the customer, place the customer on the Company's standard residential rate. If the Company moves the customer to the standard rate, the customer shall not be billed for the termination fee.

The supplying and billing for service and all conditions applying thereto, are subject to the jurisdiction of the Public Utilities Commission of Ohio, and to Company's Service Regulations currently in effect, as filed with the Public Utilities Commission of Ohio.

WITNESS RESPONSIBLE: Jim Ziolkowski

ATTACHMENT

NHT-~~8~~12

Ohio Consumers' Counsel Fourth Set Pro
CG&E C

Pg 3 of 3

Date Re

Response Due: April 26, 2004

OCC-POD-04-005

REQUEST:

5. Please provide the same information as provided in response to OCC INT-01-031, part (c) for the classes of customers that were not provided in that response.

RESPONSE:

See response to OEG-DR-01-17.

WITNESS RESPONSIBLE: Jim Ziolkowski

ATTACHMENT
WHT-13

Ohio Consumers' Counsel Fourth
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I.

OCC-POD-04-021

REQUEST:

21. Please provide any available quantification or monetary valuation of that risk by floating prices to customers 30 days between billing cycles"

RESPONSE: No quantification has been performed.

WITNESS RESPONSIBLE: Judah L. Rose

ATTACHMENT

WHT-14

Ohio Consumers' Counsel Fourth Set Prod
CG&E Case
Date Received
Response 1

OCC-POD-04-020

REQUEST:

20. Please provide all data that demonstrates the difference in prices for transactions "much less than 50 MW" from transaction of 50 MW and above.

RESPONSE: None.

WITNESS RESPONSIBLE: Judah L. Rose

ATTACHMENT

NHT-18

Pg 1 of 2

Ohio Consumers' Counsel Second
CG
I

Response Due: April 12, 2004

OCC-POD-03-002

Page 1 of 2

REQUEST:

2. Referring to page 19 of CG&E Application Exhibit 1 of the 1/9/03 Application in Case No. 03-93-EL-ATA in which the Company seeks a 13.4% Operating Risk Adjustment as part of its MBSSO that is derived from a Value Line reported "average across all industries of 16.65%" less 3.25% for Sales, General and Administrative costs, please provide the workpapers, calculations and documents supporting this proposed adjustment, including any documentation from Value Line.

RESPONSE:

The attached table provides the ten-year average operating margin using data extracted from the Value Line database for all industries. The numbers have changed slightly from the original filing, but the net number is still the same. Average operating margin of 16.5% minus 3.1% for the electric utility (central % sales, general, & administrative costs) produces 13.4%.

-continued-

Attachment
 NHT-15
 P9 2 of 2

Operating Margin by Industry Name	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
ADVERTISING	12.0%	12.3%	12.8%	13.5%	13.9%	14.8%	15.5%	15.8%	15.9%	15.5%
AEROSPACE / DEFENSE	8.8%	9.2%	10.3%	10.8%	10.3%	30.4%	24.5%	10.5%	10.8%	12.0%
AIR TRANSPORT	6.1%	5.0%	8.8%	10.9%	12.7%	13.6%	14.3%	14.3%	12.6%	12.3%
APPAREL	11.4%	11.8%	10.9%	10.9%	10.5%	11.6%	12.4%	13.4%	13.4%	12.6%
AUTO & TRUCK	10.9%	10.2%	11.4%	13.2%	14.0%	14.3%	15.9%	14.6%	14.8%	14.0%
AUTO PARTS	8.9%	9.5%	10.3%	10.7%	10.5%	10.1%	10.9%	9.3%	10.8%	9.9%
BANK (CANADIAN) COMP.										
BANK (FOREIGN) COMP.										
BANK (MIDWEST) COMP.										
BANK COMP.										
BEVERAGE (ALCOHOLIC)	18.2%	18.3%	18.3%	18.3%	20.8%	21.6%	22.1%	21.2%	21.7%	23.0%
BEVERAGE (SOFT DRINK)	17.4%	17.6%	18.7%	18.7%	18.6%	17.3%	20.3%	19.9%	19.9%	20.4%
BIOTECHNOLOGY	21.6%	21.5%	11.4%	30.5%	30.2%	28.6%	30.4%	33.1%	31.9%	21.0%
BUILDING MATERIALS	3.6%	8.4%	8.6%	9.9%	10.4%	10.5%	9.7%	11.4%	12.7%	11.1%
CABLE TV	40.6%	26.8%	30.4%	27.4%	25.5%	24.6%	24.4%	21.6%	20.3%	19.8%
CANADIAN ENERGY	19.7%	22.9%	24.2%	26.1%	28.2%	25.4%	24.0%	22.1%	26.0%	26.9%
CEMENT & AGGREGATES	13.0%	13.3%	14.9%	18.1%	20.7%	21.4%	22.5%	23.7%	23.3%	20.5%
CHEMICAL-BASIC	15.3%	14.6%	15.0%	18.0%	20.5%	26.5%	26.9%	19.3%	19.5%	17.5%
CHEMICAL-DIVERSIFIED	14.4%	15.4%	15.4%	17.4%	19.1%	17.9%	18.2%	17.6%	18.7%	19.9%
CHEMICAL-SPECIALTY	15.5%	16.2%	15.9%	16.6%	17.0%	17.4%	17.0%	17.1%	16.8%	15.2%
COAL							22.9%	21.1%	18.9%	19.5%
COMPUTER & PERIP.	15.5%	14.0%	11.4%	14.7%	15.7%	13.2%	13.7%	12.2%	12.2%	12.3%
COMPUTER SOFTWARE & SVC.	22.1%	23.5%	24.7%	24.7%	24.7%	23.8%	25.1%	25.2%	25.4%	20.1%
DIVERSIFIED CO	9.5%	10.4%	10.7%	11.4%	11.9%	11.1%	12.3%	13.5%	14.2%	10.4%
DRUG INDUSTRY	29.3%	29.1%	29.6%	25.1%	27.5%	28.1%	26.8%	27.7%	27.7%	26.8%
E-COMMERCE			14.8%	16.7%	-6.7%	3.4%	4.7%	2.6%	0.2%	-0.7%
EDUCATIONAL SERVICES	20.7%	14.3%	18.7%	16.1%	17.0%	18.1%	16.9%	17.8%	15.3%	12.9%
ELEC UTILITY (FOREIGN) COMP.										
ELECTRIC UTIL - GEN	34.1%	33.0%	33.9%	34.0%	34.9%	32.9%	27.0%	23.4%	21.3%	16.1%
ELECTRIC UTIL - EAST	34.6%	34.7%	35.0%	34.8%	35.0%	33.9%	29.5%	30.1%	28.8%	21.6%
ELECTRIC UTIL - WEST	32.9%	34.7%	34.9%	36.3%	37.4%	35.8%	29.5%	24.9%	22.3%	8.8%
ELECTRICAL EQUIP.	15.3%	15.1%	16.1%	16.9%	17.3%	17.8%	18.3%	19.1%	18.7%	23.5%
ELECTRONICS	9.3%	9.1%	9.7%	9.9%	10.6%	10.0%	10.6%	9.1%	8.6%	9.6%
ENTERTAINMENT	20.2%	21.2%	22.4%	19.1%	21.1%	20.6%	19.8%	19.8%	15.9%	21.6%
ENTERTAINMENT TECHNOLOGY	7.3%	15.7%	11.6%	11.4%	13.1%	9.7%	15.2%	18.5%	20.4%	13.2%
ENVIRONMENTAL	14.8%	13.6%	13.1%	13.3%	15.1%	18.9%	23.7%	27.0%	26.2%	24.8%
FINANCIAL SVCS (DIV) COMP.										
FOOD PROCESSING	10.9%	11.0%	10.7%	11.3%	11.7%	11.2%	11.5%	13.3%	13.4%	14.3%
FOOD WHOLESALERS	3.7%	3.6%	3.8%	3.7%	4.1%	4.2%	4.4%	4.3%	4.5%	4.7%
FOREIGN ELEC/INTERTN	11.6%	10.3%	9.8%	10.6%	10.9%	10.7%	11.3%	10.0%	9.8%	11.0%
FOREIGN TELECOM	28.0%	31.6%	31.8%	27.3%	27.6%	34.1%	32.7%	33.1%	31.0%	26.7%
FURNITURE FURNISHING	10.1%	10.1%	11.6%	11.5%	11.0%	12.1%	13.0%	13.4%	13.2%	11.9%
GROCERY	4.6%	4.3%	4.5%	5.0%	5.3%	5.5%	5.8%	6.1%	6.5%	6.6%
HEALTHCARE INFO SYS	11.9%	14.3%	13.5%	13.9%	16.8%	19.3%	20.4%	16.8%	13.7%	6.8%
HOME APPLIANCE	10.2%	9.7%	9.5%	10.6%	9.8%	9.4%	10.9%	12.1%	13.3%	12.1%
HOMEBUILDING	9.7%	9.7%	10.5%	9.5%	9.3%	10.3%	10.1%	12.2%	12.3%	12.5%
HOTEL / GAMING	20.3%	24.2%	24.6%	23.1%	25.7%	17.5%	19.2%	22.6%	25.0%	25.6%
HOUSEHOLD PRODUCTS	13.8%	14.0%	15.0%	15.8%	16.3%	17.8%	18.6%	19.4%	21.0%	21.1%
HUMAN RESOURCES	3.6%	3.6%	3.9%	4.8%	5.3%	5.6%	6.0%	6.1%	5.4%	5.1%
INDUSTRIAL SERVICES	8.5%	8.7%	9.1%	9.6%	9.6%	11.5%	10.0%	10.5%	10.5%	9.8%
INFORMATION SERVICES	16.3%	16.3%	17.4%	17.7%	17.5%	18.2%	21.2%	24.8%	24.8%	23.9%
INSURANCE (LIFE) COMP.										
INSURANCE (PROP/CASUALTY) COMP.										
INTERNET	6.2%	-15.1%	-6.1%	16.1%	12.2%	-2.2%	-3.0%	-6.9%	-26.3%	-31.4%
INVESTMENT CO. (INCOME) COMP.										
INVESTMENT COMPANY-FGN COMP.										
MACHINERY	8.8%	8.7%	10.5%	12.7%	12.8%	13.3%	13.5%	13.4%	12.6%	12.1%
MANU HOUSING/REC VEH	4.7%	6.4%	6.7%	7.6%	7.6%	8.1%	8.3%	9.4%	8.0%	4.9%
MARITIME	27.1%	21.5%	20.6%	20.7%	21.2%	20.8%	21.2%	21.4%	20.4%	19.6%
MEDICAL SERVICES	13.6%	13.8%	13.3%	13.6%	13.1%	11.8%	10.3%	12.0%	12.0%	11.7%
MEDICAL SUPPLIES	16.2%	16.0%	16.6%	16.1%	16.2%	16.8%	15.9%	15.4%	15.3%	15.5%
METAL FABRICATING	10.7%	11.9%	12.1%	13.0%	14.6%	15.5%	15.2%	14.5%	14.6%	14.4%
METALS & MIN (CM)	14.4%	15.2%	13.2%	16.5%	21.4%	18.2%	18.1%	16.9%	16.1%	17.9%
NATURAL GAS DISTRIB	21.4%	22.5%	21.3%	21.2%	23.9%	22.7%	22.0%	21.4%	24.0%	23.1%
NATURAL GAS DIVER	15.2%	23.3%	23.2%	22.9%	21.4%	17.6%	13.6%	12.1%	11.7%	9.7%
NEWSPAPER	16.5%	19.8%	20.7%	21.6%	19.3%	19.9%	22.3%	23.2%	22.7%	23.5%
OFFICE EQUIP & SUP	13.6%	13.5%	12.8%	12.9%	12.7%	13.6%	13.6%	12.8%	12.9%	9.2%
OUTFIELD SVCS/EQUIP	15.2%	14.4%	16.0%	16.3%	17.2%	18.8%	22.5%	22.3%	15.7%	20.2%
PACKAGING & CONTAINER	13.8%	14.7%	14.3%	14.7%	16.0%	15.6%	15.7%	16.8%	16.1%	15.1%
PAPER & FOREST PRODS	11.2%	12.2%	13.9%	15.3%	20.1%	14.9%	12.5%	13.4%	15.7%	17.0%
PETROLEUM-INTEGRATED	12.9%	12.2%	13.1%	13.8%	15.6%	15.0%	15.4%	15.3%	17.0%	19.7%
PETROLEUM-PRODUCING	32.7%	30.3%	31.9%	33.8%	32.5%	37.7%	36.5%	32.5%	34.7%	34.8%
PHARMACY SERVICES	6.2%	6.1%	6.0%	6.6%	6.6%	6.8%	6.6%	5.9%	5.6%	5.6%
POWER	22.1%	21.8%	21.8%	22.6%	21.8%	24.9%	26.4%	25.3%	30.6%	19.4%
PRECIOUS METALS	32.5%	33.2%	33.4%	32.4%	30.7%	26.9%	28.8%	33.0%	36.4%	31.7%
PRECISION INSTRUMENT	16.9%	16.1%	15.6%	15.9%	15.9%	15.2%	15.8%	14.5%	15.5%	17.5%
PUBLISHING	17.5%	17.5%	17.2%	17.9%	18.3%	17.9%	18.2%	18.3%	18.9%	17.2%
RAILROAD	22.2%	23.9%	24.7%	26.3%	24.5%	26.2%	26.9%	23.6%	25.1%	26.2%
RECREATION	15.1%	15.5%	16.3%	16.8%	16.2%	17.0%	17.7%	17.5%	17.2%	17.3%
REIT COMP.										
RESTAURANT	20.8%	20.7%	20.6%	21.2%	19.8%	19.4%	17.4%	17.8%	18.0%	18.0%
RETAIL BLDG SUPPLY	5.7%	7.3%	7.7%	8.6%	8.4%	8.6%	9.1%	9.3%	10.2%	9.6%
RETAIL SPECIALTY	9.4%	9.6%	8.6%	8.9%	7.7%	8.5%	9.4%	9.3%	9.4%	9.7%
RETAIL STORE	7.7%	6.0%	7.7%	7.2%	7.2%	7.6%	8.0%	8.0%	6.9%	7.4%
SECURITIES BROKERAGE COMP.										
SEMICONDUCTOR	15.5%	17.3%	23.4%	25.1%	25.6%	25.1%	27.8%	24.0%	27.5%	30.7%
SEMICONDUCTOR CAP EQ	11.5%	11.1%	16.7%	21.1%	23.5%	22.5%	18.7%	16.6%	19.7%	26.5%
SHOE	13.0%	13.2%	12.8%	11.8%	10.5%	11.5%	12.5%	9.4%	10.2%	10.8%
STEEL-GENERAL	7.2%	6.6%	7.4%	10.5%	11.5%	10.4%	11.3%	10.8%	10.3%	9.7%
STEEL-INTEGRATED	3.0%	12.4%	16.2%	15.4%	18.3%	15.0%	14.8%	14.8%	13.8%	13.1%
TELECOM EQUIPMENT	11.5%	11.6%	12.6%	11.8%	14.0%	13.7%	15.0%	15.7%	16.9%	16.1%
TELECOM SERVICES	20.0%	24.5%	25.1%	25.4%	22.5%	30.6%	31.3%	32.0%	37.6%	31.5%
TEXTILE	11.4%	13.6%	14.7%	13.0%	12.4%	12.0%	12.9%	13.6%	12.6%	12.8%
THRIFT INDUSTRY COMP										
TRE & RUBBER	10.3%	11.0%	11.9%	11.6%	11.9%	12.1%	12.4%	12.8%	10.2%	9.1%
TOBACCO	19.0%	19.9%	16.0%	17.2%	17.9%	18.8%	16.5%	16.2%	16.9%	20.9%
TOILETRIES/COSMETICS	17.1%	17.1%	17.3%	16.6%	18.0%	18.0%	19.5%	18.9%	18.9%	18.1%
TRUCKS/TRANSP LEASE	11.9%	12.9%	12.5%	12.3%	1.4%	11.2%	13.0%	15.2%	16.0%	16.2%
WATER UTILITIES	37.7%	38.9%	39.6%	39.7%	40.5%	40.5%	42.1%	42.7%	41.6%	41.7%
WIRELESS NETWORKING	22.3%	13.1%	16.7%	17.8%	16.2%	11.9%	13.5%	11.8%	9.4%	1.9%
Average	15.4%	15.5%	16.0%	17.0%	17.1%	17.3%	17.5%	17.1%	16.8%	15.9%

WITNESS RESPONSIBLE:

Richard G. Stevie

ATTACHMENT

WHT - 16

Ohio Consumers' Counsel Fourth Set
CG&E Case No.
Date Received
Response Due

OCC-INT-04-129

REQUEST:

129. In Application Exhibit 1 at 33, last full para (Mr. Rose refers to the possibility of “an increasing and volatile divergence between the indices and CB&E’s actual costs...” In such circumstances, “CG&E will revise its proposal with Commission approval.” Is the Company opposed to incorporating in its MBSSO proposal an adjustment mechanism that would reconcile recoveries and actual costs, like a fuel adjustment clause? (Such a proposal could still, for the most part, be market based, because most of the costs recovered by the Company would be incurred in the competitive market place, and the mechanism could incorporate a smoothing feature.)

RESPONSE: The Company is opposed to a mechanism that would reconcile recoveries and actual costs, like a fuel adjustment mechanism under the CMO MBSSO. This is a benefit that is not available to CRES providers and would not create a level playing field.

WITNESS RESPONSIBLE: Judah L. Rose

ATTACHMENT

Ohio Consumers' Counsel For
CG&E C
Date F

WHT-17

Response Due: April 20, 2004

OCC-INT-04-137

REQUEST:

137. Is the Company claiming that risk-related costs should be included even if they are not actually incurred, in order to boost the price of MBSSO so as not to undermine competitors?

RESPONSE: Yes, in part. The Company also must be compensated for the entrepreneurial effort involved in making the CMO MBSSO work, just like energy marketers try to obtain an operating margin.

WITNESS RESPONSIBLE: Judah L. Rose

ATT

Ohio Consumers' Counsel Fourth S
CG&E Case N
Date Receiv
Response Due: April 20, 2011

NHT - 18

OCC-INT-04-190

REQUEST:

190. For each of the operating risks identified in application Exhibit 1 at 18-19 how does the risk impose costs on CG&E?

RESPONSE: The costs can occur when outcomes differ from planned. The operating margin covers the entrepreneurial margin.

WITNESS RESPONSIBLE: Judah L. Rose

ATT
WHT-19

**Ohio Consumers' Counsel Fourth Set I
CG&E Case No. 6**

Date Received: April 16, 2004

Response Due: April 26, 2004

OCC-INT-04-191

REQUEST:

191. For each of the operating risks identified in Application Exhibit 1 at 18-19 what quantification or valuation of the risk is available to CG&E?

RESPONSE: There are no quantifications of the individual risks.

WITNESS RESPONSIBLE: Judah L. Rose

ATTACHMENT

NAT - FD 20

Ohio Consumers' Counsel Fourth

CC

I

Response Due. 11/1/11

OCC-POD-04-022

REQUEST:

22. Mr. Rose proposes "Approach #4" to setting the amount of reserves that CG&E should acquire call options for. (Application Exhibit 1 at 16) He says this approach "would require less reliance of CG&E judgment." A series of assumptions, percentages, etc., are then used to arrive at an estimate of the amount of call options that should be acquired. Please provide documentation or other quantitative or empirical basis for such assumptions, estimates, etc.

RESPONSE: None.

WITNESS RESPONSIBLE:

Judah L. Rose/Richard G. Stevie