
City of Cleveland v. The Cleveland Illuminating
Company, 1980

Transcripts

9-17-1981

Volume 26 (Part 3)

District Court of the United States for the Northern District of Ohio, Eastern Division

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1 Gaffin - cross

2 recall?

3 A Yes, that's true.

4 Q Now, another aspect of the survey work that goes to
5 whether you can rely on a survey, Mr. Gaffin, you
6 stated was that the respondents should not know the
7 purpose of the interviewing, and the interviewer
8 should not know the purpose either, is that right?

9 A Yes.

10 Q Now, were you aware when you did your survey that
11 this trial had begun in Cleveland at the time your
12 survey was taken?

13 A I knew there had been a previous trial, but I'm not
14 sure whether I recall whether I knew that the trial
15 had begun.

16 I know when I was contacted, but I don't recall
17 whether I knew the second trial had begun.

18 Q Do you know that there are only the two companies in
19 Cleveland, Muny Light and CEI, no other suppliers?

20 A No, I don't know that for a fact.

21 Q You're aware that this lawsuit is involving those two
22 parties?

23 A Yes.

24 Q And perhaps your -- let me ask you this question:

25 If there was publicity concerning this lawsuit --

1 Gaffin - cross

2 {Mr. Murphy rises from his chair.}

3 Q -- if it was available in the media for people to
4 read about this lawsuit during the time your survey
5 was going on, isn't it likely that the respondents
6 therefore could reasonably know what the purpose of
7 your survey was?

8 MR. MURPHY: Objection, your
9 Honor.

10 THE COURT: Approach the bench.

11 - - - - -
12 {The following proceedings were had at the
13 bench:}

14 MR. MURPHY: I have two
15 objections, your Honor.

16 The first is the question calls for
17 speculation.

18 The second is somewhat more serious, that
19 there is substantial publicity about this trial.

20 The jury has been admonished not to look
21 at newspapers, et cetera, and Ms. Coleman then
22 tells them there is substantial publicity in
23 the newspapers, and I strenuously object to it.

24 MS. COLEMAN: Your Honor, I'm
25 talking only about the time of the commencement

1 Gaffin - cross

2 of the trial when this survey was done.

3 THE COURT: You're getting into
4 areas -- this is so remote, Ms. Coleman, and
5 you're getting into areas that you shouldn't get
6 getting into.

7 Sustain the objection.

8 Now, let's get on with it.

9 MS. COLEMAN: My next --

10 THE COURT: Sustain the objection.

11 Let's go.

12 MS. COLEMAN: We'll have to come
13 back up here after the next question, so I want
14 to put it on the record, your Honor.

15 THE COURT: All right, put your
16 next question.

17 MS. COLEMAN: My next question is
18 whether the existence of the second trial going
19 on would be something that he would want to be
20 informed about in determining whether the timing
21 is appropriate.

22 MR. MURPHY: I would object to
23 this.

24 THE COURT: Sustained.

25 {End of bench conference.}

- - - - -

1 Gaffin - cross

2 THE COURT: Sustain the objection.

3 Let's keep it material, please.

4 BY MS. COLEMAN:

5 Q Mr. Gaffin, are you concerned when you frame your
6 questions in the survey about whether the respondent
7 has any motive to give you an answer other than his
8 true opinion?

9 A No.

10 Q You have no concern about whether the respondent is
11 giving you his true opinion or not?

12 A We have no control.

13 Q Wouldn't you want to word your questionnaire in such
14 a way as to try to avoid making inducements for your
15 respondents to answer in a way other than their
16 true opinion?

17 A Yes; we tried to encourage truthful responses.

18 Q Now, under the circumstances in which you have told
19 the respondent that the matter of his switching is a
20 public record, wouldn't that be some inducement to
21 the respondent to give an answer which would look
22 good in public?

23 MR. MURPHY: Objection.

24 THE COURT: Approach the bench.

25
- - - - -

1 Gaffin - cross

2 {The following proceedings were had at the
3 bench:}

4 MR. MURPHY: Object on the ground
5 of speculation, your Honor.

6 THE COURT: Yes.

7 Ms. Coleman, this is highly speculative and
8 it is highly improper.

9 Now, if it is your position that the question
10 in some way conveys to the respondent or to the
11 interviewer the purposes for which the interview
12 is being conducted or seeks to elicit answers,
13 that are suggested in the question, the document
14 speaks for itself, and the question speaks for
15 itself.

16 If you want to argue that on closing
17 argument, you're free to do so; but to ask this
18 man an argumentative question in a highly
19 speculative area is very improper.

20 Let's proceed.

21 MS. COLEMAN: He's supposed to be
22 an expert, he should have an opinion about his
23 questionnaire.

24 THE COURT: Let's proceed.

25 Let's proceed.

1 Gaffin - cross

2 {End of bench conference.}

3 - - - - -

4 BY MS. COLEMAN:

5 Q Mr. Gaffin, another aspect of presenting your
6 survey information deals with the accuracy of
7 reporting the interviewing information, isn't that
8 right?

9 A Transferring the information from the questionnaires
10 to the computer?

11 Q Well, in the first instance, you want to make sure
12 that the interview is accurately recorded as the
13 interviewer takes down the information?

14 A Yes.

15 Q And then you want to assure that the information is
16 accurately keypunched and accurately tabulated?

17 A Yes.

18 Q And then you want to make sure that the presentation
19 of the tabulations is right?

20 A Yes.

21 Q And you want to make sure that your report is
22 accurate?

23 A Yes.

24 Q Now, given those standards, I would ask you whether
25 it is not the case that among the 11 industrial

1 Gaffin - cross

2 customers --

3 {Ms. Coleman steps to the easel.}

4 Q {Continuing} Well, perhaps that's not necessary, we
5 are talking about such a small number.

6 Among the 11 industrial customers whose answers
7 are tabulated, there was one of them who refused to
8 talk to the interviewer at all, but his completed
9 interview was completed in the tabulations.

10 A That's not true that he refused to talk to the
11 interviewer.

12 It's true that he refused to answer a number of
13 questions or that he answered "Don't know" to a
14 number of questions, but he did, in fact, complete
15 the interview.

16 Q He completed the interview even though the interviewer
17 first reported "Refused to Respond"?

18 A I really don't know what the interviewer, of course,
19 reported. I know that was a completed interview, and
20 that one of those that was in the industrial class
21 of customers had responses that were "Don't knows"
22 and "Refused," but the interview was completed.

23 Q Look at your cluster .5.

24 I don't know how you refer to them, among the
25 industrial customers.

1 Gaffin - cross

2 {After an interval.}

3 A Are you talking about in the completed
4 questionnaires?

5 Q Supposed to be.

6 {After an interval.}

7 A I have the questionnaire in front of me for No. 5.

8 Q No. 5.

9 Would you look down at the answer recorded to
10 Question 3?

11 A Yes.

12 The Question 3 was:

13 "Our research shows that your company switched
14 from service by the Municipal Electric Light Plant
15 or Muny Light to service by the Cleveland Electric
16 Illuminating Company or CEI. Do you happen to recall
17 why you made that switch?"

18 And the respondent recorded -- the interviewer
19 recorded this response:

20 "Refused to respond. CEI called once before
21 about this. He's too busy to answer these questions."

22 Q And it is a fact on that questionnaire that all the
23 remaining questions are checked off "Don't know"?

24 A Yes.

25 But in that questionnaire, the remaining

1 Gaffin - cross

2 questions were asked and answered.

3 Q How do you know that?

4 A Because I spoke to the supervisor about it.

5 Q And it's your conclusion that this person was interviewed
6 and not that the interviewer checked off "Don't Know"
7 and signed off?"

8 A That's correct.

9 Q Now, in terms of the accuracy of your count, you had
10 some situations, did you not, where the information
11 given to you by the respondent was not what the
12 supervisor expected to get or there were multiple
13 answers to a question like, "Why did you switch?"

14 A Yes.

15 Q And how did you proceed when you got these multiple
16 answers or answered that you didn't know what to do
17 with?

18 A Well, when you get a multiple answer on an open-ended
19 question, you record both answers.

20 Q Do you have them included in --

21 A Both --

22 Q -- both tabulations?

23 A Both tabulations, that's right.

24 Q Was it your decision on how to characterize the
25 answers to the open-ended questions, or did your

1 Gaffin - cross

2 attorneys work with you on that?

3 A No, that was -- there was no decision involved.

4 They were categorized in terms of what people
5 actually said.

6 That is, there was no having to create broad
7 categories of response, which is why the responses
8 seemed so specific; they were.

9 Q Well, there was, for example, one instance where the
10 respondent mentioned the fact that CEI gave them a
11 special service.

12 A Uh-huh.

13 Q And that does not appear as a reason for switching,
14 so someone must have classified it in some other
15 classification.

16 A I don't believe that's the case, but I can check it.

17 {The witness examining his papers.}

18 Q Now, in terms of the tabulations in your report,
19 the tabulations which --

20 MR. MURPHY: Your Honor, -- excuse

21 me -- Mr. Gaffin was checking an assertion that
22 Ms. Coleman had made.

23 MS. COLEMAN: Oh, I'm sorry.

24 {After an interval.}

25 A I was just checking the tabulations on the open-ended

Gaffin - cross

1
2 questions.

3 Can you -- you could help me if you could tell
4 me which class of respondent?

5 Q Right. I'm looking for that right now.

6 {After an interval.}

7 Q Commercial constants.

8 A Commercial constants?

9 Q Yes.

10 A Okay.

11 And which question?

12 Q The question is Question No. 5.

13 A The reason for the switch?

14 Q Right.

15 A Well, there is -- the largest category is the category
16 for poor service or outages.

17 Q Right.

18 A And this is a general category because there were so
19 many responses in that category, there were 79.

20 So if the specific was one that would have
21 fallen into that category, then it might not have
22 been reported individually.

23 Whereas, something very specific and individual
24 like "Sent bills to the wrong address and then cut
25 out power" might have been reported; although, in this

1 Gaffin - cross

2 case, it looks like that was recorded under
3 "Ineffieicnt personnel" or "Sent bills to wrong
4 address."

5 Q And when the respondent to -- I'm sorry, I don't
6 have the number on that -- when the respondent to
7 one of the commercial constants said, "Chief reason
8 was I put in some infra-red equipment and CEI
9 could facilitate it", that was then classified in
10 some category and not specifically mentioned in
11 your analysis?

12 A I'm sorry; can you repeat what that respondent said?

13 Q I put some infra-red equipment in and CEI could
14 facilitate it."

15 A Well, there's one here that says, "Muny couldn't
16 handle my expansion," I'm not sure if this was
17 that.

18 Q You don't know how that was classified?

19 A I'm not sure.

20 Q Someone had to make a decision to put that in one
21 class or another?

22 A Yes.

23 Q Now, when you gave us your opinions this morning,
24 Mr. Gaffin, concerning why certain customers
25 switched from Muny to CEI, you were basing that, were

1 Gaffin - cross

2 you not, on this survey?

3 A Yes.

4 Q And you were basing it, were you not, on the -- further
5 on the sample -- the completed interviews -- pardon
6 me -- you were basing it on the completed interviews
7 that your staff undertook?

8 A That's correct.

9 Q And you have no -- you have not reviewed the evidence
10 or the testimony in this case concerning reasons for
11 switching or concerning the program which provided
12 the wiring to those customers, is that right?

13 A That's correct, I have not.

14 MS. COLEMAN: Thank you.

15 {After an interval.}

16 THE COURT: Very well, Ms.

17 Coleman, you have concluded within the time.

18 MS. COLEMAN: Two minutes.

19 THE COURT: You've got four
20 minutes of unused time.

21 MR. MURPHY: If I use that much,

22 I'll be annoyed at myself, your Honor.

23 {Laughter.}

24 THE COURT: Let's proceed.

25 - - - - -

1 REDIRECT EXAMINATION OF IRA GAFFIN

2
3 BY MR. MURPHY:4 Q Mr. Gaffin, after this lengthy cross-examination,
5 would you tell us, please, whether there was
6 anything in it that causes you to be doubtful of
7 the expert opinion you gave this morning on direct
8 examination that customers switched from Muny Light
9 to CEI service because of the liability and not
10 because of wiring provided by contractors paid for
11 by CEI?"12 A There is no reason for me to change the opinions that
13 I gave earlier, no.14 Q Mr. Gaffin, would you tell us -- briefly, please --
15 why that is so?16 A It's a rare luxury -- in the polling business, we're
17 usually dealing with universes very large like
18 registered voters in Ohio, where you have universes
19 of 5 million, and you're doing numbers of interviews
20 that seem very small in relation, like maybe 400 or
21 600.22 It's a rare luxury to be able to try to interview
23 an entire universe.24 In this case, we were able to try to interview
25 five entire universes. So I really -- we had the

1 Gaffin - redirect

2 luxury then of not even having to deal with normal
3 sampling error problems. And I just go back to the
4 data itself which, in my opinion, speaks for itself.

5 MR. MURPHY: I have no further
6 questions, your Honor.

7 {At this point, there was a loud clap of
8 thunder heard.}

9 THE COURT: I think there's a
10 message from above.

11 {Laughter.}

12 THE COURT: Ms. Coleman, would
13 you like to ask any questions?

14 MS. COLEMAN: No.

15 - - - - -
16 MS. COLEMAN: May we approach the
17 bench, your Honor?

18 THE COURT: Yes.

19 May I release the jury?

20 MS. COLEMAN: I think so.

21 THE COURT: Very well.

22 Ladies and gentlemen, you are free to go.

23 We won't give you any exhibits since we'll
24 hold those off until 8:30 on Monday morning.

25 Please, over the weekend, keep in mind the

1 Gaffin - redirect

2 Court's admonition that you are not to discuss
3 the case with anyone; you are not to view any
4 television broadcasts, listen to any radio
5 broadcasts, or read any newspaper accounts of
6 this trial since you are the sole judges of these
7 facts, without the assistance of anyone else or
8 any other source.

9 Keep an open mind until you've heard all of
10 the evidence in the case, the Court's instruction
11 on the law, and the matter is finally submitted
12 to you for your judgment.

13 With that, good night, have a nice weekend;
14 hopefully the weather will be fine during the
15 weekend.

16 MS. COLEMAN: If your Honor please,
17 I've unfortunately had time for a second thought,
18 and may we approach the bench before the jury is
19 released?

20 THE COURT: Sure.

21 MS. COLEMAN: Thank you.

22 - - - - -

23 {The following proceedings were had at the
24 bench:}

25 MS. COLEMAN: I have two motions,

1 your Honor, I thought about to bring them up
2 now before the jury leaves.

3 First, a motion to strike the direct
4 testimony on the ground that this survey is shot
5 through with flaws of all kinds as enumerated by
6 your Honor in his discussion of the survey
7 admissibility standards this morning.

8 THE COURT: Overrule your motion.

9 MS. COLEMAN: The second is a
10 request that your Honor now gives the jury the
11 cautionary instruction on survey evidence, and
12 that they must consider the specific factors that
13 your Honor --

14 THE COURT: There is no question
15 that you are entitled to that charge.

16 I was thinking about that during the course
17 of the cross-examination, and it will be included
18 in the general charge.

19 MS. COLEMAN: Rather than right
20 now?

21 MR. MURPHY: On that score, I
22 might point out that there have been two surveys
23 so far in this case, the City presented one also,
24 obviously the charge of your Honor will be
25 balanced.

1 Just an observation, your Honor, not a fight.

2 THE COURT: Good night, ladies
3 and gentlemen.

4 {The jury left the courtroom.}

5 THE COURT: Good night, gentlemen,
6 have a nice weekend, and Ms. Coleman.

7 MR. MURPHY: Thank you, your Honor.

8 {Court was adjourned until Monday,
9 September 21, 1981, at 8:30 o'clock a.m.}

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UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF OHIO
EASTERN DIVISION

City of Cleveland v. C.E.I., et al.
Civil Action No. C75-560

Transcript

Monday, September 21, 1981

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. C43
1980

1 MONDAY, SEPTEMBER 21, 1981, 9:25 O'CLOCK A.M.

2
3 LAW CLERK KURDZIEL: Your Honor, this is
4 Civil Action No. C75-560, the City of Cleveland
5 versus the Cleveland Electric Illuminating
6 Company.

7 THE COURT: Are you prepared to
8 proceed, Mr. Lansdale?

9 MR. LANSDALE: Yes.

10 THE COURT: Very well.

11 Mr. Norris, the Court would appreciate if
12 you would indicate the areas that you object to
13 in the Little Report.

14 I know that you have designated the pages,
15 but if you would outline for me what specifically
16 on the pages you object to, it would be helpful.

17 You needn't do that now.

18 MR. NORRIS: Your Honor, if I
19 could get the report back in front of me, and
20 perhaps I could do that at a break for you.

21 THE COURT: There is no hurry.

22 MR. NORRIS: All right.

23 THE COURT: Today or tomorrow.

24 Mr. Lansdale, you may proceed.

25 Bring in the jury.

1 {The jury entered the courtroom.}

2 THE COURT: Good morning, ladies
3 and gentlemen.

4 THE JURORS: Good morning.

5 THE COURT: You may proceed.

6 MR. LANSDALE: Call John
7 O'Donnell.

8 - - - - -

9
0
1 J O H N L. O ' D O N N E L L
2 of lawful age, called as a witness on behalf
3 of the defendant, being first duly sworn, was
4 examined and testified as follows:

5
6 DIRECT EXAMINATION OF JOHN L. O'DONNELL

7
8 BY MR. LANSDALE:

9 Q Will you state your name and address, please?

10 A My name is John L. O'Donnell.

11 I'm Professor of Financial Administration in the
12 Graduate School of Business Administration at
13 Michigan State University, East Lansing, Michigan.

14 Q Where do you live?

15 A I live at 1051 Wolbridge Drive, East Lansing, Michigan.

O'Donnell - direct

1
2 Q And will you please outline your educational background,
3 Professor.

4 A Yes. I have a B.A. and an M.A. in Economics at the
5 University of Cambridge, England, and I came over to
6 this country and obtained an M.B.A. and a Doctoral
7 Degree from Indiana University.

8 Q And will you please give for us your professional
9 experience since the completion of your final
10 education.

11 A I taught two years at Notre Dame, and since that time,
12 and for the past 25 years, I have taught at Michigan
13 State University, and my interests have been in
14 business finance and public utility economics.

15 Q What courses do you teach at the university?

16 A Principally in the graduate school in the area of
17 business finance.

18 Q Are you the author of any learned papers?

19 A Yes, sir. I have tried to make my contribution, and
20 my stuff has appeared in the Journal of Finance, the
21 Accounting Review, and the Journal of Business, and
22 various other, what you call in academia as learned
23 journals and there is other places.

24 Q And I believe that you have told me that you spent some
25 time in a professional capacity abroad. Tell us about

1 O'Donnell - direct

2 that.

3 A Yes, sir. I spent five years as an advisor to the
4 Turkish Government, and the Aid Mission in two
5 separate tours; and my duties encompassed general
6 economic advice and helping to build five new
7 business schools in Turkey.

8 Q What professional experience have you had in the
9 field of public utilities and electric utilities?

10 A During the last ten years, in particular, I have been
11 fairly active in our Public Utility Institute.

12 This is an institute that was formed to promote
13 research and teaching in this area of general
14 public utilities.

15 I have testified before a dozen or more state
16 commissions on a variety of problems to do with
17 finance and accounting and the organization of public
18 utilities, telephone and electrics principally, and
19 gas companies, and I have helped to organize
20 conferences, including one solely for utility
21 commissioners, that we hold once a year in
22 Washington.

23 We also publish, edit and publish learned papers
24 and other publications by scholars in the field.

25 I have also participated in such programs elsewhere

1 O'Donnell - direct

2 for about five years, and until recently each year
3 I was active in a conference put on by what is
4 called the Southwest Conference, and that takes place
5 in Georgia Tech in Atlanta, and was designed for
6 public utility executives and electric companies in
7 particular and my responsibility was in the area of
8 pricing and economic theory as it applies to public
9 utilities.

10 Q Professor O'Donnell, what is the purpose of your
11 testimony; what were you asked to do in this case?

12 A The purpose of my testimony today is to take some
13 concepts that have been put together by economists
14 and strip them down to their fighting weight, so they
15 are reasonably intelligible.

16 These had to do with forms of competition and
17 what economists mean by them, and lay the foundation
18 for me leading up to the principal point, and that
19 is the concept of the natural monopoly, and I
20 conclude that the retail distribution of firm
21 electric power in a metropolitan area such as
22 Cleveland is indeed a classic case of natural
23 monopoly.

24 Q Tell me what you did to prepare yourself for the
25 testimony specifically.

O'Donnell - direct

1
2 A I suppose the preparation fell into two parts.

3 First, I reviewed a large number of documents
4 made available to me by learned counsel, which
5 included Dr. Wein's testimony in the first trial,
6 Professor Wein's cross and direct testimony in this
7 trial, and I also read Professor Wein's report on
8 damages sustained by Muny as a result of alleged
9 CEI conduct.

10 I read most of the principal trial memoranda
11 of the Defendant CEI, and I read an article,
12 "Antitrust and Electricity Utility Industry,"
13 and I suppose "Papers" is a better term, by
14 Joe Pace of the National Economic Research
15 Associates.

16 I read a study by Arthur D. Little, "MELP
17 Mismanagement and Findings of Arthur D. Little
18 Research Team, August, 1981."

19 I read the direct and cross of A. Gerber, and
20 I read a paper headed, "MELP's Growth," by a former
21 president of the company, and I am ashamed to say
22 that his name escapes me.

23 I read a paper, "Performance in the Electricity
24 Industry of the Impact of Duplicative Competition"
25 by Neal Hammell, and I read the direct testimony

1 O'Donnell - direct

2 of Mr. Kemper.

3 These documents gave me a general background of
4 the facts of the case.

5 MS. COLEMAN: Your Honor, may we
6 approach the bench?

7 - - - - -

8 {The following proceedings were had at the
9 bench:}

10 MS. COLEMAN: Your Honor, we have
11 heard a recitation of a great deal of material
12 that has not been before the jury at this time,
13 and I object to any opinion of this witness
14 being based on such material.

15 MR. LANSDALE: He hasn't testified
16 that his opinions were based on this material.

17 I asked him what he read to specifically
18 prepare himself for this, and he has got a long
19 list of educational qualifications, and every
20 witness by the plaintiff has gotten on the stand
21 and alluded at length to materials that had
22 been read.

23 What is wrong with that? I am at a loss to
24 know how to answer the claim.

25 MS. COLEMAN: We have not referred

1 O'Donnell - direct

2 to materials which have not been ruled upon to be
3 in evidence or not even been offered yet.

4 MR. LANSDALE: I didn't hear that.

5 Would you read that to me.

6 {Record read by the reporter.}

7 MR. LANSDALE: That is a lot of
8 baloney. Dr. Wein testified at greath lengths.

9 THE COURT: Let's proceed.
10 Overruled.

11 {End of bench conference.}

12 - - - - -

13 BY MR. LANSDALE:

14 Q Professor O'Donnell, did you also at my request make
15 a review of the literature in this area?

16 A Yes, and that was my second thought of part of my
17 preparation.

18 I did what I think is a fairly extensive review
19 of what we call the learned literature, what scholars
20 have been thinking in this area, particular as it
21 obtained to natural monopoly, to that concept.

22 Q Now, Professor, tell me, what is competition as
23 viewed by you as an economist?

24 A Well, economists take this term "competition", and
25 they break it up into various types of competition.

1 O'Donnell - direct

2 They have invented some technical terms to
3 describe what they mean but, in essence, it's really
4 very simple.

5 They begin with the idea of what they call
6 "perfect competition," sometimes called atomistic,
7 everybody advances on rink-a-dink-dink terms, but
8 essentially what it means is a situation in which
9 there's a market of many buyers and many sellers,
10 not one of whom can affect prices.

11 Perhaps the type of example of this type of
12 competition most widely quoted in technical books
13 is the idea of the grain market.

14 You get grain classified into various
15 categories.

16 It's traded on the world market, and no one
17 producer or seller feels that he can effect
18 prices, and the end result is prices are set by the
19 interaction of the impersonal forces of this market.

20 Q Now, what other kinds of competition are there?

21 A Well, you move from this to a second form of
22 competition that has become known as "imperfect
23 competition."

24 This is a sort of halfway house, and I think
25 perhaps conforms more realistically to what is

1 O'Donnell - direct

2 actually taking place in most parts of the market.

3 In fact, one of my -- two of my former
4 teachers, a lady by the name of Professor Joan
5 Robertson, wrote a classic work in this field called,
6 "Economics of Imperfect Competition", a book I had
7 to study and know for reasons that were obvious.

8 In this kind of situation, what we imagine is --
9 or what we see is that producers produce different
0 products, shoes; but each of these products is
1 imbued with certain special unique real or imagined
2 characteristics that differentiate it from other
3 products.

4 So the producer does exercise some limited
5 control over the price of his product because the
6 demand for his product won't simply flee if he
7 raises or lowers the price.

8 This, I think, is the kind of situation that
9 obtains over most of the market.

0 So that's the second broad group.

1 Q Now, let me ask you about natural monopoly. You
2 used that term in your statement as to what you
3 intended to testify here today.

4 What is "natural monopoly"?

5 A Well, I suppose we now move into this third category

1 O'Donnell - direct

2 of monopoly. "Mono" means one, we've just got one
3 producer, one seller; the opposite, one buyer and
4 one seller. So the language goes on, but the idea
5 is simple enough.

6 Now, it would seem that when you look around
7 a market, there are sets of conditions where we
8 find that only one producer serves the market
9 efficiently.

0 This is particularly true in certain types of
1 industries and, like most situations, this discovery
2 in theory followed the facts.

3 When the first electricity companies and
4 telephone companies came into existence, for
5 example, many producers tried to serve the same
6 market.

7 It soon became apparent that the idea of having
8 two telephones on their desk for two different
9 companies presented complicated and unnecessary
0 problems; and communities soon found that having two
1 suppliers of electricity running down the same
2 street generated all kinds of difficulties.

3 There are then situations where competition,
4 either imperfect competition or perfect competition
5 as we have described it, just won't work either

1 O'Donnell - direct

2 because of the characteristics of the producer,
3 unique characteristics of the producer, or the
4 unique characteristics of the market, or a
5 combination of both of them.

6 Now, in this type of situation, economists
7 evolved the notion -- a fellow by the name of
8 Eli, Professor Eli, I think it was John Hopkins,
9 was perhaps the one who claimed the term, but it
10 has a history of its own, of the idea of the
11 natural monopoly.

12 Q Well now, you said there were two kinds of natural
13 monopoly.

14 Directing your attention, first, to the type
15 that you mentioned that depends upon the nature of
16 the market itself, will you describe what that is,
17 and give us an illustration?

18 A Yes.

19 There seems to be certain type of markets,
20 for example, the newspapers.

21 We've seen this emerging, where the size of the
22 market and its characteristics are such that
23 competition dwindles and only one producer
24 materializes.

25 Newspapers is a case in point.

O'Donnell - direct

It would seem that the characteristics of the demand for newspapers in the local market is such that the economics of producing newspapers is such that there's a general tendency that we can see all over the country for competition to dwindle, and one newspaper to emerge as the sole producer, the sole servicer of the market.

Similarly, I think in defense expenditures in certain areas, it would seem that because there's only one buyer, the Government, and because of the economics of, again, of the producing side of it, there's a tendency in certain areas -- rocket fuel would be a case in point -- for competition to dwindle and only one producer to emerge.

Q Now, Professor, in such a market, what is the fact as to whether one must examine the economics of the specific market to determine whether there is natural monopoly conditions in such case?

A I'm sorry, I missed the first part; I'm sorry.

THE COURT: Read the question back; please.

{The pending question was read by the reporter.}

A I --

1 O'Donnell - direct

2 Q If my question isn't clear to you, I will --

3 A No, sir.

4 Q -- I will withdraw it.

II

5 Please move to the other kind of natural
6 monopoly that you mentioned, the one depending upon
7 the characteristics of the producer as distinguished
8 from the characteristics or economics of the market
9 itself?

10 A Yes.

11 As we look at the types of producers for
12 service, what we call public utility markets
13 principally, public utility industry, some of the
14 characteristics are as follows:

15 Basically, they seem all to have a very high
16 proportion of fixed to variable costs.

17 Now, fixed costs is a term used by accountants
18 and economists and others to describe a phenomenon
19 that we're all familiar with, and that is to say, if
20 you imagine a firm in production, you can divide its
21 total costs into these two broad categories, fixed
22 and variable.

23 Now, fixed costs are those costs that over a
24 relevant range of output do not change very much
25 with output.

O'Donnell - direct

Your rent stays the same if you're paying rent regardless of whether you produce one unit or 100 units or 10,000 units.

Doctors remain the same.

Usually management overhead remains the same.

There's a whole array of costs that just don't change.

Well, for a public utility, those costs are inordinately large for a variety of reasons, not the least being that utilities use a large amount of physical capital, the servicing, the costs of that capital is large, the debt costs, and the like, they don't change regardless of what you produce.

Variable costs tend to change as output changes.

Now, when you've got any kind of producer who has a large proportion of fixed costs, it's clear that if you can spread those costs over more output, the cost per unit falls.

For instance, if your fixed costs that don't vary, on a million dollars, if you produce a million units, by definition the fixed cost per unit is a dollar.

But if you have the capacity and the market is there and you can produce two million units, your

O'Donnell - direct

fixed costs will go up 50 cents, and your average costs will fall.

So the trick is to spread these costs over as much output as you possibly can.

Now, this is one characteristic that public utilities have that tends to make it -- it contributes to the notion that when you go to the market that your serving and you have a certain amount of fixed costs that have to be covered, we discover that, in many instances, only one producer can serve that market at the lowest possible cost.

Q Directing your attention specifically to the distribution of electric energy and its sale at retail, how do you characterize this business in terms of natural monopoly?

A Well, the search of the literature shows what I believe, what I've always thought, that the distribution -- the retail distribution of electricity is really the classic case of the natural monopoly.

First, and foremost, it has those characteristics I've just outlined are fixed to variable costs.

2. It's supplying a service that has to be supplied on demand and not be stored.

1 O'Donnell - direct

2 You can't store it up and let it out when you
3 want it; so you have to have a certain minimum
4 capacity to meet these high demands when they occur.
5 So you can't take care of that problem by storing.

6 3. There's a sort of umbilical cord that links
7 the producer to the consumer; the telephone
8 company's the same.

9 You can't readily and easily switch -- you can
10 switch, but it's a lot of expense and trouble.

11 Once a customer is tied to a producer, you've
12 got these -- this kind of physical connection and
13 relationship.

14 Fourthly, demand does tend to fluctuate all over
15 the place. There's wide fluctuation in demand between
16 the peak and the load demand.

17 These characteristics, plus the fact that you
18 need the right of eminent domain, you have to go
19 across other people's property and dig up streets
20 and whatnot in order to serve the market.

21 The nature of the product. While it's hard to
22 define what a necessity is in a world in which many
23 are starving to death, the fact nevertheless remains
24 in our civilization, the provision of water,
25 communications, light and heat we regard as necessities.

O'Donnell - direct

something of a public charge with them, we don't just regard them as ordinary commodities.

All these things conspire together to make the provision of these types of services a natural monopoly in the sense that when you examine all the facts, one producer can service that particular market cheaper than two producers, and more conveniently.

Q Now, Professor, I ask you, with reference to the distribution of electric energy, is there any need, in your judgment, to study the character or the costs of the generation and transmission of electric energy in order to determine whether the distribution is a natural monopoly?

A No, sir.

Q And will you -- is it your opinion then -- what is your opinion as to whether one can isolate the business of the distribution of electric energy from the other portions of the system which delivers the energy to the customer in order to ascertain whether a natural monopoly exists?

A Well, it seems to me that the tri-pot division between generation, transmission, and distribution has a logic of its own, it's common to most lines

1 O'Donnell - direct

2 of business, production, wholesaling, and retailing,
3 and that it's not necessary to study all three in
4 order to study one; there are costs of peculiarities
5 to each stage.

6 Now, what one can say is that what happens at the
7 wholesale level may well determine who survives in
8 that natural monopoly market, but that is not a
9 matter of my concern, it's still a natural monopoly
10 market.

11 It's my contention that if the full forces of
12 competition are unleashed and they function in a
13 fashion that we normally think of them functioning,
14 then there's every indication that one or other or
15 more -- if there are more of them -- that the
16 producers will be driven out and one will remain.

17 Q Will you -- that brings up the subject of competition
18 in a natural monopoly market.

19 Can there be competition in a natural monopoly
20 market?

21 A It seems to me that there can be competition, as I
22 understand, till somebody gets driven out.

23 Q Okay, sir.

24 Will you please describe for us, from an
25 economist's point of view, the character of competition

1 O'Donnell - direct

2 in a natural monopoly market. Is this the normal
3 sort of competition that you see every day in the
4 marketplace?

5 A Well, I think because of the barriers of entry, you
6 need so much capital to get in, and because of all
7 the factors that I listed earlier, competition
8 historically is usually devolved to the very few in
9 this type of market.

10 Economists have a word for it:

11 When you no longer have imperfect competition,
12 but you've got few people serving the market, then
13 you've got a thing called oligopoly; it just means
14 you have, say, four or five, or three or four.

15 Now, under that circumstance, when you've got
16 to that stage and you have all the characteristics
17 that I've listed earlier, which are the
18 characteristics of the distribution of retail
19 electricity, you then get a form of very vicious
20 competition which usually reduces the number of
21 producers to two, a duopoly; duet, two people
22 playing a fiddle, duopoly, two people competing.

23 And when that situation arises, it is possible
24 for gentlemen's agreements to arise -- or, shall I
25 say, person agreements to arise, in which there is

O'Donnell - direct

agreement not to compete in certain areas:

We won't tell the public that your prices are a bit lower than mine. We'll just keep quiet about it. You don't make a noise; I won't make a noise. We'll agree on other matters, either explicitly or tacitly; and a sort of cat and mouse monopolization can emerge.

Economists have coined that term, "Cat and mouse." That can erupt occasionally into price wars and other types of wars that may ultimately result in one of the competitors being destroyed, or it can result and then be pacified. But it is essentially a situation of instability that will only survive provided the full forces of competition are not unleashed.

O'Donnell - direct

1
2 Q Well, if the full forces of competition are unleashed,
3 what are the exactible consequences?

4 A They are that the fellow with the longest purse and
5 the sharpest management and the fastest response to
6 the competition in front of him will survive, and
7 the other competitor will go bankrupt or be driven
8 out or acquired or would merge, and we have the one
9 observing the market, the natural monopoly.

10 Q Will you describe, Professor, what kind of competition
11 one would expect when the forces of competition are
12 unleashed in a natural monopoly market that you have
13 described?

14 A Perhaps I misunderstood you. It is vicious competition.

15 Q Vicious?

16 A Yes.

17 Q And let me ask you this question:

18 How would you as an economist expect a
19 competitor in a natural monopoly market to react to
20 a request for assistance in surviving from its
21 competitor?

22 A I would expect him to reject it.

23 Q Why would you expect him to do that?

24 A One can hardly expect that a competitive situation
25 for one of the contestants to subscribe to the

1 O'Donnell - direct

2 survival of his competitor for his own instruction.

3 This is unreasonable conduct.

4 One cannot expect that to occur, for the same
5 reason that one would expect a man to commit
6 suicide for the benefit of his neighbor.

7 I don't think that is a reasonable expectation.

8 MS. COLEMAN: May we approach the
9 bench?

10 THE COURT: Yes.

11
12 {The following proceedings were had at the
13 bench:}

14 MS. COLEMAN: I move to strike that
15 testimony. The jury is supposed to follow the
16 law, and not what any one witness thinks might
17 be reasonable under the circumstances, and I
18 object to a speech on the subject of whether any
19 witness thinks that something should or ought not
20 to be done.

21 THE COURT: He is an expert
22 witness. That is what he is brought here for.

23 MS. COLEMAN: He is not brought
24 here to tell the jury the law.

25 THE COURT: What law are you

1 O'Donnell - direct

2 referring to?

3 MS. COLEMAN: He is talking about
4 what someone ought to do or what would reasonably
5 be expected for them to do.

6 THE COURT: Overruled. Let's
7 proceed.

8 {End of bench conference.}

9
10 BY MR. LANSDALE:

11 Q Now, Professor O'Donnell, have you examined the cost
12 of service, the relative cost of service between
13 Muny Light and the Cleveland Electric Illuminating
14 Company or other specific economics of this market?

15 A No, sir.

16 Q Do you feel that in this case it is necessary or even
17 helpful to do that?

18 A Not for my purposes, no, sir.

19 It seems clear, when you go down the street,
20 that for servicing the customer, that if you put
21 one line of poles down that street and one company
22 serves that whole street, that the total cost of
23 doing that is going to be lower than if you have two
24 sets of poles and two sets of lines going down that
25 street.

1 O'Donnell - direct

2 It seems to me one doesn't need a degree or
3 much common sense to appreciate that point.

4 MR. LANSDALE: Thank you. No
5 further questions.

6 THE COURT: You may cross-examine.

7 MS. COLEMAN: Thank you.

8
9
10 CROSS-EXAMINATION OF DR. JOHN L. O'DONNELL

11
12 BY MS. COLEMAN:

13 Q Professor O'Donnell, you mentioned that you had a
14 Doctoral Degree from Indiana University.

15 Would you tell us what that degree is?

16 A Yes, Business Administration.

17 Q That is not a Ph.D.?

18 A No, that is not correct.

19 Q You are not, I gather, an engineer?

20 A No.

21 Q I gathered from listening to your description of your
22 work history that you are essentially -- that you
23 essentially have been employed in academia since
24 leaving school; is that correct?

25 A That is correct.

O'Donnell - cross

1
2 Q You have some consulting or testifying type of
3 assignments here and there?

4 A I have done consulting and I have had testifying
5 experience, yes.

6 Q But you have not been employed and working in an
7 electric utility?

8 A That is correct.

9 Q Now, you referred us to publications in the Journal
10 of Finance and the Accounting Review and the
11 Journal of Business.

12 A Yes.

13 Q And you also have a couple of articles in the Public
14 Utilities Fortnightly, which is a general industry
15 magazine for utilities?

16 A That is correct.

17 Q All of those articles are on some subject relating
18 to the finance of the public utilities or other
19 topics of finance; is that correct?

20 A The ones that you have mentioned, I believe that is
21 correct.

22 Q Are you familiar in your experience in the
23 "publish or perish" profession, Professor, of the
24 practice where your article must be reviewed by an
25 impartial group of referees?

O'Donnell - cross

1
2 A Yes, ma'am.

3 Q Have you had any of the articles reviewed by
4 referees?

5 A The Journal of Finance, the Chicago Journal of
6 Business, and the Accounting Review, all those are,
7 as I said, in my opening statement, are what we would
8 call learned papers and are refereed generally.

9 Q Were your articles refereed?

10 A Yes. That is the only way they got in there.

11 Q Now, you do not have any publications, I gather,
12 in the areas in which you have testified today; that
13 is, competition and natural monopoly; is that
14 correct?

15 A Strictly construed, yes, but, for example, I published
16 an article on competition in the oil industry and
17 its impact on costs for the West, and that appeared
18 in the Michigan Journal of Business, a publication
19 of the University of Michigan; but, no, I think in
20 substance you are correct, that I have not published
21 anything in the antitrust area.

22 Q And the oil article that you referred to is one
23 entitled "Financing OPEC Oil"?

24 A That is correct.

25 Q And that was dealing with the oil industry and not

1 O'Donnell - cross

2 the electrical industry?

3 A That is correct.

4 Q Now, what courses are you teaching at MSU?

5 A As I explained in my opening statement, I teach
6 principally in the graduate school, and I teach
7 courses in business finance.

8 This covers a multitude of sins, but has to do
9 principally with short term, long term, and
10 intermediate term costs of capital and capital
11 budgeting and all those decisions that finance
12 executives have to meet and solve in order to run
13 a corporation.

14 Q Are questions of antitrust and antitrust policy
15 part of a finance course?

16 A No, ma'am.

17 Q Have you introduced those into your curriculum for
18 the finance courses?

19 A Only peripherally. I was engaged in an accounting
20 job for United Gas vs. Pennzoil where there was
21 some antimonopoly and competitive implications.

22 I did used to teach at Indiana University for
23 two years, and I taught business and government
24 relationships, and I did a lot of work at that
25 time in the area of trying to be a lay lawyer

O'Donnell - cross

1 discussing anti-monopoly questions, but that was many
2 years ago, and I have no pretense to familiarity with
3 that legislation now.
4

5 Q That was what -- about 20 years ago?

6 A 20 years ago, yes, ma'am.

7 Q And when you were dealing with the Pennzoil spinoff,
8 your particular concern was with the financial
9 aspect of that as opposed to the competition aspect?

10 A My major interest and assignment was certainly on
11 the financial side, finance and accounting, and that
12 is my major concern, yes, and general economic
13 theory.

14 My B.A. and my M.A. at the University of
15 Cambridge was taken in economic theory.

16 Q I won't ask you how long ago that was.

17 Since you have been at M.S.U., have you taught
18 any courses in general economics?

19 A Not at M.S.U.

20 As I pointed out, in the past five years, each
21 summer I teach in the area of general economics and
22 price theory in this seminar at Georgia Tech.

23 Q And at M.S.U. have you taught utility economics?

24 A No, ma'am.

25 Q Have you taught any courses in regulated industry?

O'Donnell - cross

1
2 A I participate each summer for three days in a
3 conference that we put on for the National
4 Association of Railroads and Utility Commissioners,
5 and I cover a variety of subjects there.

6 Q Are you saying that you speak?

7 A I am one of the lecturers on the program, and I
8 have been for the past ten years, and also at the
9 conference we run at Williamsburg, and also have
10 participated in giving papers to this conference that
11 we run each year in Washington, solely for
12 commissioners, regulatory commissioners.

13 Q Have you taught any courses at MSU on public policy?

14 A No.

15 Q -- concerning regulated utilities or otherwise?

16 A No.

17 Q Now, you mention testimony that you have given about
18 a dozen state commissions.

19 Those were on behalf of electric and gas
20 utilities?

21 A Electric, gas and telephone.

22 Q And those were all investor-owned electric or gas
23 companies; is that correct?

24 A Yes; that is correct.

25 Q Now, the primary issue of your concern was the cost

1 O'Donnell - cross

2 of capital and the rate of return; is that right?

3 A No, I covered, as I said in my direct statement, I
4 covered a variety of topics, accounting topics, and
5 the questioning of financing a Pennzoil spinoff,
6 and more recently, in the last year, the cost of
7 capital dominated by contributions there.

8 But I think it is fair to say that I have done
9 a lot more than just the cost of capital, and I
10 also have acted as a consultant not for testifying,
11 but I acted as a consultant, for example, in the
12 Bell Telephone Company on the general economics of
13 providing a price index system for automatic
14 adjustment clauses for their rates; and the
15 commission in Michigan is accepting it, and it is
16 in force, so in addition to testifying, I should
17 add that there is a variety of other subjects that
18 I have been consulted on.

19 Q When you testified before the State Utility
20 Commission concerning an issue concerning the cost
21 of capital, have the commissions awarded or
22 identified the cost of capital for the utilities
23 consistent with your recommendation?

24 A Let me think a moment.

25 Most of the cases have taken place in the last

1 O'Donnell - cross

2 year, and a lot haven't been settled yet.

3 They have been within 1 percent, for example,
4 the ruling in Michigan, as I recall, I recommended
5 17 percent, and they came out with 16.

6 I am quoting from memory. The answer is that
7 they rarely have the wisdom to come out precisely
8 with the recommendation I make, but usually they
9 come within 1 or 1-1/2 percent, and I am satisfied.

10 Q When you make a study of the cost of capital for
11 the purposes of testifying in the State Commission,
12 do you study the efficiency of the use of capital
13 for your clients, the utilities?

14 A I am not sure I really understand your question.
15 Tell me what you mean by the efficiency and the use
16 of capital, please, and then perhaps I can respond.

17 Q Well, is it a consideration that when you testified
18 on the cost of capital, how the capital is used
19 by your client, and how efficiently it is used?

20 A The closest I come to that is the capital structure
21 of the capital -- is it reasonable, but are the
22 capital budgeting decisions of the management
23 intelligent, and are they the best that could be
24 made with all the benefits of hindsight?-- now, that
25 is not my assignment.

O'Donnell - cross

1
2 Q Now, in the course of your studies, either abroad or
3 in this country, did you take courses in advanced
4 calculus?

5 A No.

6 Q Function theory?

7 A No.

8 Q Econometrics?

9 A Yes -- pardon me. I haven't taken courses. I took
10 three courses a number of years ago at Michigan
11 State in calculus to brush up on what I learned,
12 but econometrics is not my field, and I have no
13 pretense to be an econometrician, and I do not
14 present myself as such.

15 Q Are you versed in advanced statistics?

16 A I know enough to get by, but there are liars
17 and statisticians, and so I became a full
18 professor because I could defend myself.

19 Q You submitted to us a list of books and articles.

20 Isn't it true that to fully understand at least
21 five of the articles on the list, you have to be
22 conversant with advanced calculus and advanced
23 statistics?

24 A You are absolutely right, and that is why I consult
25 with my colleagues when I come up against things of

1 O'Donnell - cross

2 that order that I don't follow, and I did that, and I
3 might add that those articles seem to be rather
4 purile in the sense that they didn't say a great
5 deal, but that is my judgment on the basis of the
6 advice that I sought.

7 One of my colleagues is from MIT, and he has a
8 Ph.D. in statistics, and we have him in the
9 department specifically as a research person since
10 we all can't be clever at everything, and when I run
11 up against problems of this order, I consult with
12 him and other of my colleagues, and those are my
13 conclusions on the basis of consulting with them.

14 But you are right that at least five of those
15 articles are of that order.

16 Q And when you make your evaluation of those articles,
17 are you basing it on the part that is written in
18 English that you can't understand, or are you basing
19 it upon something which someone told you on a
20 mathematical formula that occurred in the remainder
21 of the article?

22 A It is a combination.

23 In all these articles they come up with a
24 summary, and it is a combination of the two.

25 Q When were you asked to testify in this case?

1 O'Donnell - cross

2 A A long time ago. I can't remember. I would have to
3 consult my records, but I think -- but I believe I
4 may have -- it may have been February of this year,
5 as I recall.

6 I really can't remember. I would have to go
7 back.

8 Q Was it this year?

9 A I believe it was this year. There were so many
10 postponements, and I am so busy that my retrieval
11 system doesn't work too well. I believe it was
12 this year, but I may have been wrong. It may have
13 been earlier.

14 Q When did you form your opinion that the City of
15 Cleveland is a natural monopoly?

16 A First let me begin by saying that I began with that
17 prejudice to begin with, since my entire training
18 has taught me that the retail distribution of
19 electricity is a natural monopoly.

20 When somebody asks me, "Do you think that
21 East Lansing is a natural monopoly market for the
22 distribution of electricity," or telephone or
23 water service, my knee jerk reaction is "Yes"
24 because my entire -- and common sense leads me in
25 that direction.

1 O'Donnell - cross

2 My subsequent review of the literature confirmed
3 what my education had already taught me and what my
4 common sense observation led me to believe; namely,
5 with what I regard as minor variances, the great
6 body of economists are still of this opinion, that
7 the retail distribution of firm electric power is a
8 natural monopoly.

9 Q When was your education in Cambridge?

10 A 1948 to 1951, I believe.

11 Q And then you began with this conclusion, and you
12 looked around to see what else you could say about
13 this subject?

14 A No. I began with the conclusion remembering that
15 we students of this subject received our education
16 so many years ago, and I tried to keep it current.

17 What I did was review this literature with
18 specific references to this point.

19 My job in the Public Utility Institute is
20 reviewing manuscripts all the time of scholars in
21 the field.

22 I have 15 on my desk at the moment, and
23 therefore I have a good opportunity to continually
24 review what is being done in this area of
25 competition and elsewhere, so I was not entirely

1 O'Donnell - cross

2 unaware of what was going on.

3 But I went back 10 or 15 years in the literature
4 to try to highpoint and focus on this specific
5 issue, and my conclusions were that my initial
6 thinking and impressions were correct.

7 Q The Utilities Institute is concerned with utilities
8 other than electrical utilities?

9 A Yes, ma'am.

10 Q And the subjects which may be proffered to you in the
11 form of papers that people would like to have
12 published included a variety of subjects in the
13 utility area?

14 A Yes.

15 Q And you are not trying to tell us that every paper
16 that comes across your desk is dealing with the
17 question of natural monopoly?

18 A No, I wasn't trying to tell you that.

19 Q In terms of the information other than the articles
20 and the books that you have reviewed, who selected
21 those for your review?

22 A I selected them at a process of going through --
23 the system is to go back to the index of economic
24 journals -- I am sorry.

25 Q Maybe I didn't make myself clear. I understand how

1 O'Donnell - cross

2 you picked out the books and articles.

3 My question is, who picked out the testimony and
4 other information that you studied?

5 A Well, it came from two sources. One was by counsel,
6 and he said, "You ought to read this," and then I
7 asked for the documents. There are a lot of things
8 I didn't mention because I have forgotten, and a lot
9 of stuff I read that was outside of my field, so I
10 asked for certain things, and he supplied others,
11 so it was a joint process.

12 Q Did you review any -- may I call them "contemporaneous
13 documents"? Did you review any memoranda from the
14 CEI company arising at the time of the actions
15 which are the subject of this litigation?

16 A No, I didn't.

17 Q Your focus then was on the testimony; is that right?

18 A Yes.

19 Q And some reports or compilations of opinions that you
20 looked at?

21 A Yes. I asked for those things that I thought were
22 pertinent in filling me in on the general background
23 of natural monopoly.

24 I am not really interested in who threw the
25 first stone. I was just addressing the question of

1 O'Donnell - cross

2 natural monopoly.

3 Q Now, you referred a minute ago to the list of books
4 and articles which you provided, and my question is,
5 have you selected those at the top -- I gather that
6 means that there are some you didn't include? Is
7 that how I understand it?

8 A Yes. There is a welter of literature in this field,
9 and most is repetitive, and most of which it seems to
10 me, well, are just repetitive, so I just, from the
11 bundle I looked at, I just selected those that it
12 seemed to me to be the better articles, that they
13 had more meat in them, and they say more, and they
14 express pretty much what everybody else is saying.

15 Q And you consider those the authority on which you
16 relied for your testimony today?

17 A In part, yes.

18 In other words, what I was interested in was,
19 are there any of my learned colleagues who can put
20 up a good argument that the retail distribution of
21 electric power is not a natural monopoly, and my
22 conclusions were no, I don't see anything that
23 persuaded me to change my mind on this question, so
24 essentially I was looking for a good argument that
25 would persuade me that the -- that my initial

1 O'Donnell - cross

2 thinkings was wrong, and I couldn't find it.

3 Q And therefore the ones on the list are those which
4 are consistent with your initial thinking on it?

5 A I am not sure that a lot of those on the list
6 address the questions directly, as I would like,
7 but, yes. Let's say I agree with them, or they
8 agree with me, whatever way you want to put it.

9 Q When did you read those books and articles?

10 A Right up to and during the period that Mr. Lansdale
11 asked me, about a week ago, to provide that list.

12 Q Have you ever previously been asked to give your
13 professional opinion on the existence of natural
14 monopoly in any location?

15 A No, ma'am.

16 Q Turning to your discussion of the natural monopoly,
17 Dr. O'Donnell, you mentioned public utilities in the
18 same breath as natural monopoly, and I want to ask
19 you whether all natural monopolies are public
20 utilities?

21 A No.

22 Q And are you -- are all public utilities natural
23 monopolies?

24 A No.

25 Q The definition of natural monopoly relates to a firm

O'Donnell - cross

1
2 in a market, does it not?

3 A Yes.

4 Q It does not relate to the market alone?

5 A That is correct.

6 You have got to have a market to sell a product,
7 so it is rather like, which is more important, my left
8 or my right leg when I am on a walk; so you are right.

9 Q And when we are referring to a firm, we are talking
10 about the entire single company with independent
11 management, and we are talking about its physical
12 assets as well as its employees and cash and
13 management; is that right?

14 A I believe that is correct, yes, an artificial person
15 in contemplation of the law, I think is the way the
16 lawyers put it.

17 Q And we are not speaking in terms of a simple machine
18 or something like that?

19 A That is correct.

20 Q Now, in terms of a definition of a natural monopoly
21 that assumes a situation in which the single firm
22 is operating as efficiently as possible, given the
23 state of the art and prevailing knowledge at the
24 time; isn't that right?

25 A Yes.

O'Donnell - cross

1
2 that assumption to be produced.

3 Q If the single firm is now operating as efficiently as
4 possible, it may be that two firms both may provide
5 the service in the market at a lower total cost than
6 the single firm operating efficiently?

7 A No, that is not what I had in mind.

8 I had in mind that it is possible to have a
9 natural market where the regulatory process is not
10 working too well, and you have one producer whose costs
11 are not as low as they ought to be, so you have got a
12 natural monopoly with producing services in a market
13 whose costs are perhaps 5 percent higher than they
14 ought to be, but it is a situation which, even if
15 opened up to competition, there is not enough margin
16 to justify a second one coming in or saying it
17 depends upon the relative efficiency.

18 Q Now, you introduced the idea of a regulatory agency
19 when speaking of efficiency.

20 The efficiency of the firm in the first
21 instance is up to the firm and managers, is it not?

22 A Yes; that is correct.

23 Q And if it has been determined to have some regulation
24 over that firm, it may or may not be that the
25 regulation gets involved in directing the operation

O'Donnell - cross

Q In other words, a certain technology is assumed in terms of a natural monopoly?

A Correct.

Q And it may well be that if the technology changes, that one may not have a natural monopoly any longer?

A That is possible, and by the same token, if technology or circumstances change, that which normally was competition, a competition situation, may become a natural monopoly. It is conceivable, yes.

Q So that this is a concept which is not enduring though at all times, but the subject -- but it is subject to change of what is current in terms of technology and in terms of type of operations permitted by the technology?

A Yes. I think that is a fair statement.

It could change, and that is why we should reexamine these situations.

Q In addition to the assumption about technology, there is -- isn't there an assumption that the firm, the single firm, has the least cost when it is being operated as efficiently as possible; is that correct?

A That is an assumption, yes, but of course it is not necessary for a natural monopoly to exist for

O'Donnell - cross

that assumption to be produced.

Q If the single firm is now operating as efficiently as possible, it may be that two firms both may provide the service in the market at a lower total cost than the single firm operating efficiently?

A No, that is not what I had in mind.

I had in mind that it is possible to have a natural market where the regulatory process is not working too well, and you have one producer whose costs are not as low as they ought to be, so you have got a natural monopoly with producing services in a market whose costs are perhaps 5 percent higher than they ought to be, but it is a situation which, even if opened up to competition, there is not enough margin to justify a second one coming in or saying it depends upon the relative efficiency.

Q Now, you introduced the idea of a regulatory agency when speaking of efficiency.

The efficiency of the firm in the first instance is up to the firm and managers, is it not?

A Yes; that is correct.

Q And if it has been determined to have some regulation over that firm, it may or may not be that the regulation gets involved in directing the operation

1 O'Donnell - cross

2 of the firm; is that correct?

3 A It is my view that they shouldn't.

4 Q They should not?

5 A Yes.

6 Q They ought to leave it to the managers to determine
7 the efficiency of the firm?

8 A I think there are certain broad parameters to a
9 regulation concept to achieve, but when the regulator
10 usurps the management's function, he becomes
11 responsible for what happens, and I wouldn't want to
12 be in that position, to have the responsibility
13 without the profit is sort of foolish, sort of a
14 foolish position to be in.

15 Q So, out of charity for the regulators, you don't think
16 that they ought to confine their concerns, and that
17 they should not get involved in the managerial
18 aspects; is that correct?

19 A It is not so much charity. I think it is good
20 economics.

21 My advice to the regulator is to regulate, but
22 don't try to replace the management of the company,
23 and if you do, you are going to be in serious trouble.

24 Q And, in fact, commissions have found that generally
25 regulators do not get involved in the questions of

1 O'Donnell - cross

2 the management of a company; isn't that correct?

3 A I am not sure on that point. I wouldn't quite agree
4 with you.

5 Q Well, to go back to your initial comment, if a firm
6 is not operating at the optimum efficiency, that is
7 probably attributable to the management of the firm
8 and not to the regulatory process?

9 A It may be a bit of both.

10 Q You wouldn't know of the particular circumstances
11 unless you looked at it?

12 A Exactly.

13 For example, it may well be that the regulator
14 steps in and says that it is not appropriate for you
15 to build a certain power plant, and the management
16 may well say that on the basis of our experience we
17 ought to have it, and the power plant isn't built,
18 and as a result ten years later production costs
19 are higher than they ought to be, and who is
20 responsible?

21 Q Do we agree then that the natural monopoly theory
22 assumes that a single firm is operating at optimum --
23 at its best efficiency?

24 MR. LANSDALE: Objection.

25 THE COURT: Approach the bench.

1 O'Donnell - cross

2 {The following proceedings were had at the
3 bench:}

4 MR. LANSDALE: This is highly
5 repetitious. The witness testified to the
6 answer two or three times, and he expressed his
7 views to all aspects, and I object to the
8 suggestion or the attempt by counsel to
9 summarize the testimony that preceded, and I
10 object to the question.

11 MS. COLEMAN: After we have gone
12 through a number of subordinate issues, I think
13 it is important to come back to the point of
14 departure.

15 THE COURT: A certain amount of
16 repetition is permitted on cross-examination.

17 Overruled. Let's proceed.

18 {End of bench conference.}

19 - - - - -

20 THE COURT: Read the question.

21 {Pending question was read by the reporter
22 as follows:

23 "Q Do we agree then that the natural
24 monopoly theory assumes that a single firm is
25 operating at optimum -- at its best efficiency?"}

O'Donnell - cross

1
2 A I don't think this is an essential assumption, but it
3 frequently is made, and if it is convenient for the
4 discussion to make it, then I am happy to make it.

5 I said that I had -- that it was conceivable to
6 me that you could have a monopoly market in which a
7 single producer is not producing at entirely the
8 lowest cost and still there is only one producer.

9 In fact, that is the great criticism that
10 economists level against regulated natural monopolies,
11 that they are not functioning as efficiently as they
12 could or state that they ought to be.

13 I am having difficulty with the question. I am
14 not trying to be evasive. But it doesn't seem to me
15 to be essential to the main line of thinking. That
16 is my point. That is all the point I wanted to make.

17 Clearly there are limits to how inefficient you
18 can be in a competitive situation.

19 Q If the one who is there is too inefficient, and the
20 gap between the cost of that one and what they
21 ought to be, according to your theory, are too great,
22 others might come in, and the total costs to serve
23 the market might in fact be lower; is that correct?

24 A Yes.

25 Q Now, for the purposes of your conclusion offered in

1 O'Donnell - cross

2 your direct examination this morning, did you make
3 this assumption of optimal efficiency or not?

4 A No, because it seemed to me in the present
5 situation, that where you have got two companies
6 competing head on in the 35-mile area, this is a
7 very inefficient way to do it.

8 In fact, one company that served in the 35-mile
9 area had accumulated a deficit and was virtually
10 bankrupt in 1971, and that indicates that.

11 I think the optimum situation here would be
12 for one or the other to get out, and for one
13 company to serve the area.

14 Q When you talk about -- when you are referring to a
15 35-mile area, what are you talking about?

16 A The area on one of those maps that I studied in which
17 Muny Light and CEI are competing directly.

18 Q Is that the subject that you studied?

19 A I looked at the map as part of my general
20 preparation.

21 Q And counsel informed you what the map was?

22 A Yes. They showed me what the areas were, and I read
23 it in Professor Wein's testimony, the references to
24 yellow lines and blue lines, so I asked the obvious
25 question, "What is the yellow line and what is the

1 O'Donnell - cross

2 blue line," and I was told that it demonstrated that
3 since 1935 Muny Light has expanded one quarter of a
4 mile beyond the area that it had in 1931, and these
5 were the overlapping years.

6 Q That is not something you have come here prepared to
7 speak about?

8 A Not really, no. I am not an expert on geographic
9 boundaries in this issue.

10 Q -- or on the definition of markets in terms of
11 geographic markets?

12 A No. I think the market has been defined by the
13 Court, and therefore not the subject that I need to
14 address.

15 Q On the question again of the requisites of natural
16 monopoly, a definition of natural monopoly assumes
17 that certain input prices for those things which must
18 be combined to create the product or the service
19 involved; isn't that right?

20 A Well, I don't see that it is just relative to
21 natural monopoly.

22 What you are looking -- when you are looking at
23 prices, I suppose part is looking at costs and the
24 determination of those prices, yes.

25 Q And the costs of the inputs?

O'Donnell - cross

1
2 A Yes.

3 Q Those goods are materials which must be used to
4 produce the product; and is it necessary to make a
5 certain assumption about the relative costs of the
6 input in order to say something about natural
7 monopoly?

8 A Not really, no. I fail to see why that is true.

9 Q You have on your bibliography an article by Mr.
10 William J. Baumol on the producer cost tests for
11 natural monopoly?

12 A Yes.

13 Q And Professor Baumol is from Princeton and New York
14 State Universities, and he states, "Prices are taken
15 to be constant because an industry may be a natural
16 monopoly at one set of input prices and not another."

17 A That is correct; and the problem he is addressing is
18 somewhat different than I am addressing here.

19 I don't see this as a multi-product problem.

20 This is retail sales of electricity.

21 That article that you have mentioned it seems to
22 me was highly imaginative and an interesting exercise
23 and interesting reading, but it really didn't enlighten
24 me very much as to the problem at hand.

25 Q Well, again, this was one of those articles that was

O'Donnell - cross

1
2 filled with a variety of equations and higher
3 calculus?

4 A That is right.

5 Q And the article dealt, did it not, with identifying
6 whether an actual monopoly exists in both the
7 single firm product, single-product firm -- pardon me,
8 and in the multi-product firm context?

9 A Yes, but it is -- the principal thrust was the idea
10 of taking multiple products and trying to see under
11 certain assumptions what the outcome would be;
12 whether the natural monopoly would hold, and I would
13 agree with that, and in the process of doing that, if
14 you have multiple products, you have multiple prices,
15 and then you get interested in multiple inputs, and he
16 calls them multiple supplies, and I agree, but I
17 didn't find that too helpful to answer the question
18 as to whether or not the retail distribution of firm
19 electric power is a natural monopoly, and I don't
20 recall that Professor Baumol ever came to -- and I
21 don't recall anybody else building that up.

22 Q You must have had a variety of input to come out with
23 firm electric power?

24 A Yes.

25 Q And what would those include?

O'Donnell - cross

1
2 A Land, labor, and capital.

3 Q To produce the firm electric power you need also
4 certain materials, do you not?

5 A Yes. Economists usually include that under land;
6 that is right.

7 Q Under land you include coal; is that right?

8 A Yes.

9 Q Now, given the fact that you have to have multiple
10 input to come out with the product of firm electric
11 power, then the relative costs of those inputs are
12 important to determine whether you have natural
13 monopoly for firm electric power; is that correct?

14 A No. It will determine who survives.

15 If your inputs are heavily subsidized, you can
16 acquire them on terms that I can't, and you and I are
17 in head-to-head competition, and then if that factor
18 alone, and everything else being equal, then I think
19 you are going to put me out of business.

20 There is no question about that, and a natural
21 monopoly will emerge; namely, one producer will be
22 left.

23 Q Well, assume a situation --

24 MR. LANSDALE: Objection.

25 THE COURT: Let the doctor finish.

1 O'Donnell - cross

2 THE WITNESS: Thank you. I am
3 finished.

4 BY MS. COLEMAN:

5 Q Assume a situation where over time the relative
6 costs of land, labor, and capital change with respect
7 to each other; in other words, in an earlier period
8 the capital is relatively less expensive than the
9 labor, and in a later period the economic conditions
10 are such that the labor is relatively less expensive
11 and the capital more so.

12 Is it not the case that you may have a natural
13 monopoly during the earlier period because of the
14 relative costs of the input, while in this latter
15 period you may no longer have a natural monopoly?

16 A No. I don't think this follows at all.

17 Under normal circumstances, changing labor costs
18 and changing capital costs, and everything affects
19 everything equally in a competitive market if those
20 resources are bought in a competitive market, so if I
21 am in business and you are in business, and as my
22 labor cost rises yours will rise, too, since we
23 both buy in the same area.

24 Now, if that happens -- to go back to my
25 original example that at some point in time you have

O'Donnell - cross

the edge on me by being able to have some resource at a cut rate that I can't get, then, indeed, if that is a phenomenon of only one moment in time, if you exercise the power that you now have to eliminate me, you may be well able to force me out until conditions change.

Q The question I am asking you does not deal with the costs of labor of two firms at the same time.

A Yes.

Q One would assume generally that the increase in labor cost will affect all in terms of operating in the market more or less equally, depending on the wage structure or whatever?

A Correct.

Q My question to you deals with the circumstances dealing only with the input prices relative to each other for any of the firms involved in making that product.

It is true, is it not, that we have seen a situation in which the cost of some input increased at a greater rate than the cost of another input for the production of electricity?

A It seems to me there are two parts to that.

The second part -- have costs escalated, and at

1 O'Donnell - cross

2 differential rates, and the answer is yes, but I
3 don't understand the first part of your question.

4 That first part is lost on me, I am sorry.

5 Q Well, so we both understand, yes, costs have
6 escalated.

7 A Yes.

8 Q And yes, they have escalated at differential rates.

9 A Yes.

0 Q And capital costs have increased at a relatively high
1 rate compared to the escalation in labor costs.

2 A Over what time period?

3 Q Over the past 20 years.

4 A I don't have the figures in front of me, but I do
5 know that it is true for the last five years.

6 I can't recall whether it is true for all 20.

7 Subject to that, I would agree with you.

8 Q And surely within the past eight years the costs of
9 fuel have increased at a greater rate than the costs
0 of labor?

1 A Yes, I believe that is correct.

2 Q And as we look at the comparative costs for a firm
3 in the industry, and at that time CEI, we find, do we
4 not, that the relative proportions of expense for
5 power production has increased over the past 20 years

1 O'Donnell - cross

2 relative to other expenses of the production of
3 electricity?

4 A I don't know, but I would suspect that is true, and
5 I haven't looked at these numbers, so I don't know
6 what -- but what you say seems to be consistent with
7 what is general throughout the industry, but I don't
8 know specifically in this case.

9 Q So that we have a basis for discussion, will you
10 accept, subject to check, the following figures:

11 That in 1960, CEI's power production expense
12 and its transmission expense and I am speaking here
13 of the operation and maintenance expense, together
14 summed up to 59.1 percent of operations and
15 maintenance expenses.

16 A Excuse me.

17 Q And at that time the distribution and customer
18 accounts costs summed to 20.8 percent of the
19 total cost.

20 By 1970, will you accept, subject to check, that
21 CEI's power production expense and transmission
22 expenses summed to 70.2 percent of operating costs
23 and the distribution and customer accounts, 15 percent
24 of such costs?

25 MR. LANSDALE:

May I approach the

1 O'Donnell - cross

2 bench?

3 THE COURT:

Yes.

4 - - - - -

5 {The following proceedings were had at the
6 bench:}

7 MR. LANSDALE: I come up to object
8 on the ground of clarity.

9 I don't know whether you are talking total
10 costs or talking about capital costs included.

11 MS. COLEMAN: No, operations.

12 MR. LANSDALE: The first one seems
13 to say that the generation and transmission costs
14 and operations and maintenance costs were 59.1
15 percent of all operations and maintenance costs.

16 MS. COLEMAN: Right.

17 MR. LANSDALE: The last thing said
18 that power production costs was 70 percent of all
19 operating costs, and these are different things,
20 and I request that you have some clarity about
21 what costs are involved in this. That is my
22 purpose.

23 {End of bench conference.}

24 - - - - -

25

1 O'Donnell - cross

2 BY MS. COLEMAN:

3 Q Professor, counsel has suggested that perhaps I
4 misspoke in the last set of numbers.

5 For your clarification, we are speaking of
6 operations and maintenance expenses of the utility
7 and comparing the percent which power production and
8 transmission operations and maintenance are sometimes
9 referred to as O&M, as that bears to the whole O&M,
10 as compared to distribution and customer accounts
11 in the percentage of total O&M; and for 1970 I asked
12 you to accept, subject to check, that power production
13 and transmission were 70.2 percent of total O&M,
14 while distribution and customer accounts were 15
15 percent of O&M, and also I asked you to accept,
16 subject to check, that 1975 power production and
17 transmission expense as a percent of O&M was 75.3
18 percent, and distribution and customer accounts,
19 6.4 percent, and that approximately the same
20 percentages obtained last year, in 1980.

21 Will you accept those figures subject to check?

22 A Yes.

23 Q Now, as you look at those figures, you say, do you
24 not, that power production and transmission is
25 expense that has increased, so that it is a much

1 O'Donnell - cross

2 greater proportion of the total operations and
3 maintenance expense now than it was 20 years ago?

4 A 70 percent versus 85 percent -- that is 15 percent
5 more.

6 Q For 1960?

7 A I am sorry. I went back to 1970. I see. You are
8 going back to 1959.

9 It has gone from about 59 percent in 1960 to 85
10 in 1975, I agree, yes.

11 Q And therefore the relative proportion of those
12 expenses has changed over time?

13 A Yes.

14 Q And when I asked you questions concerning the
15 relative proportions changing, I am referring to that
16 phenomenon as well as the fact that in terms of the
17 plant generation, of the plant, as a percentage of
18 plant, that that has been an ever increasing percent
19 of total plant and the distribution has declined.

20 Are you familiar with that phenomenon?

21 A Yes.

22 Q My question is, under the circumstances where the
23 relative costs of the inputs have changed, might it
24 not be the case that you would have a natural monopoly
25 under one set of circumstances and not under the other?

O'Donnell - cross

1
2 A I don't think so, no.

3 I would say it is still a situation in which one
4 producer could serve the market better than two, and
5 with less inconvenience.

6 Q Let's talk for the moment about what market you are
7 referring to.

8 What is the market where there is a natural monopoly
9 here according to your opinion?

10 A Well, in this instance it is the City of Cleveland.

11 Q Have you examined the question of natural monopoly
12 with regard to the entire CEI service area?

13 A The entire area -- no.

14 The entire service area, meaning outside of the
15 City of Cleveland? -- no. I have no occasion to look
16 at that.

17 Q Are you aware that the CEI company services around
18 100 towns and cities in this area?

19 A Yes.

20 Q And is it your opinion that there is a natural
21 monopoly in each one of those?

22 MR. LANSDALE: Objection.

23 THE COURT: Sustained.

24 Q Professor, which firm in the Cleveland market is a
25 natural monopolist?

I O'Donnell - cross

2 A Whoever the survivor will be. I am not sure that I
3 fully understand the question.

4 Would you run that by me again.

5 Q Are you unable to say which firm is the natural
6 monopolist?

7 A Well, at the present time they were both striving
8 natural monopolists.

9 A natural monopoly is a condition achieved when
10 all competition has been ~~beaten out~~, so I see this
11 situation as part of a cat and mouse process, the
12 cat and mouse process that I described earlier, in
13 which the final result has not yet materialized, but
14 it would be my contention that if competition would
15 cut loose and allowed to run its natural course, that
16 one or the other of those combatants will have to
17 leave the market, and the survivor will then be the
18 natural monopolist.

19 I don't know which is going to survive.

20 Q But the theory of natural monopoly tells you that one
21 would survive?

22 A Yes. The general economic theory would say the
23 one that survives is {a} the most efficient one and
24 {b} the one that can have the longest purse.

25 It is not enough just to be more efficient.

O'Donnell - cross

1
2 you have got to be able to command the resources to do
3 the job.

4 Q And having in mind those general principles and other
5 reading that you have done, you are not in a position
6 to say today which one is the natural monopoly; is
7 that correct?

8 A If we mean the natural monopoly is the survivor, I
9 don't know who would survive if the plugs were pulled
10 and the competition opened wide.

11 On the one instance we have an entity that
12 could have the public purse behind it and has
13 all the field of government behind it and if
14 aggressively managed could perhaps and should
15 perhaps have achieved many things considered by
16 the Arthur D. Little report, the management report;
17 but on the other hand we have a very aggressive and
18 efficient, I believe, investor-owned utility, and
19 where the battle would be resolved, I don't know,
20 but I am very confident that if the cat-and-mouse
21 competition emerged and was allowed to open up into
22 the open competition, that only one would survive in
23 the end, and I don't know which one it would be.

24 Q Have you studied the efficiency of the CEI company?

25 A No.

O'Donnell - cross

Q And your studies of the Muny company is based on the Arthur D. Little report?

A That and what I have seen in the press.

Q And have you undertaken to investigate the facts if any underlying the Arthur D. Little report?

A No, I don't mind who survives. I am not here to address the question as to which is more efficient.

I think there are certain facts that speak to this issue that I find persuasive that lead me to believe that the Muny Company should have done certain things at strategic moments, but that is hindsight, and looking back over the years and saying, "You should have done this or that." It is irrelevant, because it is what happens in the future that counts, but I am not here to address that question.

I am not an engineer, and I am not interested in that issue as to which one will survive.

Q I guess what you are saying is that certainly you could not, based on your reading of those articles, predict when there will be only one in the market?

A No, I don't know.

One could choose to capitulate the following day. Who can tell how they are going to react if

O'Donnell - cross

they were confronted with that type of situation.

Q Are you aware that the Muny Light and the CEI Company had been in competition in the City of Cleveland for around 70 years?

A As I read that document by the former president of the company, yes, but it is a competition that has waxed and waned, and it seems to me that it has gone through a kind of ebb and flow that economic theory usually suggests.

As I understand it, in the early years the municipal authority was very aggressive and grew rapidly and expanded rapidly up until about 1930, and then it seemed to have languished at a theoretical moment when they had an opportunity to float bonds, and they had a duty to do certain things, but they elected not to, and as I follow through -- and then there was a period of calm in which really there were attempts not to transgress on each other.

Those are the impressions that I got from reading the documents that I referred to, and they make a lot of sense, because I think it conforms to the kind of behavior that economic theory would indicate under the circumstances because, as I read Hamilton's monograph on this subject, what he surveyed,

O'Donnell - cross

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2 when he surveyed the situation where there is
3 municipally-owned and investor-owned electricity, it
4 would seem to be, from my reading, that once again
5 this type of situation is pretty common, this ebb
6 and flow of competition, and depending upon the
7 personalities involved.

8 Q Did you read any other history of the competition
9 between CEI besides that?

0 A I read -- no. I guess that is it.

1 There was a lot of reference to it in the
2 testimony, of course, in the various places, as I
3 recall, and also there was another document that I
4 read something about this.

5 Q That is when Mr. Lindseth was the President?

6 A What was the name? Sorry.

7 Q Lindseth?

8 A That is the name, Lindseth. That is right. That is
9 correct.

10 Q And he was the President and an employee since 1917
11 of the CEI Company?

12 A That is correct.

13 Q Now, Professor O'Donnell, I want to ask you what is
14 the product here in which there is a natural
15 monopoly?

1 O'Donnell - cross

2 A Electric power.

3 Q And when you are examining the question of cost of
4 electric power, you need to know, don't you, do you
5 not, the total cost going into producing that
6 electric power?

7 A Yes.

8 Q And one must focus then, not on questions as to cost
9 of coal and the cost of capital related to generation?

10 A If I were intending on finding out what it cost to
11 produce a kilowatt hour, yes.

12 Q Well, in terms of the question of what the lowest
13 cost is to produce the kilowatt hour, one must
14 consider the cost of generation and transmission as
15 well as distribution, must you not?

16 A That is right.

17 Q Now, in terms of electricity, retail firm power, do
18 you recognize that that in turn is directed up into
19 a number of products; or is that a product itself?

20 A Well, we divide it up into commercial power, and
21 power for private homes, and residential, commercial,
22 and street lighting, yes.

23 Q Each has a different group of customers with different
24 needs and demands?

25 A Correct.

1 O'Donnell - cross

2 MS. COLEMAN: Your Honor, I am about
3 to change and go to another subject. Maybe this
4 would be a good time for the morning break.

5 THE COURT: Yes. We will take
6 our morning break at this time. Remember the
7 admonition that the Court has previously given
8 you.

9 {Recess taken.}

10 THE COURT: Please be seated.
11 Bring in the jury.

12 {The jury was seated in the jury box.}

13 THE COURT: You may proceed.

14 Ms. Coleman.

15 BY MS. COLEMAN:

16 Q Professor, isn't it likely that the survival of
17 competition for the distribution of retail firm
18 power would be the company which had attained the
19 lowest cost power?

20 A All other things remaining the same, yes.

21 Q And that is related to the cost of generation, is it
22 not?

23 A In part, yes.

24 Q So that even if the distribution function is such
25 that one company can provide distribution more

1 O'Donnell - cross

2 cheaply than two; in terms of the survival in a market
3 for retail firm power sales, the one which has the
4 lowest total cost will be the survivor?

5 A That sounds to be reasonable, the one that has the
6 lowest cost of distribution.

7 When you say "total cost," you are saying
8 that we are looking at the distribution system.

9 If you and I are serving the same market, and
10 I believe we went through this earlier, that you can
11 get a significant element of your costs -- let me
12 restate that.

13 You can get a significant part of your raw
14 materials, or whatever it is that you need to produce
15 at a lower price than I can, for some reason, and
16 other things being equal, you will drive me out of
17 business.

18 Q And that is true regardless of the fact that whether
19 our costs of distribution, the trucks that we drive
20 along the route, are the same?

21 A That is right. Your costs would be lower for the fact
22 that we have outlined, yes, and you will become the
23 natural monopolist, the end result of what economic
24 theory forecasts will be achieved. We now have one
25 supplier, if you will, in that retail market.

O'Donnell - cross

Q And that supplier would depend upon the total cost of the product which is distributed and not just on the cost of distribution?

A I am having trouble with that. I am sorry.

MR. LANSDALE: Objection.

Q If the product --

A May I make my position clear.

If your costs of distribution are lower than mine --

Q Yes.

A -- you will survive, and I will go to the wall.

Q Even if that distribution costs is a whole lot more than it costs you for the same product?

A Well, would you rephrase your question?

Q Say we are in the dairy business.

A In what?

Q In the dairy business.

A The dairy business, yes.

Q And we each deliver milk to the doors of houses, as is hardly done any more, but supposing that is the case, and the distribution is the cost of trucks and the fuel --

A And the milk.

Q -- and the cost of milk -- well, the cost of milk is

O'Donnell - cross

not related to the cost of the truck, is it?

A No.

Q But the cost of the delivered product relates both to the cost of the truck and the cost of the milk?

A Correct.

Q And if that were an actual natural monopoly market, in order to assess the lowest product cost, one must look at both the cost of the milk and the cost of the truck?

A Right.

Q And similarly in terms of electrical power, in terms of the electrical power industry, if our product is retail power, to determine what the lowest cost to serve would be, you look at the cost of the commodity, the power, as well as the cost of the system used to get it there, the distribution system?

A Correct.

Q -- as well as the transmission system, which comes from the generation?

A The cost per kilowatt hour that a customer will be charged will be the total costs of that kilowatt hour, yes.

Q And the question of the total costs relates to all of those functions producing the power?

1 O'Donnell - cross

2 A Right, if I understand you properly, yes.

3 Q Now, I don't know that you specifically did give us
4 a definition of that monopoly.

5 How you define that?

6 A It is a situation in which the supply of a good or a
7 service can be rendered at the lowest possible cost
8 by one supplier.

9 Q And you recited to us six criteria which you took
10 into account in concluding that the distribution
11 and sales of electric power and retail was a natural
12 monopoly?

13 A Yes.

14 Q One of those was that it is a necessity, if I recall
15 correctly; is that correct?

16 A Yes. I prefaced that -- what I did was review the
17 literature on this subject, and I gave you the
18 summation on the thinking on this area which I concur
19 with, and one of those reasons that is advanced to
20 distinguish a natural monopoly is that the product is
21 viewed in some sense as being a special necessity
22 charged with a public purpose.

23 Q Are these the criteria that you think should be
24 used here, or is this just what the literature says?

25 A Both. I think the delivery of fresh water and

O'Donnell - cross

1
2 sewage and electric light and telephones are of a
3 peculiar nature and charged with certain social
4 importance.

5 Q Well, we have, do we not, a number of necessities
6 which are not natural monopolies?

7 A Absolutely.

8 Q Such as food?

9 A That is correct. The concept that most economists use
10 as to what is and what is not charged with the public
11 purpose is vague, I agree with that, no question
12 about it.

13 Q And another one of your criteria was the need for
14 the use of public land?

15 A No. I said the power of eminent domain.

16 Q That is something conferred by the state?

17 A I am not a lawyer, but I think that is correct.

18 Q Well, assuming that it is, then it is something
19 which comes into the economic process, and it is not
20 there in and of itself?

21 A That is correct. It is a special right that the
22 supplier has to be given in order to perform his
23 function.

24 Q Well, as an economist in terms of economic theory,
25 you would consider, certainly, that it is possible

1 O'Donnell - cross

2 for someone to provide a service which involves
3 taking up space on the sidewalk and obtaining the
4 right to do so through negotiations with the owners
5 of the sidewalk?

6 A Yes; that is possible.

7 Q But that is a cumbersome way to do so, and therefore
8 for a particular situation, a right to a more
9 expeditious process is conferred on certain public
10 bodies, and on utilities like the CEI company; right?

11 A Correct.

12 Q And therefore the need for the use of property which
13 doesn't belong to you is not something that
14 necessarily is inherent in the idea of a public
15 utility -- pardon me -- the right of eminent domain
16 is not inherent in the idea of a public utility?

17 A It is peculiar to it.

18 If I wanted to sell shoes, I think I would have
19 a very different problem in setting up a retail store
20 than if I decided as a third person to come into and
21 complete delivery of electricity for the residents of
22 the City of Cleveland.

23 Now, I would have to have, among other things,
24 in the latter case, I would have to have the City
25 agree that, among other things, I was going to have

1 O'Donnell - cross

2 the right to put lines across people's land and big
3 trenches, and so forth, that would invade their
4 privacy, and demand the use of their property.

5 Q Are you aware that in the City of Cleveland both the
6 Muny Light Company and the CEI Company may exercise
7 its right of eminent domain?

8 A I assume they have to, since they were natural
9 monopolists and in that market, and they would have
10 to have that right as a public utility to be able to
11 perform the functions that they perform, yes.

12 Q So that right doesn't necessarily indicate to us that
13 only one person has the right?

14 A Correct; but I would submit that the more entities
15 that you have having that right, the more confused
16 the situation becomes, and the more likelihood of
17 public disruption and a jungle of telegraph poles
18 all over the place and a network of redundant wires,
19 and so forth, and all of this would be a public
20 inconvenience in my book. I wouldn't want it in my
21 community, and I think there are many people --

22 Q Well --

23 MR. LANSDALE:

Please, let the

24 witness finish.

25 THE COURT:

Finish your answer.

O'Donnell - cross

1
2 A {Continuing} I think the fact that all over the
3 country the retail distribution of electricity is
4 regarded as a natural monopoly, and it does not
5 attest to public stupidity. There is good reason --
6 there is great common sense among the common people,
7 and then, what you are doing --

8 Q Just so we understand why we are on this, the
9 decision wheter to have the wires of more than one
10 company or to give more than one company eminent
11 domain is probably decided in whatever state or
12 city requires of the policy decisions to be made?

13 A Absolutely.

14 Q Now, you refer to another aspect that you think is
15 important in your discussion of natural monopoly,
16 that there must be a link between the producer and
17 the consumer; is that right?

18 A Yes; a physical link.

19 Q A physical link; and that is true in your estimation
20 as to other industries which are also natural
21 monopolies?

22 A Of those that we call public utilities. It is not
23 universal. I mean, you can say there is not a
24 physical link between a satellite and a customer,
25 but it certainly is true of telephones and electric

O'Donnell - cross

distribution and gas companies, and it is true of
sewage and water.

Q In terms of telephones --

A I find that it is hard to find a public utility where
it is not true.

I think it is a generally correct statement.

Q We have now at this time in the telephone industry,
we now have competition and more than one service
provided in terms of long-distance calls. There is,
for example, MCI?

A That is correct, but I think the situation there is
different.

I don't have two telephone companies in East
Lansing offering two different telephone lines and
two different telephones.

I think the situation that you have just
described of competition in telecommunications goes
largely to the use of attachment to an existing
pipeline system, but there is no move on the part
of MCI to replace Bell Telephone's wiring.

There is a move on to use Bell's system, and to
establish some alternative systems by microwave, due
to a move in technology which is -- which goes to
our earlier point, that technology might change

1 O'Donnell - cross

2 situations, as indeed it does, but I don't see this
3 in the type of situation being true for the retail
4 distribution of electric power.

5 For example, if you were to tell me that there
6 was a special gadget that you could put in my house
7 and beam in electric light and power without the
8 need of being attached to any one company and
9 without the right of having telephone poles and
10 wires down the road, and so forth, and power lines,
11 and this might have a radical effect on the way
12 electricity is delivered to the private home.

13 I am not disputing that point, but that is not
14 the situation, and those are not the facts. We have
15 to deal with the technology as it exists.

16 Q Well, you are unable to predict whether there will
17 be only one company left in the market; is that
18 correct?

19 A That is correct.

20 Q So it may well be in the coming period over which
21 time there are two competitors in the market that
22 the technology will change such as the characteristics
23 of the market changes?

24 A It is possible, yes.

25 MR. LANSDALE:

I object. May I

1 O'Donnell - cross

2 approach the bench?

3 THE COURT: Overruled.

4 Q Now, another characteristic that you refer to was the
5 situation of the demand, and I gather thatn you have
6 in mind the technical difficulties of storing
7 electricity and the need to have it readily
8 attainable?

9 A And the question of having peak capacity. You have
10 to have sufficient capacity to take care of the peak
11 as well as the low demand, so it is a fluctuation in
12 the demand and the size, and you can't store it; that
13 is right.

14 Q There has been developed at this point, at least, one
15 method, and that is through the pump storage approach;
16 right?

17 A That is right.

18 Q And there are under development -- there is a method of
19 storage in the nature of fuel cells, a sort of
20 gigantic battery?

21 A That is news to me. I was not aware of that.

22 Q Now, you also referred to, as a consideration in your
23 conclusion, the high ratio of fixed costs to variable
24 costs in the electric industry?

25 A Yes.

O'Donnell - cross

- Q There is a high rate of fixed costs to variable costs in a whole number of industries?
- A Yes.
- Q Steel?
- A Yes.
- Q And other industries producing durable goods?
- A Yes.
- Q And therefore that characteristic alone is not indicative of whether there are or will be only one competitor serving a particular market?
- A No. I think the criteria is that you have got to have a situation where it can be shown that one competitor will serve the market cheapest where the competition is unworkable in the long pull.
- Q And the high ratio of fixed to variable costs is not dispositive in that question at all?
- A Would you repeat that.
- Q The high ratio of fixed to variable costs is not dispositive of whether you have a natural monopoly?
- A No, but I think it is a very significant part of the story.
- Q Given the fact that all of your six criteria have to be interacting with each other to come to this conclusion, how do you weigh them and what weight do

1 O'Donnell - cross

2 you give to each in concluding that any particular
3 industry is a natural monopoly?

4 A I am not sure I try to weigh each one individually.
5 That isn't necessary.

6 The key question before the house is this:

7 If you have a number of customers to serve with a
8 distribution system, is it cheaper to serve them with
9 one system or a duplicative system, and I think the
10 evidence is persuasive on all of those six counts
11 that the total costs of the single system will be
12 lower.

13 Q Well, a number of these have nothing to do with the
14 costs.

15 "Is it a necessity," that doesn't have to do
16 with the costs?

17 A All right. I agree.

18 Q Now, you did not mention a factor which is mentioned
19 in some of your authorities, and that is a situation
20 in which they are addressing marginal costs?

21 A Well, I did really. It is just that these terms
22 "marginal costs" and "average costs" and so forth,
23 when I said that fixed, high fixed costs is part of
24 the picture, this includes that as you expand production
25 over some relevant range, you are decreasing average

O'Donnell - cross

1 costs, and I explained that when I talked about
2 fixed costs.

3
4 Q And the standard kind of way in which that is
5 depicted graphically is in terms of the number of
6 units and unit costs and dollars per unit, and you
7 indicated a curve something like this {drawing on
8 the easel}?

9 A Yes, going down to the left.

10 As you produce more, the average costs per
11 unit falls, because you are spreading the fixed
12 costs over a larger number of units; that is correct.

13 Q Now, it is a fact, isn't it, that these days the
14 marginal costs, the costs of those additional
15 units, is higher than the average cost in the
16 electric power industry?

17 A We are talking about now about which costs? --

18 I can see that -- well, we will probably be -- yes --
19 additional incremental units of capital, for example.

20 The added units you have on board are costing,
21 say, 15 percent, whereas the one that you have got
22 on board, you got cheaper, and, yes, I can see
23 that possibility.

24 Q The added units of capital today may be, may well be
25 higher than the average costs of unit capital?

O'Donnell - cross

1
2 A Yes.

3 Q And the costs of capital, as you said, is a highly
4 significant factor in this whole cost?

5 A Yes; correct.

6 Q So it may well be that the curve is coming up this
7 way {indicating} because the added costs are greater
8 than the average costs now?

9 A You can deposit any set of circumstances of that
0 order, and if the assumptions are correct, that will
1 happen, but that doesn't go to the issue.

2 The issue is still whether one producer, even
3 under those circumstances, is the most economical
4 way to serve a market.

5 Baumol, one of the authorities I quote, makes
6 this point very significantly, and I agree that this
7 is a significant issue; not just that you have
8 falling average costs, but the more significant
9 thing is that you have situations in which one
0 producer, all things considered, can serve the
1 market cheaper than two.

2 Q By the way, is this your view now as regards the
3 generation and transmission of electricity, that
4 there is no longer a natural monopoly?

5 MR. LANSDALE:

Objection.

1 O'Donnell - cross

2 THE COURT: Approach the bench.

3 - - - - -

4 {The following proceedings were had at the
5 bench:}

6 THE COURT: Read the question.

7 {Question read.}

8 MR. LANSDALE: This is not an
9 issue in this case, and the witness has not
10 testified to that. It is beyond the scope of the
11 direct, and it is dragging in an issue that has
12 no relevance here, and I object to interrogating
13 this witness about it.

14 MS. COLEMAN: The issue is
15 mentioned in the witness's summary of his
16 testimony, as was given to us, your Honor, and the
17 relevance that has been established by the
18 testimony that shows that those portions of the
19 electric production are important to determining
20 the total costs.

21 MR. LANSDALE: I don't remember any
22 statement in the written statement given to you,
23 but if it is in there, it doesn't make any
24 difference. He hasn't testified about it, and
25 this introduces confusion, and it is not in our

1 O'Donnell - cross

2 opinion relevant to the indication, and the
3 witness has not testified about it. I object.

4 THE COURT: Sustained. Let's
5 proceed.

6 {End of bench conference.}

7 - - - - -

8 BY MS. COLEMAN:

9 Q Now, Dr. O'Donnell, among the articles in the book that
10 you studied, besides the terms provided to you by
11 counsel, was there a study of the actual costs of
12 producing and delivering retail power in Cleveland?

13 A No.

14 Q And you have done --

15 A Let me go back. Excuse me. Let me think a moment.

16 I am sorry. I was thinking of your last question.
17 I wanted to be sure that I am answering the question.
18 Would you give that to me again.

19 THE COURT: Read the question.

20 {Question read by the reporter.}

21 A The answer is no.

22 Q And isn't it the case that a number of the authorities
23 which you cite in your bibliography state that no
24 empirical study has been done to prove generally
25 that in the electric industry any portion of it is a

O'Donnell - cross

natural monopoly?

A Some of the authorities have said that there is a fellow by the name of Primo who is now a resident on our campus from the University of Illinois, who argues for certain sized utilities, he feels that retail distribution is not a natural monopoly.

In other words, everything I read, to the best of my recollection, with that one exception, most authorities who address this are either of the opinion that the retail distribution of electricity is a natural monopoly or they remain askance, and they don't express an opinion, and they express a general feeling, but outside of Primo, I could find no one who said it wasn't.

Q You have an article by Caldwell Daniels, III on your list.

A You will have to refresh my recollection. You will have to tell me what it is about.

Q It is about -- it is an antitrust bulletin, the spring of '81.

He stated that there is simply no empirical evidence which indicates that any firm now recognized as a natural monopoly operates under conditions with the hypothesis of traditional theory.

O'Donnell - cross

1
2 A Yes. I believe that is right.

3 Q You cited -- by the way, the Primo article in your
4 bibliography?

5 A I can't remember. I probably did. I know I read it,
6 and I have it here, and it was part of my review.

7 Q You had also on your bibliography a book entitled,
8 "Regulated Industries by Mitchell and
9 Kleindorfer"?

10 A Yes.

11 Q And an article in that book by Walter Schultz, Mr.
12 Schultz stated:

13 "Unfortunately it has never been demonstrated
14 empirically which parts of the electric sector are
15 indeed natural monopolies.

16 "Further, even if it is scaled in duplication,
17 it may be no more wasteful than the efficiency of
18 the monopoly."

19 A That is right.

20 In other words, I don't take that as a definitive
21 opinion.

22 Q The reason a number of people are saying it may
23 not or may not be is that they have no empirical
24 studies that have been done as those authorities
25 indicated; right?

O'Donnell - cross

1
2 A I think it would be more correct to say that it is
3 extremely difficult to conduct meaningful empirical
4 studies of this type of problem, and that is why not
5 many are being done.

6 It is awfully difficult to make comparisons.
7 It is like trying to compare the appropriateness or
8 efficiency of public power versus private power, and
9 it is like two men looking from prison bars, and one
10 sees mud and the other sees stars, and I strongly
11 suspect that ideological underpinnings rather than
12 objective economics governs the situation, because
13 it is very, very difficult to make those types of
14 comparisons.

15 The statisticians seem to come out with almost
16 any conclusion that their ideological underpinnings
17 lead them to.

18 My friends in the aerodynamic department tell
19 me that a bumble bee cannot fly. Well, I have seen
20 it fly, so I know it flies, and when I walk into any
21 situation of this type that we see with electricity
22 retail distribution and look at the facts surrounding
23 the contesting that goes on between, say, the two
24 contestants in this case, and I look at what is
25 involved, and I find the arguments persuasive that

O'Donnell - cross

1
2 natural monopoly, which is common throughout the
3 country and predominant in this case in a retail
4 distribution of electricity is correct.

5 Q This is a theory that is correct, even though the
6 bee flies?

7 A No. I think it is correct. The theory is correct;
8 that is right. It seems to me obvious that as most
9 of us, as most of our studies show, it is -- it is
10 of use, and the number of customers that you have
11 got on the line, and the amount of power that they
12 take determines the advantages you get from the
13 economies of scale, and if you are going to serve
14 1,000 customers over whatever, it seems to be clear
15 then that one system will be cheaper than two.

16 Q Are you referring to the studies that you have done?

17 A No. I am saying by common observation -- I am saying
18 that it is difficult to conduct statistical studies
19 of costs that will definitively show one thing or the
20 other.

21 It seems very difficult to do because of getting
22 companies of comparable size, but when faced with that
23 kind of situation, I think a certain amount of common
24 sense has to intervene.

25 Q Particularly if you don't know the statistical methods

1 O'Donnell - cross

2 that would be required to adjust for all the
3 variables?

4 A If you can't adjust for all the variables.

5 Q Now, we have one entry on one of your articles by
6 Leland-Newburgh, which was an attempt to look at
7 distribution costs and comparative efficiency, and
8 that authority stated, did he not, that the results
9 of this work raised some questions about natural
0 monopoly theory?

1 A Yes. It raises some questions. It is equally true
2 that there are other articles, and one in the Public
3 Utility Fortnightly, that is emphatic in the
4 distribution at retail that it is a natural monopoly,
5 and the article you are quoting speaks to the
6 industry in general and not to a specific part of it.

7 In other words, it may well be that certain
8 parts of an industry through technological change are
9 no longer as easily defined as a natural monopoly as
0 they were before, and that is not the question I am
1 addressing.

2 I am addressing -- and my research of this topic
3 was specifically to the retail distribution of
4 electricity.

5 Q Is it not the case that two of the authorities on your

O'Donnell - cross

1 bibliography, the article by Baumol and the article
2 by Richard Schnalensee in a note on economies of
3 scale and natural monopoly in the distribution of
4 public utility service, both indicate a rather
5 rigorous mathematical study must be performed to
6 determine whether natural monopoly in fact exists?
7

8 A That is correct.

9 Q And Professor Baumol states, among other things,
0 "We would have to know the entire cost curve and
1 perform the mathematical tests?"

2 A That is a statement like saying good is good.

3 The point is that knowledge is not perfect.
4 We rarely if ever know all these curves and will
5 never know them.

6 At some point in time we have to work with the
7 information that we have, so I don't quarrel that if
8 we had perfect information we might know what we are
9 doing, and that it is correct, but we will never have
0 perfect information, and we will never know all those
1 curves; therefore, that becomes an exercise of
2 intellectual interest but not very productive.

3 Q Well, there is plenty of information around about
4 individual utility systems, is there not?

5 A There is a lot of information, but if the problem

O'Donnell - cross

that you are addressing would lend itself to the type of statistical test that you seem to have in mind. I am puzzled why it has not been done.

Q Well, you haven't done it, at any rate?

A I think it is an impossibility in the terms in which you see it.

Q And the statistical test which Professor Baumol and Professor Schnalensee have required have been deeply relevant, have they not?

A I think they are suggesting certain approaches to the problem that might work, and in that sense they are representative. I don't know that there is anything particularly new in the technique of such, and I don't see -- I come back to my original point:

I don't see that it solves any problems or takes us anywhere.

If ultimately what they are suggesting can be done persuasively, and if they produce the evidence that they say might exist, then I will change my mind, but in the absence of that evidence, and those facts, with all that available, I think the main body of economists like myself will hold that the distribution of retail electricity is a natural monopoly, and it stands that way.

O'Donnell - cross

1
2 Q And that is based on assumptions and "received wisdom"
3 rather than any study of the particular costs and total
4 costs in the market?

5 A No, I don't think it is in the absence. There is
6 nothing wrong with received wisdom, by the way.

7 The question suggests that there is something wrong
8 with wisdom, and at my age it is a point that I get
9 more dedicated to with every year that passes. There
0 is nothing wrong with that.

1 The point is that cost studies have been done,
2 and let me put it this way:

3 If I understand it, in the trial some evidence
4 will be produced on the questions of costs as they
5 pertain to the system, and it is very costly business
6 to do this, and we rarely have the money to do it, and
7 perhaps that evidence will come out in this trial, but
8 all the evidence that I know of, empirical and
9 theoretical and observed conduct of what happens
0 and observed practice around the country convinces me
1 that it is a natural monopoly.

2 Q Part of the observations were the existence of
3 single suppliers in a number of markets.

4 A Virtually all the markets, except from the Hamilton
5 study, if my memory is right, about 49; and of those,

. O'Donnell - cross

where there are dual suppliers, largely it is the result of historical accident.

I think a good case can be made that it is not direct competition, a situation in which a city is divided in half, and you say to the municipal authority, "You take one half and we will take the other, and we stay out of each others hair."

That is not head-on competition, or say a situation where, "We will agree not to tell the public about a differential in price," and so forth, and we all play the game. That is not competition.

So it seems to me that if the competitive model for two suppliers works as well as it ought to, the situations wouldn't exist in this form.

Q You yourself have not studied that question, I guess?

A Which question now?

Q Well, when I asked the question -- and perhaps you can respond to it, and I will ask you this question:

Have you done any studies of how you came to be in the various markets where electricity, where in most instances there was only one supplier?

A No. What I have done is read other people's work.

Q So you don't know what actions of the single supplier led to the single supplier domination of that market?

O'Donnell - cross

A No. That is incorrect.

I know of various cases that I have read, and the history of the industry, and I have read that, but what I am saying is that I have not personally gone out and conducted a study of my own to decide why it is in East Lansing that we only have one telephone company or one sewage authority or one water authority or one electric company supplying us with power.

Q You spoke about types of competition, and I want to ask you if it is not the fact that you believe that competition is preferable because it results in the lowest price and maximum output of the competition of goods and services most preferred by consumers?

A Yes.

Q Now, if you know, do you have an opinion about natural monopoly without doing this study -- let me ask you whether you also have an opinion about this situation where there is in the market two suppliers, and when there are in the market two suppliers, the differences in cost are the differences between this lowest cost line and the dotted line?

A In other words, the dotted line is the higher cost supplier. Are you now talking about total long-run average cost?

O'Donnell - cross

1

2 Q Right.

3 A Total long-run average cost?

4 Q Right.

5 A So in the long pull that is the position that would
6 emerge, all cases taken into account?

7 Q Right.

8 A So the objective would be to produce the ideal
9 at that lowest point, and the incremental costs
10 will cut at that lowest point?

11 Q Right.

12 My question is, when you have two suppliers in
13 the market, and their costs together are at the level
14 of the dotted line.

15 A Excuse me. I missed that statement, "Before the
16 dotted line."

17 Q When you have two suppliers in the market.

18 A Yes.

19 Q -- and their costs of production are at the level of
20 the dotted line --

21 A They are both identical.

22 Q -- can you tell without a study how much higher their
23 costs are than what it would be if only one supplied
24 the market?

25 A I am trying to understand the question.

1 O'Donnell - cross

2 We have got two suppliers producing at their
3 lowest costs?

4 Q Right.

5 A And the question now is, if one of them is knocked
6 out or withdrew, and presumably the market is large
7 enough to supply two suppliers at optimal price,
8 and it is no longer a natural monopoly market.

9 This is not a natural monopoly market. It is
10 two suppliers both operating in the market, and both
11 making normal profits, just enough to keep them in
12 business.

13 Q I want you to assume a natural monopoly market.

14 A Well, I think there is a contradiction in terms --

15 Q -- Can you assume that?

16 A If that is a natural monopoly market, then by
17 definition one of those producers must be at the
18 lowest cost producer. There must be an optimal size
19 for serving the whole market. If you and I are both
20 in the market, we both need a minimum amount of plant
21 and equipment to go on, and it is evident to me, if
22 I cut my costs and take over your market share, I
23 go to the low point on my cost curve.

24 That is the natural monopoly market situation.

25 You have got an inconsistency in your assumption, if

O'Donnell - cross

I understand you correctly.

Q You recognize that there is a situation where there are two firms operating in a market?

A Yes.

Q And I want you to assume with me that type of situation where there are two firms operating. Can you do that?

A Yes.

Q And assume with me that the total cost of both of those firms when they are both operating in the market is at this higher level.

Perhaps I should draw a total cost curve if the other curve is giving you problems {indicating}.

A Okay.

Q Assume a situation where the total cost is at a higher level than if one serves.

A Yes.

Q And this is a natural monopoly market.

A Yes.

Q My question is, can you tell without a study how much greater the costs are?

A No. I am sorry. I misunderstood your question.

No, I can't tell unless I have got some figures.

Q And it may well be that if one did have the figures and one did do the study, that the cost of producing

O'Donnell - cross

1
2 at this higher price level, when added to the cost of
3 regulation, might be outweighed from what people
4 perceived is the benefit of having two in the market;
5 is that correct?

6 A You will have to go over that slowly again, please.
7 I am sorry.

8 Q Well, our hypothetical assumes, and your theory of
9 natural monopoly assumes that when there are two,
10 they are operating at a lower cost level?

11 A Right.

12 Q You can't tell me how much higher without figures?

13 A That is right. I don't need the end result of what
14 I am interested in. I am saying, pull out the plugs
15 and let me fight it out. I don't need to know.

16 Q And you don't know?

17 A And I don't know.

18 Q And in this situation, when we are interested in total
19 costs, we are talking about the total social costs
20 and not merely the cost of the firm?

21 A If you wish to include those in, yes.

22 Q And maybe that the costs imposed by having two firms
23 in the market is outweighed by the value that the
24 people assigned to having two firms in the market
25 and the competition thereby?

O'Donnell - cross

1
2 A How do they measure the value? You mean that the
3 costs of regulation -- let me see.

4 Do you mean the costs of regulating one firm
5 will outweigh the higher costs of having two firms
6 there; is that the thrust of which you are saying?

7 Q No.

8 My question is this:

9 There are some incremental -- some amount of
0 costs between these two lines {indicating}?

11 A Correct.

12 Q And it is your theory that there is a higher cost
13 when there are two competitors?

14 A Right, but two systems are more costly than one.

15 There is something like 26 substations in the
16 35 miles where you are competing, and there has been
17 some testimony, and I think it was Mr. Kemper's, that
18 I read, that he said, "All but three could be
19 served by existing substations that CEI has now.

20 If that is correct, then that is duplication,
21 and it seems to me if you did it that way with the
22 excess substations, you would save money.

23 Q Professor, my question is this:

24 Do you as an economist recognize that values
25 may be assigned to goods of whatever kind or type?

O'Donnell - cross

1

2 A Assigned?

3 Q Yes. That one can speak of the value of this cup
4 {indicating} or the value of this podium?

5 A Well, you can speak of it, but I am not sure.

6 If you are telling me that that is the price
7 determined in the market, then it has meaning, but
8 if you tell me you have assigned a price of \$1,000
9 to the podium, it is not of consequence to me.

10 Q Well, in terms of all the considerations that go
11 into making adjustments, some value must be assigned,
12 at least a relative value?

13 A I wouldn't proceed that way. I think you can add up
14 the cost of regulation and add up what you pay, if
15 that is the point.

16 If I want to know what regulation costs, I can
17 assign a cost to it, and if these regulatory proceedings
18 drag on for six months, we can add up the costs
19 of the witnesses that are involved, and if that is
20 what you mean, I would agree with you, that we go to
21 market and find out what things cost, and then we say,
22 "That is what they cost."

23 Is this the context that you have in mind?

24 Q You would compute a cost for regulation?

25 A Yes.

O'Donnell - cross

1
2 Q And one might have regulations associated with the
3 one firm's situation, and that involved certain costs
4 which were capable of being computed?

5 A Yes.

6 Q If you have a two-firm situation, then, according
7 to your theory, that involves certain additional
8 costs?

9 A You have got now both the regulation and the cost
10 of the two systems.

11 Q Assume that you have the regulation in both instances,
12 then operating in this level of the two firms, you have
13 the cost of operating with two firms, and you have the
14 cost of regulation?

15 A Right.

16 Q My question to you is, may not be the case that
17 the total of those costs, the cost of regulation and
18 whatever this amount of cost is, is less than the
19 value of the competition between the two companies
20 operating at this level?

21 A No. I think that is absolute nonsense.

22 It seems to me that you have just proved that
23 the two costs are higher plus regulations, and an
24 additional cost.

25 I can't see how one can come to the conclusion

O'Donnell - cross

1
2 that it would be lower in the fashion that you have
3 described.

4 Q Well, we have many instances, do we not, Professor,
5 of things which are a social cost which only lately
6 have been evolved into dollars and cents value; isn't
7 that true, as the cost of air pollution?

8 A There is a whole history behind that as a result of a
9 book called "Welfare Economics," and the answer is
10 it has been known since 1920, and if you mean that
11 it has become now politically known, the answer is
12 yes, but academically it has been recognized for
13 many years.

14 THE COURT: Perhaps this would

15 be an opportune time for us to take our recess.

16 Ladies and gentlemen, keep in mind the
17 Court's admonition. We will see you at 1:30.

18 {Luncheon recess had.}
19
20
21
22
23
24
25

1 MONDAY, SEPTEMBER 21, 1981, 1:40 O'CLOCK P.M.

2
3 THE COURT: Please be seated.

4 Bring in the jury.

5 {The jury entered the courtroom and the
6 following proceedings were had in their hearing
7 and presence.}

8 - - - - -

9
10 JOHN L. O'DONNELL

11 resumed the stand and testified further as
12 follows:

13
14 THE COURT: You may proceed.

15 Ms. Coleman.

16 MS. COLEMAN: Thank you, your

17 Honor.

18
19 CROSS-EXAMINATION OF JOHN L. O'DONNELL

20
21 BY MS. COLEMAN:

22 Q Dr. O'Donnell, you had told us this morning that you
23 could walk out into the street and you could see if
24 there were four lines rather than one line, that
25 there was extensive duplication there.

O'Donnell - cross

Are you really able to tell what is duplication?

A I'm sorry; am I really able to tell?

Q Tell what equipment is excess duplication?

A I had somebody point it out to me, yes.

Q Are you an engineer?

A No, ma'am.

Q Are you familiar with system planning?

A No.

Q Isn't it a fact that in the engineering industry, it is customary to have redundancy in duplication in a given system so that there is a backup facility in case of a failure of the first?

A I find the question of redundancy contradictory.

If you mean that most systems are engineered in order to provide excess or capacity in the event of failure, yes, I'm aware of that. I'm aware that in generating capacity, you usually have a certain percentage of excess capacity for when you have a plant down for repairing, and so forth, I'm well aware of that.

But in the discussions that I had with the people that took me around and showed me physically these facilities, we discussed questions of that order, and it is my conclusion that duplication

O'Donnell - cross

exists.

Q And that is not based on your own study or your own knowledge as an engineer or a systems planner since you have not studied and you have no engineering knowledge?

A I have done the study and -- since I have gone out and seen it, and I have asked the, I think, elementary questions that are reasonable for a person to ask, but I am not an engineer.

Q You testified this morning that under the natural monopoly theory, if competition is unrestrained, one will then have one competitor surviving?

A Yes, ma'am.

Q And my question to you is:

When you do have unrestrained competition, did you have in mind free of laws, antitrust laws?

A No.

Q What restraints did you have in mind?

A The kind of restraints that I have in mind are any agreements that limit competitive activity that one would normally expect to find in a free market.

Q Are you aware during the past 20 years in this market of any agreement to limit competitive activity?

O'Donnell - cross

A I know of no specific agreement; I cannot recall one.

Q Dr. O'Donnell, are you familiar with the history of rates charged for electric power in this community, in the City of Cleveland?

A In general, to the extent that, from the history I have read and the history of the corporation, that, in general, I believe MELP has been in the habit of fixing its rates about 5 percent lower than CEI's.

But I have not pursued the rate pattern, distribution of rates, or the subject in any detail beyond that.

Q Taking as an assumption that the Muny rates have been lower than CEI rates by 5 percent, perhaps as much as 15 percent, I would like to ask you if CEI is the firm which remains at an unknown time, what will be the effect on rates in the City of Cleveland?

A No idea.

Q Will they go up, or will they go down?

A It may well be with exploding costs that they will go up, but I would expect them to go up at a lower rate than otherwise would have been the case.

Maybe they will go down; I don't know.

There is one thing I am sure of is that the costs of distribution when there is one system will

O'Donnell - cross

1
2 be lower than if there is two.

3 How those savings are shared, how they're
4 distributed, and what the outcome is, I don't know;
5 it would be foolish to predict.

6 Q If there is only one company left, what do you
7 suppose would happen to the distribution facilities
8 belonging to that company which is no longer in
9 business?

10 A I would assume they would be first acquired and paid
11 for by the acquiring firm, and then I assume the
12 acquiring firm would proceed to plan the distribution
13 system more-rationally than it is at the present
14 time; that is to say, by eliminating over time the
15 duplication that exists.

16 Q But during the initial period at least, all that
17 duplication, as you call it, will exist in place?

18 A Rome wasn't built in a day, not even by Mussolini,
19 so I assume it will take time.

20 Q And there is no distribution system which is built
21 all at one time except perhaps in a new city like
22 Brazilia?

23 A I would imagine that's a true statement.

24 Q So that for any system, whether it is the only
25 competitor in town or one of two, its system

O'Donnell - cross

1 reflects the changes over time of putting in new
2 distribution systems, perhaps a higher voltage, new
3 distribution lines to serve customer loads which are
4 developing in unforeseen places?
5

6 A I would imagine distribution systems developed, yes.

7 Q Do you consider price competition a form of
8 unrestrained competition?

9 A I consider it a part of competition, but I'm not sure
10 what you mean by -- yes.

11 I'm not sure entirely in my mind what is implied
12 in your context of the word "unconstrained".

13 Q That was your term.

14 A Then the answer is yes.

15 Q And do you believe there is a value for consumers in
16 having the ability to choose between two competitors
17 as applied to a particular product?

18 A There is a value in using the word in a philosophical
19 sense in everything, but it may be a costly value.

20 The question in economics is typically whether
21 the cost of the choice escapes the benefits. But
22 there is value in it; I see a philosophical
23 connotation to your words.

24 If customers like paying more for things than
25 otherwise they would have to pay because they are

O'Donnell - cross

philosophically attached to some notion, it is their privilege.

But what they should be aware of is that they're paying for it or somebody is going to pay for it.

I have no objection to you giving me a dime for a nickel all day if you wish to do so if it gives you some kind of philosophical pleasure.

Q Is competition just a philosophical matter, --

A No.

Q -- or is it recognized by economists as an actual value?

A It has actual value because competition, when it exists, as we all know, has a tendency to drive prices down to the minimum cost and for the maximum output.

The problem is that in a natural monopoly market, competition of this character does not exist.

Q You know that to be the case with regard to the City of Cleveland?

A That is my conclusion.

A company that's been running an accumulated loss of \$35 million and has the kind of history that Muny has, tells me something that cannot be denied.

Q Based on what you've read?

O'Donnell - cross

1
2 A That's right.

3 Q Which does not include the documents produced during
4 the time -- during the historical time that is under
5 study here?

6 A I've had the benefit of -- yes; the answer is "Yes."

7 I haven't read -- I'm sure I have not read
8 everything that has ever been written or published
9 by this problem.

10 MS. COLEMAN: I have no further
11 questions, your Honor.

12 THE COURT: Redirect?

13 MR. LANSDALE: No questions, your
14 Honor.

15 THE COURT: Thank you.

16 You may step down, Professor.

17 THE WITNESS: Thank you, sir.

18 THE COURT: Please remove the
19 microphone.

20
21 THE COURT: Call your next
22 witness.

23 MR. MURPHY: Your Honor, we call
24 Ken Jackman.

25

1 K E N N E T H J. J A C K M A N,
2 of lawful age, called as a witness on behalf
3 of the defendant, being first duly sworn, was
4 examined and testified as follows:
5

6 DIRECT EXAMINATION OF KENNETH J. JACKMAN
7

8 BY MR. MURPHY:

9 Q Would you state your name, please, sir?

0 A Kenneth John Jackman.

1 Q What is your address, please?

2 What is your home address?

3 A 5434 Berkshire, that's in North Olmsted.

4 Q Are you presently employed, Mr. Jackman?

5 A I'm partially employed.

6 Q By whom?

7 A By SIFCO industries.

8 Q In what capacity are you partially employed?

9 A At this moment, I am an odd job man, if you'd like
0 to put it that way. Any project that they require
1 help on, they call me.

2 Q Did you formerly work for SIFCO on a full-time
3 basis?

4 A Yes, I am.

5 Q When did you working on a part-time basis?

Jackman - direct

1
2 A In February of '78.

3 Q Was that on the occasion of your formal retirement
4 from the company?

5 A Yes, that was following my retirement in September,
6 '77.

7 Q How long did you work for SIFCO, please?

8 A Well, I worked for SIFCO in Canada from 1950 to 1959.

9 Then I came down here at their invitation in
0 '59, and I worked for them entirely or on their
1 behalf because I worked overseas until I retired in
2 '77.

3 Q Would you start in '59 and work towards your
4 retirement and tell us what duties you had at SIFCO
5 from time to time?

6 A Well, when I came back down here in '59, I was here
7 for two or three months; and then I went down to
8 Argentina to set up the initial stages of a
9 forge plant to support the blossoming automotive
0 business in Argentina.

1 I came back at Christmas in '59 -- '60, and
2 then I was plant engineer at two plants which we
3 had then, one at East 72nd Street, and the other
4 now at East 64th Street.

5 Then I was instrumental in laying out and setting

Jackman - direct

1
2 up a forge plant in India. I was there from '63
3 to '67 on a technical assistance basis as plant
4 engineer, et cetera, et cetera, for Bark Forge.

5 Q Did you return to Cleveland in 1967?

6 A Yes.

7 Q And you became plant engineer at that time?

8 A Well, yes, I resumed my plant engineer duties at that
9 time.

0 Q Did you continue in that position until your retirement?

1 A Yes.

2 Q Mr. Jackman, am I correct that "SIFCO" is really

3 just a shorthand version for -- _____

4 A Steel Improvement and Forge Company.

5 Q Thank you. _____

6 And it is located where, please?

7 A That's on East 64th Street.

8 Q Mr. Jackman, I would like to ask you, please, what
9 is SIFCO's business?

0 A SIFCO is in the forging business.

1 We manufacture forgings for all kinds of
2 vehicles, on the road, off the road, aircraft,
3 tanks, weaponry, and aircraft, of course.

4 Q Mr. Jackman, let me draw your attention, please,
5 to early 1972, if I might.