COMMONWEALTH OF PENNSYLVANIA

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November 3, 2010

HAND DELIVERED

Rosemary Chiavetta, Secretary
Pa. Public Utility Commission
Commonwealth Keystone Building
P.O. Box 3265
Harrisburg, PA 17105-3265

Re: Joint Application of West Penn Power Company d/b/a Allegheny Power, Trans-Allegheny Interstate Line Company and FirstEnergy Corp. for a Certificate of Public Convenience Under Section 1102(A)(3) of the Public Utility Code Approving a Change of Control of West Penn Power Company and Trans-Allegheny Interstate Line Company
Docket Nos. A-2010-2176520 and A-2010-2176732

Dear Secretary Chiavetta:

Enclosed for filing are the original and ten (10) copies of the Main Brief, on behalf of the Office of Small Business Advocate, in the above-docketed proceedings. As evidenced by the enclosed certificate of service, two copies have been served on all active parties in this case.

If you have any questions, please contact me.

Sincerely,

Lauren M. Lepkoski

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Assistant Small Business Advocate
Attorney ID #94800

Enclosures

cc: Parties of Record
Robert D. Knecht
John Wilson

BEFORE THE

PENNSYLVANIA PUBLIC UTILITY COMMISSION

Joint Application of West Penn Power Company d/b/a Allegheny Power, Trans-Allegheny Interstate Line Company and FirstEnergy Corp. for a Certificate of Public Convenience under Section 1102(A)(3) of the Public Utility Code Approving a Change of Control of West Penn Power Company and Trans-Allegheny Interstate Line Company	:	Docket Nos. A-2010-2176520 A-2010-2176732

MAIN BRIEF
ON BEHALF OF THE
OFFICE OF SMALL BUSINESS ADVOCATE

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Dated: November 3, 2010

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases

Statutes

Rules and Regulations

I. INTRODUCTION/PROCEDURAL HISTORY

On May 14, 2010, a Joint Application was filed by West Penn Power Company ("West Penn") d/b/a Allegheny Power, Trans-Allegheny Interstate Line Company ("TrAILCo"), and FirstEnergy Corporation ("FirstEnergy") (collectively, the "Joint Applicants"), seeking approval by the Pennsylvania Public Utility Commission ("Commission") of the merger of Allegheny Energy, Inc. ("Allegheny Energy") with FirstEnergy under Section 1102 of the Public Utility Code, 66 Pa. C.S. §1102, and Section 69.901 of the Commission's Rules of Practice and Procedure, 52 Pa. Code §69.901.[1] The Joint Application included extensive testimony by witnesses for the Joint Applicants.

West Penn is a Commission-certificated public utility and electric distribution company ("EDC") which currently operates as a subsidiary of Allegheny Energy and provides service to all classes of customers in western Pennsylvania. Allegheny Energy is a public utility holding company based in Greensburg, Pennsylvania.[2]

TrAILCo is a corporation organized and existing under the laws of the state of Maryland and the Commonwealth of Virginia that is engaged in the business of transmitting electricity in interstate commerce.[3] TrAILCo is an indirect public utility subsidiary of Allegheny Energy and is certificated by the Commission.[4]

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[1] Joint Application at 1, ¶ 1.

[2] Joint Application at 2-3, ¶¶ 5, 8. Allegheny Energy has three public utility subsidiaries that conduct business as Allegheny Power: West Penn, in Pennsylvania; Monongahela Power Company in West Virginia; and Potomac Edison Company in Maryland, West Virginia, and Virginia.

[3] Joint Application at 2, ¶ 6.

[4] Joint Application at 2-3, ¶¶ 6 and 8.

FirstEnergy is a corporation organized and existing under the laws of the state of Ohio and is a Commission-certificated energy services holding company headquartered in Akron, Ohio.[5] FirstEnergy owns, directly or indirectly, all of the outstanding common stock in the following Pennsylvania EDCs: Metropolitan Edison Company ("Met-Ed"), Pennsylvania Electric Company ("Penelec"), and Pennsylvania Power Company ("Penn Power"). FirstEnergy owns the following additional subsidiaries: the Waverly Electric Light and Power Company (New York), the Ohio Edison Company (Ohio), the Cleveland Electric Illuminating Company (Ohio), the Toledo Edison Company (Ohio), and the Jersey Central Power and Light Company (New Jersey).[6]

Merger Sub is a Maryland Corporation and wholly-owned subsidiary of FirstEnergy formed for the sole purpose of effecting the merger.[7]

Allegheny Energy will merge with Merger Sub. As the surviving corporation, Allegheny Energy will become a wholly-owned subsidiary of FirstEnergy.[8] Each Allegheny Energy shareholder will receive 0.667 shares of FirstEnergy common stock for each share of Allegheny Energy common stock held.[9] Upon completion of the merger, existing shareholders of FirstEnergy will own approximately 73% of the combined company while former Allegheny Energy shareholders will own

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[5] Joint Application at 2, ¶ 7.

[6] Joint Application at 2-3, ¶ 7.

[7] Joint Application at 4, ¶ 9.

[8] Joint Application at 4, ¶ 10.

[9] *Id.*

approximately 27% of the combined company.[10] FirstEnergy will remain the corporate parent of Met-Ed, Penelec, and Penn Power (and its out-of-state subsidiaries) and will become the corporate parent of Allegheny Energy and its subsidiaries, including West Penn and TrAILCo.[11]

On May 24, 2010, Administrative Law Judges ("ALJs") Wayne L. Weismandel and Mary D. Long, assigned as the presiding officers in the proceeding, issued an order scheduling a Prehearing Conference for June 22, 1010.

On June 3, 2010, the Commission issued a Secretarial Letter to all parties identifying twelve issues and areas of concern that the Commission wished the parties to address.

On June 14, 2010, the Office of Small Business Advocate ("OSBA") filed a Notice of Intervention and Protest with respect to the Joint Application. The OSBA filed and served its Prehearing Memorandum on June 15, 2010.

Other active parties are the Commission's Office of Trial Staff ("OTS"); the Office of Consumer Advocate ("OCA"); the Pennsylvania Department of Environmental Protection ("DEP"); the International Brotherhood of Electrical Workers ("IBEW"); the Utility Workers Union of America ("UWUA") and UWUA Local 102 ("Local 102") (collectively, "UWUA Intervenors"); the Pennsylvania State University ("PSU"); the Met-Ed Industrial Users Group ("MEIUG") and the Penelec Industrial Customer Alliance ("PICA") (collectively, "MEIUG/PICA"); the West Penn Power Industrial Intervenors ("WPPII"); the Pennsylvania Rural Electric Association ("PREA"); the Pennsylvania

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[10] *Id.*

[11] Joint Application at 4, ¶ 11.

Mountains Healthcare Alliance ("PMHA"); the West Penn Power Sustainable Energy Fund ("WPPSEF"); the York County Solid Waste and Refuse Authority ("YCSWRA"); ARIPPA; the Clean Air Council ("CAC"); Citizens for Pennsylvania's Future ("PennFuture"); Constellation New Energy, Inc. and Constellation Energy Commodities Group, Inc. ("collectively, "Constellation"); Direct Energy Services LLC ("Direct"); the Retail Energy Supply Association ("RESA"); and Citizen Power, Inc. ("Citizen Power").

The Prehearing Conference took place on June 22, 2010, at which a litigation schedule was established.

On July 15, 2010, the Joint Applicants submitted Supplemental Direct Testimony.

The OSBA submitted OSBA Statement No. 1, the Direct Testimony of its witness Dr. John Wilson, on August 17, 2010. OSBA Statement No. 2, the Rebuttal Testimony of Dr. Wilson, and OSBA Statement No. 3, the Rebuttal Testimony of additional OSBA witness Robert D. Knecht, were submitted on September 13, 2010. OSBA Statement No. 4, the Surrebuttal Testimony of Dr. Wilson, was submitted on October 1, 2010.

Evidentiary hearings were held on October 12-15, 2010.

During the course of this proceeding, the parties engaged in numerous settlement discussions, which resulted in a non-unanimous settlement. A Joint Petition for Partial Settlement ("Settlement") was filed with the Commission on October 25, 2010. The Settlement requests approval of the merger with only those modifications spelled out in the Settlement. The OSBA is not a signatory to the Settlement.

II. LEGAL REQUIREMENTS FOR MERGER APPROVAL

A. General Statutory Provisions

Section 1102(a) of the Public Utility Code, 66 Pa. C.S. §1102(a), requires that the Commission issue a certificate of public convenience as a legal prerequisite for the transfer or acquisition of certain property. Section 1102(a) provides, in pertinent part:

> (a) Upon the application of any public utility and the approval of such application by the commission, evidenced by its certificate of public convenience first had and obtained, and upon compliance with existing laws, it shall be lawful:
>
> * * *
>
> (3) For any public utility or an affiliated interest of a public utility as defined in section 2101 . . . to acquire from, or to transfer to, any person or corporation, including a municipal corporation, by any method or device whatsoever, including the sale or transfer of stock and including a consolidation, merger, sale or lease, the title to, or the possession or use of, any tangible or intangible property used or useful in the public service . . . .

Section 1103(a) of the Public Utility Code, 66 Pa. C.S. §1103(a), provides the statutory standard for granting a certificate of public convenience, as follows:

> A certificate of public convenience shall be granted by order of the commission, only if the commission shall find or determine that the granting of such certificate is necessary or proper for the service, accommodation, convenience, or safety of the public.

B. Special Statutory Provisions

In addition to the statutory provisions applicable to all mergers, there are special statutory requirements applicable to reviewing a merger in the electric industry.

First, Section 2811(a) of the Public Utility Code, 66 Pa. C.S. §2811(a), imposes a general duty on the Commission regarding "anticompetitive" conduct and "the unlawful exercise of market power," as follows:

> The commission shall monitor the market for the supply and distribution of electricity to retail customers and take steps as set forth in this section to prevent anticompetitive or discriminatory conduct and the unlawful exercise of market power.

Second, with respect to the specific issue of whether a merger would impede the development of the electric retail market (thereby negatively impacting the retail prices ratepayers must pay for electricity), Section 2811(e)(1) states:

> In the exercise of authority the commission otherwise may have to approve the mergers or consolidations by electric utilities or electricity suppliers, or the acquisition or disposition of assets or securities of other public utilities or electricity suppliers, the commission shall consider whether the proposed merger, consolidation, acquisition or disposition is likely to result in anticompetitive or discriminatory conduct, including the unlawful exercise of market power, which will prevent retail electricity customers in this Commonwealth from obtaining the benefits of a properly functioning and workable competitive retail electricity market.

C. Case Law

In *City of York*, the Pennsylvania Supreme Court provided the legal standard for granting a certificate of public convenience under Section 1103(a) in public utility merger and acquisition cases. Specifically, the Supreme Court stated:

> [A] certificate of public convenience approving a merger is not to be granted unless the Commission is able to find affirmatively that public benefit will result from the merger .... [T]hose seeking approval of a utility merger [are required to] demonstrate more than the mere absence of any adverse effect upon the public .... [T]he proponents of a merger [are required to] demonstrate that the merger will affirmatively promote the 'service, accommodation, convenience, or safety of the public' in some substantial way.

City of York v. Pennsylvania Public Utility Commission, 449 Pa. 136, 141, 295 A.2d 825, 828 (Pa. 1972).[12]

Under Section 1103(a), "[t]he commission, in granting such certificate [of public convenience], may impose such conditions as it may deem to be just and reasonable." Consistent with Section 1103(a), the Commission has held that "[i]n order to ensure that a proposed merger is in the 'public interest,' the Commission may impose conditions on its granting of the certificate of public convenience." *Joint Application for Approval of the Merger of GPU, Inc. with FirstEnergy Corp.*, Docket No. A-110300F0095, 2001 Pa. PUC Lexis 23 (Order entered June 20, 2001). Consequently, by imposing conditions pursuant to Section 1103(a), the Commission may approve a transaction which would not meet the *City of York* standard without those conditions.

Moreover, the Pennsylvania Supreme Court applied Section 1103(a) in deciding the appeal of the Commission's decision regarding the Verizon/MCI merger. *See Popowsky v. Pennsylvania Public Utility Commission,* 594 Pa. 583, 937 A.2d 1040 (Pa. 2007). The Supreme Court ruled that "while in some circumstances conditions may be necessary to satisfy the Commission that public benefit sufficient to meet the requirement of Section 1103(a) will ensue, even where the PUC finds benefit in the first instance, Section 1103(a) also confers discretion upon the agency to impose conditions which it deems to be just and reasonable."[13]

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[12] Although *City of York* involved a merger, as in this case, its holding is also applicable to an acquisition. Section 1102(a)(3), which imposes the certificate of public convenience requirement, makes no distinction based on whether property is acquired by the "sale or transfer of stock," a "consolidation," a "merger," a "sale," or a "lease."

[13] *Popowsky*, 594 Pa. at 611, 937 A.2d at 1057.

Through its ruling in *Popowsky*, the Court provided further guidance on the evidentiary findings the Commission is required to make before approving a merger or acquisition. Specifically, the Court opined that:

> the appropriate legal framework requires a reviewing court to determine whether substantial evidence supports the Commission's finding that a merger will affirmatively promote the service, accommodation, convenience, or safety of the public in some substantial way. In conducting the underlying inquiry, the Commission is not required to secure legally binding commitments or to quantify benefits where this may be impractical, burdensome, or impossible; rather, the PUC properly applies a preponderance of the evidence standard to make factually-based determinations (including predictive ones informed by expert judgment) concerning certification matters.[14]

In other words, the applicants are required to prove the likelihood of "substantial" affirmative public benefits and to do so by a preponderance of the evidence.

In both *City of York* and *Popowsky*, the Supreme Court simply concluded that there was substantial evidence to support the Commission's finding that the proposed transaction would provide affirmative public benefits. The Supreme Court did not hold that it would have been erroneous if the Commission had found (a) that the benefits were proven by a preponderance of the evidence but (b) that those benefits were not "substantial" and, therefore, did not justify approval of the transaction. In other words, even if the Commission finds by a preponderance of the evidence that a transaction would yield affirmative public benefits, the Commission is not permitted to approve that transaction unless it finds that the benefits would be *substantial*.

The Supreme Court emphasized in *Popowsky* that the Commission is required to weigh any anticompetitive effects of a merger, *i.e.*, detriments, against the merger's

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[14] *Popowsky*, 594 Pa. at 611, 937 A.2d at 1057.

advantages, *i.e.*, affirmative benefits, in order to determine if the merger would produce ***net*** public benefits. Specifically, the Supreme Court stated as follows:

> We also differ with the OCA's suggestion that the PUC's analysis of the effect of the Verizon /MCI merger on competition is immaterial to its assessment of public benefit. In line with the DOJ and FCC assessments, competitive impact is a substantial component of a rational net public benefits evaluation in the merger context. That the ultimate determination may be that the impact is modest, minimal, or non-existent does not negate the necessity of undertaking the examination in the first instance or remove the factor from the weighing and balancing process. ***Significantly, in terms of the net public benefits arising out of corporate consolidation, anticompetitive effects may offset or negate advantages and result in a denial of regulatory approval.*** Indeed, it is for this very reason that large merger transactions are so highly regulated.[15]

Consistent with the "net" benefits test, the Commission has recognized that a merger transaction has both benefits and detriments which must be balanced as part of the process for determining whether the transaction should be approved. For example, in a recent merger proceeding, the Commission specifically stated:

> The proposed transaction, like all transactions that are presented for our approval, has advantages and disadvantages. On balance, we find the advantages outweigh the disadvantages.[16]

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[15] *Popowsky v. Pennsylvania Public Utility Commission*, 594 Pa. at 610-611, 937 A.2d at 1056-1057 (Pa. 2007). (emphasis added)

[16] *Joint Application of The United Telephone Company of Pennsylvania LLC d/b/a Embarq Pennsylvania and Embarq Communications, Inc. for Approval of the Indirect Transfer of Control to CenturyTel, Inc.*, Docket No. A-2008-2076038 (Order entered May 2, 2010) at 22.

D. Non-Unanimous Settlements

Despite the Commission's policy of encouraging settlements, a non-unanimous settlement is entitled to no evidentiary presumption.

Specifically, Section 5.231(a) of the Commission's Rules of Practice and Procedure, 52 Pa. Code §5.231(a), states that "[i]t is the policy of the Commission to encourage settlements." Significantly, Section 5.231(a) does not state that "[i]t is the policy of the Commission to promote ***non-unanimous*** settlements." Furthermore, Section 5.231(a) does not state that non-unanimous settlements are entitled to a presumption in favor of their approval.

The Commonwealth Court commented on the use of non-unanimous settlements when it reviewed the merger of FirstEnergy and GPU Energy. *See ARIPPA v. Pennsylvania Public Utility Commission*, 792 A.2d 636 (Pa. Cmwlth. 2002). The Court observed that "[n]on-unanimous settlements, while not common, are not unique and have been the source of some controversy." *ARIPPA*, 792 A.2d at 658. After making that observation, the Court cited to an article by Professor Stefan H. Krieger regarding the dangers of non-unanimous settlements. Of particular relevance, the Court quoted Professor Krieger as follows:

> The danger of such an approach is obvious. Parties with a substantial interest in a utility proceeding can be left out of the decision-making process. Although commissions that permit nonunanimous settlements require review of these settlements to determine their reasonableness, these commissions often defer to the decision of the consenting parties.
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> * * *
>
> Furthermore, in their zeal to reap the benefits of the nonunanimous settlement process, commissions shift the burden of proof to the nonconsenting parties by forcing them to prove the unreasonableness of the settlement. While both traditional regulatory hearings and

> the unanimous settlement process provide protection for all parties, the nonunanimous settlement process places some parties at a severe disadvantage.[17]

ARIPPA, 792 A.2d at 658-659.

Ultimately, the Court noted as follows:

> While challenging the way the non-unanimous Settlement Stipulation was approved and its effect on other orders, ***surprisingly***, Intervenors do not challenge the ability of the Commission to approve such a settlement.
>
> * * *
>
> Because that issue was not raised, we will not address the issue of whether the Commission can enter such an order . . . .

ARIPPA, 792 A.2d at 660. (emphasis added)

The Court also identified, but did not reach, the question of "whether fact-finding made to support a settlement is the same as independent fact finding, adjudicative fact-finding, when there is no pre-ordained outcome." *ARIPPA*, 792 A.2d at 660.

In view of the language of Section 5.231(a) and the Court's *dicta* in *ARIPPA*, a non-unanimous settlement should be treated no differently than if multiple parties take the same position on a list of issues in their individual briefs.

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[17] Compounding that disadvantage before the Commission is the privileged nature of settlement discussions. *See* Section 5.231(d). Because of the privilege, non-settling parties are often deprived of their best chance to prove the unreasonableness of the settlement, *i.e.*, by revealing the changes they proposed in the settlement and the position of one or more other parties on those changes.

III. STATEMENT OF THE QUESTIONS INVOLVED

1. Should the merger be approved, as filed, with only the conditions set forth in the Settlement?

   ANSWER: No.

2. Should the merger be approved with the conditions set forth in the Settlement, plus the following additional conditions:

   a. First Energy and its affiliates shall not engage in municipal aggregation in the service territories of Met-Ed, Penelec, Penn Power, and West Penn prior to the enactment and implementation of authorizing legislation or June 1, 2013, whichever is later; and

   b. FirstEnergy shall administratively locate the generating assets of FirstEnergy and Allegheny Energy in separate subsidiaries that shall not coordinate regarding whether to bid in a particular default service procurement and regarding what price to bid?

   ANSWER: Yes.

3. Should Direct Energy's proposal to auction off the non-shopping customers of Met-Ed, Penelec, Penn Power, and West Penn to EGSs, on an opt-out basis, be approved?

   ANSWER: No.

4. Should Direct Energy's proposal to base the default service rates of Met-Ed, Penelec, Penn Power, and West Penn entirely on spot market prices be approved?

   ANSWER: No.

5. Should RESA's proposals to change the design of default service for Met-Ed, Penelec, Penn Power, and West Penn be approved?

   ANSWER: No.

IV. SUMMARY OF ARGUMENT

A. Municipal Aggregation

FirstEnergy plans to use Allegheny Energy's low-cost generation to expand FES's opportunities in the Pennsylvania retail market. A key element of that retail market expansion is municipal aggregation. Despite the fact that legislation authorizing municipal aggregation has not yet been enacted, FES is already soliciting contracts with municipalities governed by the Home Rule Charter and Optional Plans Law.

As pursued by FirstEnergy, municipal aggregation will violate the Public Utility Code because all customers in the participating municipalities will receive aggregation service, rather than default service, if they do not affirmatively opt out of the aggregation.

Furthermore, FirstEnergy's municipal aggregation strategy will increase the risk faced by suppliers of full-requirements contracts, thereby resulting in higher default service rates for non-shopping customers during the January 1, 2011, through May 31, 2013, default service period.

Finally, because of its advantage as the incumbent utility and its ownership of local generation capacity, FirstEnergy's municipal aggregation strategy will make it harder for other electric generation suppliers to compete.

Although the Settlement will produce some affirmative benefits, those benefits will be far outweighed by the harm FirstEnergy's municipal aggregation strategy will do to default service customers. Therefore, consistent with the "net benefits" test articulated by the Supreme Court in *Popowsky*, the Commission must reject the proposed transfer of control of Allegheny Energy to FirstEnergy, unless the Commission imposes the following additional conditions:

a. First Energy Corporation and its affiliates shall not engage in municipal aggregation in the Met-Ed, Penelec, Penn Power, and West Penn service territories prior to the enactment and implementation of authorizing legislation or June 1, 2013, whichever is later; and

b. FirstEnergy shall administratively locate the generating assets of FirstEnergy Corporation and Allegheny Energy, Inc., in separate subsidiaries that shall not coordinate regarding whether to bid in a particular default service procurement and regarding what price to bid.

B. Direct Energy

Direct Energy proposed to auction (on an opt-out basis) all of the customers of Met-Ed, Penelec, Penn Power, and West Penn that are not shopping as of June 1, 2013. Direct Energy proposed to set the default service rate for opt-out customers solely on the basis of spot market prices, beginning on June 1, 2013.

Direct Energy's proposal will have a negative impact on default service customers that will be similar to the negative effect of FirstEnergy's municipal aggregation strategy, *i.e.*, unless they affirmatively choose default service, customers will receive service at rates not subject to Commission oversight.

Furthermore, because Direct Energy's proposal will not take effect until the default service period beginning June 1, 2013, it will not solve the competitive problems Direct Energy claims will result from the merger.

Therefore, the Commission should reject the proposal and allow Direct Energy to raise it in the four EDCs' default service proceedings for the period beginning June 1, 2013.

C. RESA

RESA proposed numerous changes in the design of default service for Met-Ed, Penelec, Penn Power, and West Penn. Those changes will not take effect until the default service period beginning June 1, 2013. Furthermore, many of those changes are inconsistent with the Commission's default service regulations and Policy Statement and inconsistent with prior Commission precedent.

Because RESA's proposals will not take effect until the default service period beginning June 1, 2013, they will not solve the competitive problems RESA claims will result from the merger. Therefore, the Commission should reject the proposals and allow RESA to raise them in the four EDCs' default service proceedings for the period beginning June 1, 2013.

V. ARGUMENT

A. Municipal Aggregation

1. Summary

The Settlement states the agreement of the Joint Applicants and some of the intervenors "that the Joint Application as modified only by this Joint Petition and Settlement shall be approved without further modification."[18] The Settlement is silent on the issue of municipal aggregation. Therefore, the Settlement, in effect, recommends approval of FirstEnergy's municipal aggregation strategy.

The OSBA does not deny that the Settlement will provide some affirmative public benefits. However, those benefits will be more than offset by the harm to default service rates and retail competition caused by FirstEnergy's participation in municipal aggregation. Therefore, as proposed and modified by the Settlement, this merger can not satisfy the "net benefits" test articulated by the Supreme Court in *Popowsky*.

The evidence shows that FirstEnergy needs Allegheny Energy's generating assets in order to enhance the ability of its affiliate, First Energy Solutions ("FES"), to achieve the level of participation in municipal aggregation intended under FirstEnergy's retail marketing strategy. Although the General Assembly has not yet passed legislation authorizing municipal aggregation, FirstEnergy is already soliciting contracts with municipalities.

There are two possible remedies to the harm caused by municipal aggregation. First, the Commission could simply reject the merger. Second, the Commission could approve the merger subject to the condition that FirstEnergy and its affiliates not

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[18] Settlement at 7, ¶13.

participate in municipal aggregation until the later of (a) the enactment and implementation of authorizing legislation or (b) the beginning of the next default service period for all post-merger First Energy EDCs on June 1, 2013.

2. Nature of "Municipal Aggregation"

As explained by Constellation witness David Fein, municipal aggregation allows a municipality to buy electricity for its residential and small commercial and industrial ("Small C&I") customers from a single electric generation supplier ("EGS"). In theory, a municipality could provide aggregation for its residents and businesses on either an "opt-in" or an "opt-out" basis. However, Mr. Fein (in unrebutted testimony) asserted that FirstEnergy and its affiliates support the adoption of "Municipal Opt-Out Aggregation," which would automatically enroll residential and Small C&I customers with a single EGS unless the customers affirmatively opt-out of such service.[19]

FES Vice President Tony Banks explained FirstEnergy's concept of municipal aggregation in testimony before the House Consumer Affairs Committee in support of authorizing legislation. Specifically, Mr. Banks stated as follows:

> My testimony will focus on how opt-out municipal aggregation would provide an effective rate mitigation tool to customers served by competitive markets for electric generation here in Pennsylvania, and how it is already working in other states-like Ohio for example-to provide customers with meaningful savings on their electric bills.
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> ***
>
> . . .Opt-out municipal aggregation is a way for local communities to combine their residential and small

[19] Constellation Statement No. 1 at 13.

> businesses into a single, large buying group-attracting more participation from generation suppliers and promoting greater competition in the retail electricity marketplace. Rather than compete for individual customers-which drives up marketing and back-end costs-electric generation suppliers would compete to serve these large buying groups. And the lower cost to enroll these customers allows the supplier to pass the savings on to customers in the form of lower prices.[20]

3. Relevance of Municipal Aggregation to this Merger

a. FirstEnergy's Marketing Strategy

FirstEnergy CEO Mr. Anthony Alexander testified in this proceeding that FirstEnergy's retail marketing strategy (in Pennsylvania and in other states, including Ohio) is to target the following three retail sales channels:

- Direct Sales;
- Municipal Aggregation; and
- Sales into the Provider of Last Resort ("POLR") Auctions.[21]

Mr. Alexander testified that FirstEnergy is already an active "retail" provider in Pennsylvania.[22] Specifically, FES currently participates in two out of the three targeted sales channels in Pennsylvania under its retail marketing strategy, *i.e.*, direct sales and sales into the POLR Auctions.[23] Mr. Alexander acknowledged that FirstEnergy's retail

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[20]Direct Energy Cross-Examination Exhibit No. 9.

[21]Hearing Transcript at 261- 262. Mr. Alexander's reference to "direct sales" is to the customer-by-customer solicitations commonly employed by EGSs. His reference to "sales into the Provider of Last Resort auctions" is to bidding in the Request for Proposal or auction process used by an EDC to acquire electricity for default service customers. Bidding in default service procurements does not constitute "retail competition," as the Commission appears to define "retail competition."

[22]Hearing Transcript at 262.

[23] Direct Energy Cross-Examination Exhibit No. 3.

marketing in Pennsylvania currently is limited because of the shortage of generation, but he predicted that acquiring Allegheny Energy's generation assets will help FirstEnergy overcome that limitation. Specifically, Mr. Alexander summarized the effect of the merger on FirstEnergy's retail strategy as follows:

> Having additional generation will expand our opportunities to attract additional retail customers not only in Pennsylvania but elsewhere.
>
> ***
>
> It's the addition of generation that allows you to participate more fully in the retail market opportunities that Pennsylvania presents. It's not unlike the 500 megawatts we added to the system. It gave us more capability to participate in retail markets across the area. The Allegheny generation will be similar to that.[24]

As Mr. Alexander testified, FirstEnergy currently follows the same retail marketing strategy in Ohio that he hopes the merger will enable FirstEnergy to implement more effectively in Pennsylvania.[25] Under the retail marketing strategy in Ohio, FES currently serves 79% of what Mr. Alexander defines as retail load, *i.e.*, the combination of FES's direct sales, aggregation sales, and default service sales in its franchise service territories.[26]

Mr. Alexander testified that, even with the acquisition of Allegheny Energy's generation assets, FES will probably not be able to achieve the same level of success in Pennsylvania that it has reached in Ohio because it will continue to lack an amount of

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[24] Hearing Transcript at 262.

[25] Hearing Transcript at 261-262.

[26] Hearing Transcript at 262-264.

generation comparable to its Ohio assets. Nevertheless, Mr. Alexander testified that it is FES's strategy to integrate its generation capability with the above listed three retail channels and acknowledged the following:

> Our goal is to deploy all of our generating resources and sell the product we produce in whatever channels there are available to us, including the wholesale market if we are unsuccessful in executing our retail strategy, in whatever market we are attempting to participate in.[27]

As Mr. Alexander's testimony shows, the principal benefit of this merger to FirstEnergy is the acquisition of Allegheny Energy's generation so that FirstEnergy can expand its opportunities in Pennsylvania's retail markets.[28] One way FirstEnergy intends to expand is through municipal aggregation.[29] Therefore, the Commission can not approve this merger without first assessing the impact of municipal aggregation.

b. Legislative Matter

The Joint Applicants conceded that municipal aggregation is an issue in this merger proceeding when they stated the following in the Joint Application:

> FirstEnergy, through its FirstEnergy Solutions subsidiary, has been extremely active in supporting and promoting retail electric competition in Pennsylvania, as most recently evidenced by its support and endorsement of municipal aggregation. FirstEnergy believes that the Merger will enable it to expand its ability to bring the benefits of retail marketing offers to customers in additional areas of the Commonwealth.[30]

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[27] Hearing Transcript at 266.

[28] Hearing Transcript at 262.

[29] Joint Application at 17, ¶28 and Joint Applicants Statement No. 1 at 17.

[30] Joint Application at 17, ¶28.

Numerous parties submitted direct testimony about the adverse effects that FirstEnergy's participation in municipal aggregation will have on retail competition and on default service procurement.[31] Joint Applicants witness Mr. Frank Graves responded to those concerns by testifying in rebuttal that municipal aggregation should not be an issue in this proceeding because municipal aggregation has not been statutorily authorized in the case of most Pennsylvania municipalities and that legislative changes will be needed to make municipal aggregation widely possible.[32] Interestingly, FirstEnergy did not attempt to rebut the intervenors' testimony that municipal aggregation will have a negative impact on default service.

OCA witness Ms. Barbara Alexander also testified that municipal aggregation is irrelevant to this proceeding because the municipal aggregation activities that occur in Ohio are pursuant to Ohio law and regulations that are not relevant or duplicated in Pennsylvania.[33]

The argument of Mr. Graves and Ms. Alexander that municipal aggregation is not relevant to this proceeding is demonstrably incorrect. FirstEnergy has no intention of waiting for legislation to be passed in order to begin soliciting municipalities to contract for electricity through municipal aggregation. For example, FirstEnergy CEO Mr. Alexander confirmed that FES has solicited Meadville to enter an agreement under which

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[31] *See, e.g.*, OSBA Statement No. 1 at 17-20, Constellation Statement No. 1 at 13-14, RESA Statement No. 1 at 9-10, and Direct Energy Statement No. 3 at 17-18. In addition to raising the issue in testimony, the OSBA objected to FirstEnergy's plans in the OSBA's initial pleadings in this proceeding. *See* OSBA Intervention and Protest at ¶¶ 16(g) and 18(d)-(f).

[32] Joint Applicants Statement No. 10-R at 19.

[33] OCA Statement No. 2-R at 11. Any merit to Ms. Alexander's argument is undercut by FES's efforts to solicit municipal aggregation contracts prior to the enactment of legislation setting the rules in Pennsylvania.

FES will provide electric generation service (beginning January 1, 2011) to all residential and Small C&I customers within the municipality that do not opt-out of the aggregation pool.[34]

Counsel for FirstEnergy suggested that Meadville is already eligible to engage in municipal aggregation because Meadville is a home rule municipality and, therefore, is not subject to the same restrictions that apply to other municipalities that might need authorization by the pending legislation.[35] However, FirstEnergy presented no testimony that explicitly drew that distinction or that explained what percent of FirstEnergy's Pennsylvania load arises from customers residing or otherwise located in a home rule municipality. Furthermore, FirstEnergy provided no memorandum spelling out the legal theory to which counsel was apparently referring.

Joint Applicants witness Dr. William Hieronymus suggested a different reason why the Commission should not consider municipal aggregation in this proceeding, *i.e.*, that any restrictions on municipal aggregation should be addressed generically. Specifically, Dr. Hieronymus testified as follows:

> Currently, there is little if any aggregation of retail load in Pennsylvania. In the event that aggregation proves to be an attractive service, there is nothing distinguishing about the Joint Applicants that warrants restrictions specific to them, and nothing that even vaguely relates to the effects of the merger. Hence, the restrictions on aggregation that [OSBA witness] Dr. Wilson proposes are not properly in this proceeding and should be

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[34] Direct Energy Cross Examination Exhibit No. 5 and Hearing Transcript at 278.

[35] Hearing Transcript at 424.

considered, if at all, in a docket in which all interested parties can participate.[36]

However, as proven through Mr. Alexander's own testimony and the merger application itself, approval of this merger will provide the generation resources FirstEnergy needs in order to expand into municipal aggregation aggressively. The fact that FirstEnergy is already soliciting contracts for municipal aggregation (without waiting for generic legislation) demonstrates that the impact of municipal aggregation must be addressed in this merger proceeding and not deferred to another proceeding.

c. Negative Impact on Retail Competition

To approve this merger, the Commission must first find that the merger will not negatively impact the retail market. That requirement is spelled out in Section 2811(a) and (e)(1) of the Public Utility Code, 66 Pa. C.S. §2811(a) and (e)(1).

FirstEnergy's position is that the proposed merger will not have a negative impact on the competitive retail market. For example, FirstEnergy CEO Mr. Alexander attempted to debunk the idea that FirstEnergy might want to harm the retail market in any way. Specifically, Mr. Alexander asserted that FirstEnergy has been extremely active in supporting and promoting retail competition in Pennsylvania, which he contends is evident by FirstEnergy's support and endorsement of municipal aggregation.[37] However, contrary to Mr. Alexander's assertion, the evidence shows that FirstEnergy's business strategy with regard to municipal aggregation will have a negative impact on retail competition rather than a positive impact.

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[36] Joint Applicants Statement No. 4-R at 38-39.

[37] Joint Applicants Statement No. 1 at 17.

Mr. Alexander summarized the benefits of municipal aggregation (vs. one-on-one solicitation of retail customers) as follows:

> It's complex marketing when you're going to the mass market. It's a combination of TV, radio, other opportunities, direct mail. What government aggregation does is allow these customers to automatically enroll if they choose to receive a discount off their price to compare that they would otherwise pay for default service, and in the case of Meadville, be able to choose any other supplier they want without a switching fee.[38]

However, it is precisely this ability to avoid the normal marketing costs in the Met-Ed, Penelec, and West Penn service territories, where FES will have the "home team advantage," that will negatively impact retail competition. As Direct Energy witness Dr. Mathew Morey testified:

> FE is taking full advantage of a procurement structure that has a consequence very little shopping by residential and small commercial customers. I believe that such a market structure helps FE advance its retail strategy because it would be harder (and more costly) to lure away commercial customers through direct marketing; and a municipal aggregation plan that FE has supported in statements to the legislature would be more difficult (and perhaps impossible) if most customers were already shopping. [39]

FirstEnergy's business strategy is to use the generation obtained from Allegheny Energy to facilitate municipal aggregation.[40] Municipal aggregation is likely to be

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[38] Hearing Transcript at 279.

[39] Direct Energy Statement 1-SSR at 4.

[40] If the merger is approved, FES will have access to Allegheny Energy's generating facilities that are not likely to be available to its EGS competitors.

targeted to municipalities in the service territories of FirstEnergy's own EDCs. As Mr. Alexander testified, part of FirstEnergy's business model is to market its retail operations actively in states in which FirstEnergy has regulated distribution companies.[41] Consistent with that strategy, Mr. Alexander testified that the majority of FES's retail sales are in FES-affiliated franchise service territories.[42]

This strategy of targeting its own EDC service territories holds true for government, *i.e.*, municipal, aggregation contracts in Ohio. As Mr. Alexander testified, the vast majority of FES's government aggregation contracts are in the franchise service territory of FirstEnergy. For example, according to FirstEnergy's second quarter results, the total of FES's government aggregation in all of Ohio was the same as the total government aggregation in FirstEnergy's franchise service territory.[43] Furthermore, Dr. Morey testified and Mr. Alexander conceded, FirstEnergy targets areas that are close to where it owns generation.[44] Therefore, if this merger is approved, it is likely that FirstEnergy will target municipal aggregation in areas close to the location of Allegheny Energy's generating facilities.

FirstEnergy may argue that other EGSs have the competitive ability to make offers to the same municipalities that FES has.[45] However, although other EGSs may

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[41] Hearing Transcript at 273.

[42] Hearing Transcript at 274.

[43] Hearing Transcript at 275-276. According to Mr. Alexander, FES has recently entered into government aggregation contracts in Duke Energy's service territory, but he conceded that the vast majority of FES's government aggregation is in FirstEnergy's franchise territory.

[44] Direct Energy Statement No. 1-SSR at 3 and Hearing Transcript at 273-274.

[45] Hearing Transcript at 561.

have the ability to make offers to municipalities in FirstEnergy's service territories, it does not follow that these other EGSs have the same chance of succeeding as FES does. Specifically, OSBA witness Dr. John Wilson explained FES's "home team advantage" as follows:

> Mr. DeCusatis: And that's because other EDCs do not have the competitive ability to go out and make the same kinds of offers and compete on the same basis as FirstEnergy?
>
> Dr. Wilson: Well, some of them have the ability to make offers, but the ability to make an offer does not necessarily put you in the position of having equal presence in the market.
>
> For example, the community north of Pittsburgh . . . that is considering or going forward, has made a deal with FirstEnergy on municipal aggregation recently, Meadville, I'm sure that if it had been Delmarva Power and Light that went to them and said, 'Here's a deal that we'd like to do with you,' the reception would have been different than FirstEnergy, who they have a long history of knowing, whose brand is something familiar to them, who have advantages in the geographic area in which they are located.
>
> So, others can make offers, but I don't think anybody would have been in the position to successfully carry out that type of an offer other than FirstEnergy at this time, and certainly, probably next in line would be AES if they are known and received in the area.
>
> Mr. DeCusatis: And I apologize. I may have misspoken. I'm getting my acronyms wrong. I said—I believe I said EDC when I meant to say EGS. [46]

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[46] Hearing Transcript at 562.

In addition, Direct Energy witness Dr. Morey testified that FirstEnergy's own documents show that FES's post-merger marketing strategy will include promoting its "long-term customer relationships" and its "local brand," *i.e.*, customers' relationships with FirstEnergy's EDCs and the "FirstEnergy" brand.[47]

The matter of "equal presence" (as the "home team advantage" was labeled by Dr. Wilson) is of immediate concern because FirstEnergy is already soliciting contracts with municipalities within its service territory, *e.g.*, Meadville.[48] The pending municipal aggregation legislation would apply the same rules to both home rule and non-home rule municipalities.[49] The bill also would require that "[a] municipal aggregator of electricity shall use a competitive procurement or request-for proposal process to select the electric generation supplier from the lowest responsible qualified bidder. . . ."[50] However, because the legislation has not been enacted, there is currently no requirement for competitive procurement.

To compound the problem, OSBA witness Dr. Wilson related (in unrebutted testimony) that FirstEnergy appears to have offered Ohio municipalities financial "sweeteners" in exchange for locking up the residents and businesses in those municipalities as generation customers of FES.[51] Direct Energy witness Mr. Frank Lacey

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[47] Direct Energy Statement No. 1-SSR at 3.

[48] Direct Energy Cross-Examination Exhibit No. 5.

[49] House Bill 2619, Printer's Number 4406, page 2, lines 1-7; page 3, lines 15-19; and page 7, lines 5-12. The legislation is available on-line at the General Assembly's web site: http://www.legis.state.pa.us

[50] House Bill 2619, Printer's Number 4406, page 11, lines 19-23. The legislation is available on-line at the General Assembly's web site: http://www.legis.state.pa.us

[51] OSBA Statement No. 1 at 18-19.

also testified that "[in Ohio FES] offers municipalities substantial amounts of cash."[52] More specifically, RESA witness Mr. Richard Hudson stated that FES provides one-time financial grants in annual payments of $3 to 4 million to Ohio municipalities.[53] Although Mr. Alexander testified that FES offered no such "sweeteners" to Meadville, he gave no indication that such incentives will be "off the table" for other municipalities.[54]

FirstEnergy is likely to argue that the lack of competitive procurement will not harm Meadville ratepayers because, as Mr. Alexander testified, the Meadville aggregation rate will be a discount off the default service rate.[55] Furthermore, Mr. Alexander testified that FES's typical municipal aggregation contract charges a rate that is a discount off the default service rate.[56] However, the fact that FES offers a discount off the default service rate does not mean that FES offers a better rate than other EGSs would offer if they had the same contacts with municipal officials that FirstEnergy has.

FirstEnergy is also likely to argue that municipal aggregation will not harm retail competition because customers may switch to other EGSs.[57] However, for the same reason this argument does not work for Direct Energy's proposal, it does not work for municipal aggregation. Both proposals are opt-out, which requires a consumer to take

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[52] Direct Energy Statement No. 3 at 17-18.

[53] RESA Statement No. 1 at 9.

[54] Hearing Transcript at 285.

[55] Hearing Transcript at 279.

[56] Hearing Transcript at 280. As described by Mr. Alexander, FirstEnergy's strategy appears similar to opening the bids from other EGSs in a default service procurement and then allowing FES to submit its bid.

[57] *See* testimony of Joint Applicants witnesses Mr. Charles Fullem and Mr. Schnitzer, Hearing Transcript at 480-481 and 953-954, respectively.

affirmative action to decline the offer. As both Joint Applicants witness Mr. Michael Schnitzer and OCA witness Ms. Alexander recognized, opt-out takes advantage of inertia.[58] For example, Ms. Alexander testified:

> Particularly, if it's structured in such a way that you are, you just learn and understand that you have this right to opt out, and then you must affirmatively take the time and effort to achieve the opt out.
>
> And so the literature is replete with information that shows that in most cases merchants try to structure a transaction as a negative option because they know very well they will make a bigger profit as a result of forcing people to understand that they have a right and take action.[59]

Ms. Alexander further explained why opt-out municipal aggregation in Pennsylvania is of particular concern. Specifically, Ms. Alexander testified:

> Judge Weismandel: As a consumer advocate, would you think it was advantageous to the citizenry that that program [municipal aggregation] be on an opt out basis as opposed to opt in?
>
> Ms. Alexander: Generally, no. But let me say that the state laws in Ohio and Massachusetts, where there is a similar law, required the municipality to go through quite a bit of consumer education and public vote-taking by elected officials prior to allowing the aggregation program to operate in a negative option way.
>
> And so the theory of this is that your elected officials have conducted a transparent process that has been approved by the state regulating commission in both those states that allows them to select an aggregator on your behalf.

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[58] *Hearing Transcript at 953-955.*

[59] Hearing Transcript at 722.

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> And I'm not familiar and did not know of any state regulation of this aspect of the situation in Pennsylvania. And that greatly affects the validity, in my opinion, of how this has happened.[60]

There are multiple possible solutions to the edge FirstEnergy will realize in retail competition by acquiring Allegheny Energy's generation assets. First, the Commission could simply reject the merger. Second, the Commission could impose a condition that prohibits FirstEnergy and its affiliates from engaging in municipal aggregation in the service territories of FirstEnergy's Pennsylvania EDCs prior to enactment and implementation of legislation establishing rules governing municipal aggregation. Third, the Commission could impose an alternative condition recommended by OSBA witness Dr. Wilson, *i.e.*, prohibit FirstEnergy and its affiliates from engaging in municipal aggregation in the service territories of FirstEnergy's Pennsylvania EDCs unless there is competitive procurement.[61]

d. Negative Impact on Default Service

i. Elimination of Default Service Bidder

In addition to its negative impact on retail competition, opt-out municipal aggregation will also have a negative impact on the rates paid by default service customers.[62] As OCA witness Mr. Richard Hahn testified, the merger will consolidate

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[60] Hearing Transcript at 724-725.

[61] OSBA Statement No. 1, at 19-20.

[62] *See, e.g.*, Hearing Transcript at 561 (the cross-examination of OSBA witness Dr. Wilson); Constellation Statement No. 1 at 13-14 (the direct testimony of Constellation witness Mr. Fein); and Constellation Statement No. 1-SR at 11 (the surrebuttal testimony of Constellation witness Mr. Fein).

two entities that control a large percentage of the low-cost generating plants in PJM.[63] According to Mr. Hahn, FirstEnergy currently owns 12% and Allegheny Power currently owns 8% of the region's low-cost generation.[64] As OSBA witness Dr. Wilson testified, merging two of the dominant owners of generation in the region means less competition in the default service procurements.[65] Direct Energy witness Dr. Morey agreed.[66]

FirstEnergy's strategy is to promise municipal aggregation customers a discount off the default service rate.[67] As Direct Energy witness Mr. Frank Lacey testified, it is difficult to understand how FES can afford to make such a promise for an extended period of time in view of the uncertainty about the future direction of market prices. Particularly puzzling, according to Mr. Lacey, is FirstEnergy's willingness to make such commitments in Ohio for periods of up to nine years.[68] One possible explanation is that FirstEnergy can make such guarantees because it is willing and able to commit low-cost generation to municipal aggregation rather than to bid that generation into the default service procurements.

As another possible explanation, Mr. Lacey testified that "FES's willingness to commit cost savings compared to a utility default service price that will change several times during the term of the agreement may indicate that inappropriate communications

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[63] OCA Statement No. 1 at 32.

[64] Id.

[65] OSBA Statement No. 1 at 16.

[66] Direct Energy Statement No. 1-SRR at 1-2.

[67] *See* testimony of FirstEnergy CEO Mr. Alexander, Hearing Transcript at 280.

[68] Direct Statement No. 3 at 17-18.

may even be expected between the regulated company and FES."[69] In that regard, Mr. Lacey argued that the existing code of conduct in Pennsylvania is not sufficient to prevent inappropriate interactions between the regulated company and its sales affiliate.[70] Therefore, structural measures, *e.g.*, OSBA witness Dr. Wilson's proposal to require Allegheny Energy and FirstEnergy to keep their generating assets separate, are important.

Joint Applicants witness Mr. Hieronymus asserted that there is "no basis" for requiring separate generation subsidiaries.[71] Nevertheless, the Joint Applicants indicated that, at least initially, it was their intent to maintain the FirstEnergy and the Allegheny Energy generating assets in separate subsidiaries.[72] Furthermore, FirstEnergy CEO Mr. Alexander testified that the Company has made no decision as to where the generation will reside, under what subsidiary, and how it will be moved around. Mr. Alexander also testified that FirstEnergy will deal with those questions at a later date.[73] Given that testimony, there is no evidence of record as to why keeping the FirstEnergy and the Allegheny Energy generating assets separate would be a major additional burden, other than the vague and unquantified protest by Joint Applicant witness James Pearson that this could separate them "from the financial metrics of the corporate family."[74]

If FirstEnergy is willing and able to guarantee municipalities a discount off the default service rate, it is reasonable for the Commission to infer that, without municipal

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[69]Direct Statement No. 3 at 18.

[70] Direct Statement No. 3 at 17-19.

[71] Joint Applicants Statement No. 4-R at 32.

[72] Joint Application at Exhibit F-1.

[73] Hearing Transcript at 282.

[74] Joint Applicants Statement No. 2-R at 4.

aggregation, the same generation which serves municipal aggregation customers would be bid into the default service procurements at relatively low prices. Therefore, if FirstEnergy dedicates a significant portion of Allegheny Energy's low-cost generation to retail competition (including municipal aggregation) rather than to default service, the result is likely to be higher default service rates.

There are several possible solutions to this negative impact on default service rates. First, the Commission could simply reject the merger. Second, the Commission could approve the merger with a condition recommended by OSBA witness Dr. Wilson, *i.e.*, that the generating assets of Allegheny Energy be administratively located in a subsidiary which operates independently from FES and is prohibited from coordinating with FES regarding whether or not to bid in a particular default service procurement and regarding what price to bid.[75]

ii. Excessive Default Service Rates

The current default service plans for Met-Ed, Penelec, Penn Power, and West Penn rely primarily on full-requirements contracts for serving the Small C&I load. This reliance by all four EDCs on full-requirements contracts will extend through May 31, 2013.[76]

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[75] OSBA Statement No. 1 at 21-22.

[76] *Petition of the West Penn Power Company d/b/a Allegheny Power for Approval of its Retail Electric Default Service Program and Competitive Procurement Plan for Service at the Conclusion of the Restructuring Transition Period*, Docket No. P-00072342 (Order entered July 25, 2008); *and Joint Petition of Metropolitan Edison Company and Pennsylvania Electric Company For Approval of Their Default Service Programs*, Docket Nos. P-2009-2093053 and P-2009-2093054 (Order entered November 6, 2009). At the public meeting held on October 21, 2010, the Commission approved the Joint Petition for Settlement in Penn Power's most recent default service case for the period from June 1, 2011, through May 31, 2013. *See Petition of Pennsylvania Power Company for Approval of its Default Service Program*, Docket Number P-2010-2157862.

OSBA witness Dr. Wilson warned that allowing the implementation of opt-out municipal aggregation for default service electricity to be delivered prior to June 1, 2013, will have a negative impact on the default service procurements of these four EDCs.[77] Unfortunately, the evidence, *e.g.*, Meadville, shows that FirstEnergy intends to enter into municipal aggregation contracts for the delivery of electricity in the service territories of its affiliated EDCs prior to June 1, 2013.[78]

Constellation witness Mr. Fein warned that opt-out municipal aggregation causes particular concerns for the use of full-requirements contracts. Specifically, Mr. Fein testified as follows:

> Wholesale suppliers bidding to serve an EDC's default service supply requirements under such a DSP [default service plan] understand, accept and account for the fact that the EDC's load will change as customers *at their own election* choose *to leave* Default Service for competitive retail supply from an EGS, and that such individual customers may at some point in time *return* to Default Service.
>
> Municipal Opt-Out Aggregation, however, fundamentally changes the patterns and ways in which customers both leave and return to Default Service. If it seems that Municipal Opt-Out Aggregation policies are likely to be implemented in the near term, bidders in procurements under DSPs already approved by the Commission will recognize and account for the significant load variability differences that Municipal Opt-Out Aggregation programs present with respect to serving a portion of an EDC's Default Service supply requirements. In order to address such differences, wholesale suppliers may either limit their participation in Default Service procurements or else account for the increased risk of large-scale

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[77] OSBA Statement No. 1 at 20.

[78] *See* Direct Energy Cross-Examination Exhibit No. 5.

> declining and returning load under Municipal Opt-Out Aggregation through additional premiums in their bids. Reduced participation and/or additional premiums will lead only to *less* competitive Default Service procurements with *less* competitive Default Service bids, to the *detriment* of utilities' Default Service consumers. Higher Default Service prices will be paid by *all* customers who remain on Default Service, even though all municipalities may not have implemented or do not plan to implement Municipal Opt-Out Aggregation programs.
>
> In summary, the implementation of Municipal Opt-Out Aggregation represents a new 'default' product for *certain* municipalities' customers that will *increase* the costs of EDCs' statutorily-mandated Default Service product for *all* customers. Potential wide and growing disparities between customers, *including* between municipalities, that may result from Municipal Opt-Out Aggregation would be harmful to the Commission's energy future.[79]

Furthermore, Dr. Wilson testified on cross-examination that if FirstEnergy were to proceed the way it has in Ohio with municipal aggregation, then municipal aggregation would essentially destroy default service as it currently exists in Pennsylvania. Specifically, Dr. Wilson testified as follows:

> Mr. DeCusatis: And when you say the history in Ohio, the history in Ohio would be that they there have municipal aggregation legislatively approved and FirstEnergy is a participant in that market?
>
> Dr. Wilson: Not merely that, but rather the way in which FirstEnergy has participated. That is to lock up for long periods of time communities within their service territories by making payments to those communities not purely on price-of-electricity basis.

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[79] Constellation Statement No. 1-SR at 10-11. (emphasis in original)

> Certainly, if that sort of thing were to occur in Pennsylvania, it would mount a very severe threat to the default service supply programs that are successful and operating now. It would greatly increase the risks of those programs and likely reduce participation of them in the future and be a threat to consumers who are benefiting from those types of default service supply acquisition programs at the present time, particularly those that operate on a full requirements basis.
>
> Mr. DeCusatis: And that is because other EDCs are prohibited for some reason from competing in the same way that FirstEnergy does?
>
> Dr. Wilson: No. It's because if municipal aggregation moves forward on a basis other than opt-in and on a basis other than competitive bidding and prior to the expiration of the default service programs, particularly with the type of conduct and experience that we've had with FirstEnergy in Ohio, it would be something that would imperil, I think, the ability of the state to have an effective default service supply program in competition with that.[80]

As a way to mitigate the negative impact on default service rates, Mr. Fein suggested that, at least, FES should be required to determine the amount of load to be served by municipal aggregation before wholesale suppliers submit their default service bids.[81] Consistent with Mr. Fein's logic, such advance notice should result in smaller risk premiums because the bidders will have greater certainty about what the default service load will be.

Ultimately, there are two solutions to the negative impact opt-out municipal aggregation will have on default service procurement results. First, the Commission

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[80] Hearing Transcript at 561-562.

[81] Constellation Statement No. 1 at 13-14.

could reject the merger. Second, the Commission could approve the merger with a condition proposed by OSBA witness Dr. Wilson, *i.e.*, prohibit FirstEnergy and its affiliates from engaging in municipal aggregation for delivery prior to the expiration of existing default service programs on May 31, 2013.

iii. Conflict with Duty under Act 129

The act of October 15, 2008 (P.L. 1592, No. 129) ("Act 129"), dictates how default service is to be procured throughout Pennsylvania. Specifically, Act 129 added Section 2807(e)(3.2) of the Public Utility Code, 66 Pa. C.S. §2807(e)(3.2). Section 2807(e)(3.2) requires the EDC (or alternative default service provider) to procure electricity to serve default service ratepayers through a "prudent mix" of spot market purchases, short-term contracts (for periods of up to four years), and long-term contracts (for periods of more than four years but not more than 20 years). Section 2807(e)(3.4) provides that the "prudent mix of contracts . . . shall be designed to ensure . . . ***[t]he least cost to customers over time***." (emphasis added)

FirstEnergy's goal of promoting municipal aggregation is in conflict with the duty of its EDCs to ensure that the generation obtained for default service customers is purchased at least cost.[82] If this merger is approved without appropriate conditions, the Commission will be allowing FirstEnergy to acquire low-cost generation and use it for retail customers (such as municipal aggregation customers) instead of bidding that low-cost generation into the default service procurements conducted by its own EDCs.

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[82] *See* 66 Pa. C.S. §2807(e)(3.4) and (3.7).

4. No Authority for Opt-Out Municipal Aggregation

a. Statutes Governing Home Rule Municipalities

As FirstEnergy witness Mr. Graves testified, there currently is no specific statutory authority for FES, or any other EGS, to contract with a municipality to provide aggregation on an opt-out basis.[83] Because FirstEnergy has not presented its legal argument, the OSBA does not know the basis for FirstEnergy's apparent conclusion that some municipalities, *i.e.,* home rule municipalities, already have that authority.

Significantly, FirstEnergy's conclusion appears dubious under the Home Rule Charter and Optional Plans Law, 53 Pa. C.S. §2901 *et. seq.* Specifically, Section 2962(c)(2) specifies that "[a] municipality shall not . . . [e]xercise powers contrary to, or in limitation or enlargement of, powers granted by statutes which are applicable in every part of this Commonwealth." The Commonwealth Court has already construed similar language in the predecessor statute. In that case, the Court held that a home rule municipality remains subject to the Public Utility Code and, as a result, is not permitted to sell water in an adjoining municipality without Commission approval of the rates. *See City of McKeesport v. Pennsylvania Public Utility Commission*, 65 Pa. Cmwlth. 179, 472 A.2d 30 (Pa. Cmwlth. 1982). Therefore, there appears to be no basis for the argument that home rule municipalities have the power to perform any function regulated by the Commission unless the Public Utility Code provides express authorization.

In addition, Section 2962(c)(1) provides that "[a] municipality shall not . . . [e]ngage in any proprietary or private business except as authorized by statute." Once again, the Commonwealth Court has already construed similar language in the prior

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[83] Joint Applicants Statement No. 10-R at 19.

statute. For example, in *Associated Pennsylvania Constructors v. City of Pittsburgh*, 134 Pa. Cmwlth. 536, 579 A.2d 461 (Pa. Cmwlth. 1990), the Court held that the sale of asphalt by a home rule city to other municipalities violated the ban on engaging in a proprietary or private business without express statutory authorization. Therefore, if a home rule municipality is not permitted to sell asphalt from a plant it lawfully maintains for its own needs, there is no apparent basis for concluding that a home rule municipality may purchase electricity for its residents and businesses on an opt-out basis without express statutory authorization.

b. Specific Governs General

Even if FirstEnergy can identify some general provision of the Home Rule Charter and Optional Plans Law (or some other statute) in support of its argument, any such general provision must yield to the specific language of the Public Utility Code.[84]

Any argument that a home rule municipality may serve as an "aggregator" or "broker" under the Electricity Generation Customer Choice and Competition Act, 66 Pa. C.S. Chapter 28, fails. Section 2803 of the Public Utility Code, 66 Pa. C.S. §2803, defines "aggregator" as "[a]n entity, licensed by the commission, that purchases electric energy and takes title to electric energy as an intermediary for sale to retail customers." Similarly, Section 2803 defines "broker" or "marketer" as "[a]n entity, licensed by the commission, that acts as an agent or intermediary in the sale and purchase of electric energy but that does not take title to electric energy." FirstEnergy has provided no evidence that Meadville, or any other home rule municipality, is licensed as an aggregator, a broker, or a marketer.

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[84] See 1 Pa. C.S. §1933, which provides that in construing two conflicting statutes, the particular shall govern the general.

Section 2803 also defines "electric generation supplier" to include "a person or corporation . . . brokers and marketers, aggregators or any other entities . . . that purchases, brokers, arranges or markets electricity . . . for sale to end-use customers utilizing the jurisdictional transmission and distribution facilities of an electric distribution company." Section 2809(a) of the Public Utility Code, 66 Pa. C.S. §2809(a), specifies that "[n]o person or corporation, including municipal corporations which choose to provide service outside their municipal limits . . ., brokers and marketers, aggregators and other entities, shall engage in the business of an electric generation supplier in this Commonwealth unless the person or corporation holds a license issued by the commission." Once again, FirstEnergy has offered no evidence that Meadville, or any other home rule municipality, holds a license under Section 2809(a) to purchase electricity on behalf of the residents and businesses of that municipality.

c. Meaning of Default Service

FirstEnergy may argue that because Section 2809(a) explicitly requires a municipality to obtain a license to provide service outside the municipal limits, the statute is intended to exempt municipalities from having to obtain a license to purchase electricity for customers within the municipal limits. However, any such argument must fail if the municipality is engaged in *opt-out* aggregation.

Section 2803 defines the Default Service Provider ("DSP") as:

> 'Default service provider.' An electric distribution company within its certified service territory or an alternative supplier approved by the commission that provides generation service to retail electric customers who:
>
> > (1) contract for electric power, including energy and capacity, and the chosen electric

> generation supplier does not supply the service; or
>
> (2) ***do not choose an alternative electric generation supplier***. (emphasis added)

Section 2807(e)(3.1) of the Public Utility Code, 66 Pa. C.S. §2807(e)(3.1), states the obligations of a default service provider. In pertinent part, Section 2807(e)(3.1) provides as follows:

> Following the expiration of an electric distribution company's obligation to provide electric generation supply service to retail customers at capped rates, if a customer contracts for electric generation supply services and the chosen electric generation supplier does not provide the service or ***if a customer does not choose an alternative electric generation supplier***, the default service provider shall provide electric generation supply service to that customer pursuant to a commission-approved competitive procurement plan. (emphasis added)

As FES Vice President Mr. Banks testified before the House Consumer Affairs Committee, "Today, if customers take no action to shop for electric generation service, they automatically receive default service from their local electric utility."[85] Similarly, Joint Applicants witness Mr. Schnitzer opined in this proceeding that his definition of default service is if a customer does nothing, the customer is on default service.[86] Specifically, Mr. Schnitzer testified as follows:

> Well, I mean, in the sense that they are on default service, but the point is that however they got there, by doing nothing, that's where they ended up. And that's my definition of default service, if you do nothing, what happens. [87]

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[85] Direct Energy Cross-Examination Exhibit No. 9.

[86] Hearing Transcript at 938.

[87] Hearing Transcript at 938.

Accepting FirstEnergy's argument that home rule municipalities already have the authority to engage in opt-out aggregation will, in effect, change the meaning of default service. As Mr. Banks explained to the House Consumer Affairs Committee:

> Municipal aggregation is not much different than the structure already in place today in Pennsylvania. Today, if customers take no action to shop for electric generation service, they automatically receive default service from their local electric utility. Similarly, under opt-out municipal aggregation, customers ***who take no action will automatically default to the generation supplier*** with whom their municipality has negotiated a price, presumably lower than the utility default service price.[88] (emphasis added)

As Sections 2803 and 2807(e)(3.1) require, customers who take no action are to be served by the default service provider rather than by an EGS, either directly or through municipal aggregation.

d. Slamming

Even if the Commission were to agree with FirstEnergy's redefinition of "default service," municipal aggregation by home rule municipalities would run afoul of Section 2807(d)(1) of the Public Utility Code, 66 Pa. C.S. § 2807(d)(1). Specifically, Section 2807(d)(1) provides that "[t]he Commission shall establish regulations to ensure that an electric distribution company does not change a customer's electricity supplier without direct oral confirmation from the customer of record or written evidence of the customer's consent to a change of supplier." Under FirstEnergy's municipal aggregation, FirstEnergy's affiliated EDC will be changing a customer to an affiliate, FES, without

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[88]Direct Energy Cross-Examination Exhibit No. 9.

direct oral confirmation from the customer or written evidence of the customer's consent to the change.

B. Direct Energy's Proposal

1. Overview of Direct Energy's Proposal

Direct Energy witness Dr. Mathew Morey argued that if the merger is approved as proposed, the merger will violate Section 2811 of the Public Utility Code because the merger will fail to promote the benefits of a properly functioning and workable competitive retail electric market to residential and Small C&I customers.[89] Consistent with that conclusion, Direct Energy witnesses Dr. Morey, Ms. Nora Mead Brownell, and Mr. Frank Lacey proposed that the Commission impose the following conditions on the merger:

- The Commission should replace FirstEnergy's EDCs as the providers of default service in their respective service territories.

- The Commission should order the alternative default service provider(s) to auction all customers that are on default service as of June 1, 2013, to EGSs, unless the customers affirmatively opt-out of the auction. Proceeds from the auction would be distributed among all customers who have not opted for default service. EGSs who procure customers through this auction would be obligated to provide service to those customers at a fixed per-kWh rate for two successive six-month periods, unless the customer affirmatively opts for alternative service.[90] After one-year, the rates charged by the EGSs to these customers would not be regulated by the Commission.

- The Commission should order the alternative default service provider(s) to provide default service supply through a spot market procurement method to those customers who opted out of the auction, as well as to those customers whose EGS can not provide the service, goes out of

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[89] Direct Energy Statement No. 1 at 10-12.

[90] Direct Energy Statement No. 3 at 13. The fixed rate would be adjusted based on a market index after the first six months.

business, or exits the market without providing for the continuation of supply from another EGS.

- The Commission should create a new, third-party billing company to perform the function now provided by the EDCs.[91]

This Brief will treat the foregoing conditions that Direct Energy is requesting, collectively and individually, as "Direct Energy's proposal."

2. Not Relevant to the Merger

Direct Energy witness Dr. Morey testified that default service is an anachronism. Specifically, Dr. Morey testified:

> With a reasonably robust competitive wholesale market now in place in PJM, and a wide range of competitive retail options available in other service territories in Pennsylvania, the notion of default service can be interpreted as a vestige of history under the traditional cost of service monopoly. In essence, default service is a holdover from the transitional period in which regulators sought to protect small business and residential customers from the volatility of wholesale market prices and to ensure that if no independent retail service providers emerged to serve them, they would always have a service provider (in the form of the incumbent utility). Such concerns may have been reasonable at the outset of the restructuring process; establishing a DSP of this type is a reasoned, plausible step given the uncertainties at the time. However, the Commonwealth is now at a point where the retail markets in both FE and Allegheny service territories are reasonably restructured, and the continuation of a structure that is likely to perpetuate a monopoly DSP stands as a significant barrier to achieving the benefits of retail competition for all customers.[92]

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[91] Direct Energy Statement No. 1 at 5-6, Direct Energy Statement No. 2 at 5-6, and Direct Energy Statement No. 3 at 3-4.

[92] Direct Energy Statement No 1 at 32-33.

Dr. Morey's concerns regarding default service apply to all default service providers in Pennsylvania. Essentially, Direct Energy is trying to use this merger as an opportunity to restructure how electric service is provided to consumers throughout Pennsylvania. However, eliminating default service is unlawful under Act 129 and is inconsistent with the Commission's default service regulations and Policy Statement. Moreover, West Penn, Met-Ed, and Penelec are still under rate caps.

There is no basis for relitigating the Commission's Policy Statement in this proceeding, before the Commission knows how the retail market will be affected after the rate caps have expired in these service territories. Furthermore, Direct Energy's proposal is not effective until June 1, 2013, which would be two years after the merger is approved and after the rate caps have expired. Therefore, Direct Energy can litigate its proposal in the EDCs' next default service proceedings after the Commission has some evidence as to the direction competition is taking in these service territories.

3. Removal of EDCs as Default Service Providers

As explained by Direct Energy witness Mr. Lacey, the first part of Direct Energy's proposal is to have the Commission appoint an alternative default service provider(s) for the FirstEnergy EDC service territories.[93]

Section 2802(16) of the Public Utility Code, 66 Pa. C.S. §2802(16), and Section 54.183 of the Commission's regulations, 52 Pa. Code § 54.183, govern the designation of an alternative default service provider. Specifically, Section 2802(16) states as follows:

> It is in the public interest for the transmission and distribution of electricity to continue to be regulated

[93] Direct Energy Statement No. 3 at 5.

> as a natural monopoly subject to the jurisdiction and active supervision of the commission. Electric distribution companies should continue to be the provider of last resort in order to ensure the availability of universal electric service in this Commonwealth unless another provider of last resort is approved by the commission.

Section 54.183(b) of the Commission's regulations sets forth the process for how a default service provider is to be changed. Specifically Section 54.183(b) states as follows:

> (b) The DSP may be changed by one of the following processes:
>
> (1) An EDC may petition the Commission to be relieved of the default service obligation.
>
> (2) An EGS may petition the Commission to be assigned the default service role for a particular EDC service territory.
>
> (3) The Commission may propose through its own motion that an EDC be relieved of the default service obligation.
>
> (c) The Commission may reassign the default service obligation for the entire service territory, or for specific customer classes, to one or more alternative DSPs when it finds it to be necessary for the accommodation, safety and convenience of the public. A finding would include an evaluation of the incumbent EDC's operational and financial fitness to serve retail customers, and its ability to provide default service under reasonable rates and conditions. In these circumstances, the Commission will announce, through an order, a competitive process to determine the alternative DSP.

Direct Energy's proposal is premature. None of the four EDCs involved in this proceeding has filed a petition to be relieved of its default service obligation. None of the EGSs participating in the instant proceeding has filed a petition requesting to be assigned

the role of a default service provider. The Commission has not adopted a motion that any of the four EDCs be relieved of its default service duty. Therefore, Direct Energy's proposal that the Commission should replace FirstEnergy's EDCs as the provider of default service in their respective service territories should not be considered in the instant proceeding.

Rejection of this part of the proposal would not deprive Direct Energy of a remedy. If Direct Energy is prepared to make the case that an alternative default service provider should be appointed in one or more of the four EDC service territories, then Direct Energy is permitted to file a petition with the Commission in accordance with Section 54.183(b).

4. Opt-Out Auction

a. Summary

Direct Energy witness Mr. Lacey testified that after the Commission has ordered an alternative default service provider for the four EDC service territories, the alternative default service provider(s) should auction off each customer that is on default service as of June 1, 2013, to a competing EGS, unless the customer affirmatively opts out of the auction.[94] In this respect, the opt-out feature of Direct Energy's proposal is conceptually similar to the opt-out procedure in FirstEnergy's municipal aggregation. By forcing a customer to take affirmative action to opt out of service by an EGS, both Direct Energy's proposal and FirstEnergy's municipal aggregation unlawfully change the meaning of default service.

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[94] Direct Energy Statement No. 3 at 7-9.

b. Meaning of Default Service

Section 2803 of the Public Utility Code defines the Default Service Provider ("DSP") as follows:

> 'Default service provider.' An electric distribution company within its certified service territory or an alternative supplier approved by the commission that provides generation service to retail electric customers who:
>
> (1) contract for electric power, including energy and capacity, and the chosen electric generation supplier does not supply the service; or
>
> (2) ***do not choose an alternative electric generation supplier***. (emphasis added)

Section 2807(e)(3.1) of the Public Utility Code states the obligations of a default service provider. In pertinent part, Section 2807(e)(3.1) provides as follows:

> Following the expiration of an electric distribution company's obligation to provide electric generation supply service to retail customers at capped rates, if a customer contracts for electric generation supply service and the chosen electric generation supplier does not provide the service or ***if a customer does not choose an alternative electric generation supplier***, the default service provider shall provide electric generation supply service to that customer pursuant to a commission-approved competitive procurement plan. (emphasis added)

As Sections 2803 and 2807(e)(3.1) recognize, customers who take no action are to receive default service, not service from an EGS. In contrast, Direct Energy proposes that customers who do not affirmatively choose an alternative supplier be arbitrarily auctioned off to alternative suppliers. Under Direct Energy's proposal, the only customers who would be eligible for default service would be those customers who affirmatively choose default service. Therefore, the Commission must reject the opt-out

auction element of Direct Energy's proposal because it is inconsistent with the plain language of the statute.

c. *Pike* Precedent

According to Direct Energy witness Ms. Brownell, Direct Energy's proposal for an opt-out auction in this proceeding is similar to the opt-out aggregation the Commission approved for Pike County Light and Power Company ("Pike") in 2006.[95] However, what the Commission actually concluded in that 2006 proceeding was that "an opt-out program is not prohibited by Section 2807(d)(1) of the Public Utility Code."[96] The Commission opined that Section 2807(d)(1) and the regulations promulgated under it are intended to prevent unauthorized switching of customers, or "slamming."[97] The Commission did point to other authority for approving the type of aggregation program adopted in that case.[98] However, the Commission took care to note that "[w]e again emphasize that this action [adopting an opt-out aggregation program] should not be construed as precedent in future proceedings, but as a solution to a unique problem."[99]

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[95] Direct Energy Statement No. 2 at 16-17. *See Petition of Direct Energy Services, LLC for Emergency Order Approving a Retail Aggregation Bidding Program for Customers in Pike County Light & Power Company's Service Territory*, Docket No. P-00062205 (Order entered April 20, 2006) at 14.

[96] *Id.*

[97] *Id.* at 15.

[98] *Id.*, citing *George v. Pennsylvania Public Utility Commission*, 735 A.2d 1282 (Pa. Cmwlth. 1999), *app. den.*, 563 Pa. 650, 758 A.2d 1202 (Pa. 2000); and *Petition for Approval of PECO . . . Market Share Threshold Bidding/Assignment Process,* Docket No. P-00021984 (Order entered May 1, 2003).

[99] *Petition of Direct Energy Services, LLC for Emergency Order Approving a Retail Aggregation Bidding Program for Customers in Pike County Light & Power Company's Service Territory*, Docket No. P-00062205 (Order entered April 20, 2006) at 17.

Direct Energy's proposal in this merger proceeding also ignores the unique factual situation in the 2006 Pike proceeding. Pike had had the misfortune of conducting an auction for two years' worth of default service electricity in the fall of 2005 shortly after Hurricane Katrina had caused a spike in prices in the wholesale electricity market, which was passed on directly in the rates paid by Pike for default service supplies. Consequently, Pike's rates increased by over 70% on a total-bill basis and by 129% on a generation-only basis.[100] Direct Energy has provided no evidence that the special circumstances that confronted Pike will be present if the proposed merger is approved. In fact, if the ramifications of the merger will be extraordinary rate increases, then the Commission should simply reject the merger outright.

d. PECO Market Share Threshold Precedent

Direct Energy witness Ms. Brownell pointed to the Commission's approval of a settlement providing for a market threshold ("MST") program in PECO's service territory as a justification for Direct Energy's proposal to auction off the default service customers of Met-Ed, Penelec, Penn Power, and Allegheny Power on an opt-out basis.[101] However, PECO's MST program was significantly different than Direct Energy's proposal in this proceeding.

First, under PECO's MST program, the parties to a *settlement* agreed that PECO would begin randomly assigning customers to EGSs only if shopping did not reach a designated level by January 1, 2003. Specifically, the MST was to be implemented only if shopping did not exceed 50% for residential and commercial customers (based on the

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[100] *Id.* at 2.

[101] Direct Energy Statement No. 2 at 16.

number of customers for residential and small commercial customers, and based on peak load for large commercial customers). Failure to reach the specified shopping levels by January 1, 2003, was to trigger PECO's duty to make random assignments of customers to EGSs on an opt-out basis.[102] In contrast, Direct Energy's proposal in this merger proceeding would have the Commission order an opt-out auction without waiting to determine how much shopping actually occurs after the rate caps have been lifted.[103]

Second, PECO's MST program was approved by the Commission before the expiration of PECO's rate caps. At the time PECO's MST program was approved, Section 2807(e)(3) required each EDC to acquire electric energy at "prevailing market prices" to serve those customers who did not choose an EGS or whose EGS failed to deliver. However, because PECO was still under rate caps, PECO was required to serve its default service customers at capped rates and not at "prevailing market prices." Consequently, as OCA witness Ms. Barbara Alexander pointed out, customers who were randomly assigned to EGSs could return to PECO's default service at the capped rates.[104] However, as Direct Energy witness Mr. Lacey explained, under Direct Energy's proposal in this proceeding, the customers who are auctioned off can return only to an alternative default service supplier who will be charging them spot market prices rather than a capped rate.[105]

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[102] *Petition for Approval of PECO Energy Company's Market Share Threshold Bidding/Assignment Process,* Docket No. P-00021984 and *Petition for Approval of "The Better Choice" Plan to Meet PECO Energy Company's Market Share Threshold Requirements,* Docket No. P-00021992 (Order entered February 6, 2003).

[103] Direct Energy Statement No. 3 at 7 and Hearing Transcript at 1030.

[104] OCA Statement No. 2-R at 14.

[105] Direct Energy Statement No. 3 at 7-8.

e. Unregulated Rates

As explained by Direct Energy witness Mr. Lacey, the non-shopping customers that are auctioned off will receive a fixed per-kWh price that reflects the six-month NYMEX strip price (plus an administrative adder) for two successive six-month periods. After those twelve months, those customers who do not affirmatively choose a different service will be subject to a price set by the EGS without Commission oversight.[106] As a result, those customers who do not affirmatively opt for either utility "default" service or alternative EGS service will default into an unregulated service.

As Mr. Lacey testified, under Direct Energy's proposal, the Commission will have no authority to review an EGS's rates or the procurement strategy the EGS pursues. Specifically, the Commission will review the EGS's price structure for the first year only; after the first year, the Commission will not be reviewing the EGS's rates because, according to Mr. Lacey, the Commission reviews only monopoly rates and not rates set in the competitive market.[107] Mr. Lacey acknowledged that, in contrast, the Commission currently reviews default service procurement plans and the bid prices for default service plans.[108] Furthermore, under Section 54.188(d) of the Commission's regulations, the Commission actually does more than "review" the results of an EDC's competitive procurement; in fact, the Commission "approves or disapproves" the results.

According to Mr. Lacey, there will be no need for Commission oversight of the EGSs' rates after the first year because, if an EGS overcharges, a customer will have the

[106] Direct Energy Statement No. 3 at 13.

[107] Hearing Transcript at 1039 and 1040.

[108] Hearing Transcript at 1039 and 1040.

option to take service from a different EGS that offers a better price.[109] However, Mr. Lacey's argument overlooks inertia. As Joint Applicants witness Mr. Schnitzer testified:

> The issue with Direct's proposal, with the opt-out effectively assignment to EGSs is that customers who end up being served by EGSs under that model have not affirmatively elected to be served by EGSs. It's the opt-out provision that gets them there.
>
> And so then the question is, how is that going to work out for customers. And really what this is all about is what happens to the so-called sticky customers, or Your Honor, to your questions of Mr. Graves a few moments ago, those customers who for $6.00 a month just don't find it to be worth their time or whatever to seek another option.
>
> And under the current default service arrangements, those customers get the benefit of the best that the wholesale procurement can do for them as the Commission approves it. And under an assignment to an EGS, they are subject to whatever kind of customer and market segmentation the EGS might choose to do in terms of its pricing and they may or may not get prices that reflect marginal costs or the most efficient price of wholesale markets, and they may not be moved to switch at a moment's notice if they don't.[110]

5. Spot as the Default Service Rate

a. Summary

Direct Energy witness Mr. Lacey testified that the alternative default service provider should be required to supply generation through the spot market to those customers who opt-out of the auction and to those customers whose EGSs can not

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[109] Hearing Transcript at 1031.

[110] Hearing Transcript at 953-954.

provide the service, go out of business, or exit the market without providing for the continuation of supply from another EGS.[111] Direct Energy's proposal in this regard is inconsistent with the statute, with Commission regulations, and with Commission precedent.

b. Act 129

On December 3, 1996, the "Electricity Generation Customer Choice and Competition Act" ("Competition Act") became law. As originally enacted, Section 2807(e)(3) of the Public Utility Code, 66 Pa. C.S. §2807(e)(3), required that each EDC acquire electric energy at "prevailing market prices" to serve those customers who do not choose an EGS or whose EGS fails to deliver.

The act of October 15, 2008 (P.L. 1592, No. 129) ("Act 129"), repealed Section 2807(e)(3) and the "prevailing market prices" standard and imposed a new requirement that the EDC competitively acquire default service electricity through a "prudent mix" of contracts and at the "least cost to customers over time."[112] Specifically, Section 2807(e)(3.2) requires the EDC to procure electricity to serve default service ratepayers through a "prudent mix" of spot market purchases, short-term contracts (for periods of up to four years), and long-term contracts (for periods of more than four years but not more than 20 years).[113] Section 2807(e)(3.4) provides that the "prudent mix of contracts . . . shall be designed to ensure . . . [t]he least cost to customers over time."

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[111] Direct Energy Statement No. 3 at 7-8.

[112] *See* Section 3 of Act 129, amending 66 Pa. C.S. §2807(e).

[113] Under Section 2807(e)(3.3), the Commission may permit long-term contracts to extend beyond 20 years.

Direct Energy has presented no evidence that placing default service customers on spot will produce the least cost to customers over time, as Act 129 requires. "Least cost" means least cost for a reasonable default service product. If the legislature had intended for default service to be spot market-based, the legislature could have mandated such an approach. In fact, if spot market default service rates had been the legislature's intent, there would have been no reason to eliminate the "prevailing market prices" standard for default service procurement that was in the statute prior to the passage of Act 129.

Furthermore, if the legislature had intended that default service be provided solely through the spot market, it is unlikely that the legislature would have specified in Section 2807(e)(7) that "[t]he default service provider shall offer residential and small business customers a generation supply service rate that shall change no more frequently than on a quarterly basis."

c. Commission Regulations/Policy Statement

The Competition Act required the Commission to promulgate regulations defining the obligation of EDCs to serve retail electric customers at the conclusion of the restructuring transition period.[114] The Commission issued its final form default service regulations at *Rulemaking Re Electric Distribution Companies' Obligation to Serve Retail Customers at the Conclusion of the Transition Period Pursuant to 66 Pa. C.S. §2807(e)(2)*, Docket No. L-00040169 (Order entered May 10, 2007) ("Final Rulemaking Order"). The Commission also issued a policy statement at *Default Service and Retail Electric Market*, Docket No. M-00072009 (Order entered May 10, 2007) ("Policy Statement"). The Commission's Final Rulemaking Order and Policy Statement became

[114] *See* 66 Pa.C.S. § 2807(e)(2).

effective upon publication in the *Pennsylvania Bulletin* on September 15, 2007. The Commission's default service regulations and Policy Statement do not reflect the amendments made to Section 2807 by Act 129.

The key aspects of the Commission's Policy Statement regarding default service procurement are the following:

> § 69.1805. Electric generation supply procurement.
>
> A proposed procurement plan should balance the goals of allowing the development of a competitive retail supply market and also including a prudent mix of arrangements to minimize the risk of over-reliance on any energy products at a particular point in time. In developing a proposed procurement plan, a DSP should consider including a prudent mix of supply-side and demand-side resources such as long-term, short-term, staggered-term and spot market purchases to minimize the risk of contracting for supply at times of peak prices. Long-term contracts should only be used when necessary and required for DSP compliance with alternative energy requirements, and should be restricted to covering a relatively small portion of the default service load. An over-reliance on long-term contracts would mute demand response, create the potential for future default service customers to bear future above market costs, and limit operational flexibility for DSPs to manage their default service supply. The plan should be tailored to the following customer groupings, but DSPs may propose alternative divisions of customers by registered peak load to preserve existing customer classes.
>
> (1) Residential customers and non-residential customers with less than 25 kW in maximum registered peak load. Initially, the DSP should acquire electric generation supply for these customers using a mix of resources as described in the introductory paragraph to this section. Consideration should be given to procuring most fixed-term supply through full requirements or block contracts of 1 to 3 years in duration. Contracts should be laddered to minimize risk, in

> which a portion of the portfolio changes at least annually, with a minimum of two competitive bid solicitations a year to further reduce the risk of acquisition at a time of peak prices. In subsequent programs, the percentage of supply acquired through shorter duration full requirements contracts and spot market purchases should be gradually increased, depending on developments in retail and wholesale energy markets.
>
> (2) Non-residential customers with 25-500 kW in maximum registered peak load. The DSP should acquire electric generation supply for these customers using a mix of resources as described in the introductory paragraph to this section. Fixed-term contracts should be 1 year in length and may be laddered to minimize risk, with a minimum of two competitive bid solicitations a year to further reduce the risk of acquisition at a time of peak prices. In subsequent programs, the percentage of supply acquired through shorter duration purchases and spot market purchases should gradually be increased, depending on developments in retail and wholesale energy markets.
>
> (3) Nonresidential customers with greater than 500 kW in maximum registered peak load. Hourly priced or monthly-priced service should be available to these customers. The DSP may propose a fixed-price option for the Commission's consideration.

Section 54.186 of the Commission's default service regulations also addresses the issue of default service procurement, requiring procurement at "prevailing market prices" and the use of "competitive bid solicitation processes, spot market energy purchases, or a combination of both."

The Commission's regulations and Policy Statement give direction to how a default service provider should acquire electric generation supply for residential and non-residential customers for the first default service period after the EDC's rate caps have expired and also in subsequent default service periods. As OSBA witness Mr. Knecht

explained, "In general, the Commission has determined that, at least for initial DS [default service] procurement plans, these requirements may be satisfied for small business customers by procuring DS supplies primarily through the use of full-requirements, load-following contracts, supplemented by a modest amount of spot market supplies."[115]

However, the Commission's Policy Statement provides that for subsequent residential and non-residential (less than 25 kW peak demand) default service periods, "the percentage of supply acquired through shorter duration full requirements contracts and spot market purchases should be *gradually increased*, depending on developments in retail and wholesale energy markets."[116] (emphasis added) A virtually identical statement of policy applies to non-residential customers with peak demand of 25 kW to 500 kW.

As Direct Energy witness Mr. Lacey confirmed, the proposal to make spot the default service rate would not apply until the default service period beginning June 1, 2013.[117] West Penn, Met-Ed, and Penelec's rate caps expire on December 31, 2010. Therefore, West Penn, Met-Ed, and Penelec's default service period that begins on June 1, 2013, will be the second default service period after the expiration of rate caps. There is nothing in the Commission's Policy Statement that supports basing default service rates *entirely* on spot market prices in the second default service period after the rate caps have expired.

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[115] OSBA Statement No. 3 at 4.

[116] 52 Pa. Code §69.1805.

[117] Direct Energy Statement No. 3 at 6 and Hearing Transcript at 1030.

d. *Pike* Precedent

Direct Energy witness Mr. Lacey pointed to Pike as precedent for serving the default service load entirely through the spot market.[118] Unfortunately, Direct Energy is once again ignoring the unique circumstances that led to using the spot market as the exclusive source of default service in the Pike service territory. As OSBA witness Mr. Knecht explained:

> First, PCL&P [Pike] is a very small EDC, with only about 20 MW of load and some 5,000 customers.
>
> Second, PCL&P is not interconnected with PJM but rather with NYISO, and it has a power purchase agreement with its NY affiliate.
>
> Third, in PCL&P's 2005 default service procurement, it had the misfortune to conduct its single default service auction just after Hurricane Katrina, when market prices for energy were at an extremely high level. To mitigate the impact of the ensuing rate increase on customers, the Commission approved an 'opt-out' aggregation plan offered by Direct Energy for residential and small commercial customers.
>
> Fourth, because most customers did not affirmatively opt out of Direct Energy's aggregation service, few default service customers remained for whom PCL&P subsequently needed to procure default service supplies.
>
> For those reasons, none of which are relevant to any of the EDCs in this proceeding, I recommended and the Commission accepted a DS [default service] procurement plan for PCL&P based primarily on spot market supplies.[119]

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[118] Direct Energy Statement No. 3-SR at 9-10.

[119] OSBA Statement No. 3 at 8.

As Joint Applicants witness Mr. Schnitzer testified, spot market pricing can benefit default service customers in a period of declining market prices, but spot market pricing can have an adverse effect on default service customers when market prices are rising. Specifically, Mr. Schnitzer testified, as follows:

> So the fact that spot pricing right now might look like an attractive option and customers might like it is not in any indicative of what will happen if there's a price shock, and we have evidence from California, for instance, from some number of years ago, what happens when customers are in spot pricing and the spot prices skyrocket and it becomes both an economic and a political issue very quickly.[120]

6. Proposal Premature

Direct Energy witness Dr. Morey argued that the proposed conditions are necessary because the merger, in combination with the retail electric market structure in Pennsylvania, will fail to promote the benefits of a properly functioning and workable competitive retail electric market to residential and Small C&I customers.[121] However, even if Direct Energy's proposed conditions can survive the legal and policy objections outlined above (which they can not), those proposals will not take effect until the default service period beginning June 1, 2013. Therefore, the conditions that Direct Energy proposes in the instant proceeding will not cure the problems Dr. Morey contends will exist with the wholesale and retail markets because of the merger.

First, Direct Energy's proposal will not cure market power problems in the wholesale market. As Dr. Morey testified, . . . if we have market power problems in the

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[120] Hearing Transcript at 942.

[121] Direct Energy Statement No. 1 at 10-11.

wholesale market, that regardless of whether this default service auction proposal was approved or used as a condition on this merger, whether you had that or not, it's still conceivable that market power problems in the wholesale market could raise prices for wholesale power, and EGS's would be paying higher prices."[122] Therefore, if the merger is approved and the problems predicted by Dr. Morey and other parties occur in the wholesale market, Direct Energy's proposal will not cure them.

Second, Direct Energy's proposal will not cure any of problems that occur in the retail market. West Penn, Met-Ed, and Penelec's rate caps expire on December 31, 2010. As Direct Energy witness Mr. Lacey confirmed, Direct Energy's proposal will allow FES to obtain as many retail contracts (including through both direct sales and municipal aggregation) as possible prior to June 1, 2013.[123] Furthermore, any of the retail customers that FES obtains by June 1, 2013, will be kept by FES and will not be auctioned off.[124] Mr. Lacey also conceded that FES will be able to compete with other EGSs to provide generation to customers in FirstEnergy's service territories from now until June 1, 2013, *i.e.*, FES will be able to compete in the default service procurements in the service territories of the four FirstEnergy EDCs. [125] FES will also be able to bid to serve the non-shopping customers on or after June 1, 2013.[126] In sum, as Mr. Lacey testified, "Direct's proposal will have no impact on the market between January 1, 2011

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[122] Hearing Transcript at 823.

[123] Hearing Transcript at 1030.

[124] Hearing Transcript at 1030.

[125] Hearing Transcript at 1030.

[126] Hearing Transcript at 1030.

through May 31, 2013." [127] Therefore, as OSBA witness Mr. Knecht testified, Direct Energy's proposal can be addressed in each EDC's next default service proceeding in which the level of shopping after the expiration of rate caps will be known.[128]

[127] Hearing Transcript at 1037.

[128] OSBA Statement No. 3 at 6-7.

C. RESA's Proposals

1. Summary

RESA witness Mr. Hudson recommended that default service procurement for Met-Ed, Penelec, Penn Power, and West Penn be modified in numerous ways, *e.g.*, to require each EDC to purchase a larger share of default service electricity on the spot market, to shorten the length of any full-requirements contracts, to subject more customers to hourly pricing, and to reduce the amount of default service load that can be served by any one wholesale bidder.[129]

RESA's proposals to redesign default service procurement are not relevant to this proceeding. As OSBA witness Mr. Knecht observed, "Mr. Hudson proposes only to change *future* DS [default service] procurements."[130] Furthermore, as Mr. Knecht pointed out, "Mr. Hudson has offered similar proposals in previous DS proceedings, and the Commission has rejected them."[131] Therefore, RESA should pursue Mr. Hudson's proposals in each EDC's next default service proceeding rather than attempt to leverage them into this merger proceeding.

2. Shopping

The objective of most of RESA's proposals, *e.g.*, those to make the default service rate more volatile, is to increase the number of shopping customers. Even if those proposals were relevant to this proceeding, Mr. Knecht explained why it would be

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[129] RESA Statement No. 1 at 21-22.

[130] OSBA Statement No. 3 at 9. (emphasis added)

[131] OSBA Statement No. 3 at 9.

premature for the Commission to approve them. Specifically, Mr. Knecht testified as follows:

> Moreover, locking in DS procurement rules now would reduce the flexibility that the Commission would otherwise have when the current DS Procurement Plans come up for renewal. Many changes may occur in electric markets over the next two years, and the Commission will have significantly more information regarding market competition at that time. For example, because rate caps are still in place for Penelec, Met-Ed, and West Penn Power, the Commission has little relevant information regarding shopping in those EDCs' service territories. However, by the time their DS procurement plans are up for renewal, much more relevant information will be available. By locking in changes in DS procurement now, the Commission may preempt options that look more attractive two years from now.[132]

3. *Hourly Pricing*

In a more pointed effort to create an incentive to shop, Mr. Hudson proposed a major increase in the number of customers exposed to hourly pricing. Specifically, Mr. Hudson proposed to place Small C&I customers with maximum peak demand over 100 kW on hourly pricing.[133] This proposal is inconsistent with the Commission's default service regulations and Policy Statement.

Specifically, both Section 54.187(h)-(i) of the regulations, 52 Pa. Code §54.187(h)-(i), and Section 69.1805 of the Policy Statement, 52 Pa. Code §69.1805, set forth the preferred grouping of customers for procurement purposes and recommend hourly pricing for only those commercial and industrial customers with maximum peak loads of 500 kW and above. Although Section 69.1805 states that default service

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[132] OSBA Statement No. 3 at 9-10.

[133] RESA Statement No. 1 at 20.

providers "may propose alternative divisions of customers by registered peak load to preserve existing customer classes," default service providers must present a persuasive rationale for the change.

As Mr. Knecht observed, there is no persuasive rationale for adopting RESA's proposal to lower the threshold for hourly pricing. Specifically, Mr. Knecht testified as follows:

> First, Mr. Hudson presents no evidence that there is any lack of competition among EGSs to supply C&I customers over 100 kW at those EDCs whose rate caps have expired. Second, if Mr. Hudson's proposal is intended as a response to reduced competition resulting from the merger, it is not clear why his remedy should be targeted only at the C&I customers over 100 kW. Third, Mr. Hudson provides no assessment of the magnitude of the impact his proposal could be expected to have on the number of shopping customers or affected load. Fourth, Mr. Hudson's proposal would be better addressed in each EDC's next DS [default service] proceeding, when the Commission will know how much retail shopping has occurred simply because rates caps have expired.[134]

4. Load Caps

Mr. Hudson also proposed to set the maximum share of any particular default service procurement that a single supplier may win, *i.e.*, the load cap, at 33%. As Mr. Knecht explained, this proposal is not reasonable for this proceeding, for the following reasons:

> It could be argued that Mr. Hudson's proposed load cap will increase competition in wholesale procurements by spreading market share around more evenly. However, to the extent it has any effect at all, Mr. Hudson's proposal will increase rates paid by DS customers. It is difficult to understand the logic of trying to protect DS ratepayers from

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[134] OSBA Statement No. 3 at 10.

> anti-competitive practices by increasing their rates. In prior DS proceedings, the issue of how much DS supply may reasonably be provided by a single supplier required a balancing of interests. Setting the maximum limit higher will generally result in lower rates for DS ratepayers, because fewer 'in the money' bids will be excluded. However, setting the maximum limit higher will expose DS to greater risk of an individual supplier being unable to meet its obligations under the contract. In considering this issue in the past, the Commission has generally decided that Mr. Hudson's proposal sets the maximum limit too low.[135]

Significantly, the Commission rejected RESA's proposal for a 33% load cap in the proceeding to approve the current default service plan for Met-Ed and Penelec.[136]

5. Recommendation

In view of the foregoing, the Commission should reject RESA's proposals in this merger proceeding. Such rejection would not prejudice RESA because the same, or similar, proposals can be raised in the next Met-Ed, Penelec, Penn Power, and West Penn default service proceedings.

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[135] OSBA Statement No. 3 at 10-11.

[136] *Joint Petition of Metropolitan Edison Company and Pennsylvania Electric Company for Approval of Their Default Service Programs*, Docket Nos. P-2009-2093053 and P-2009-2093054 (Order entered November 6, 2009) at 18.

VI. CONCLUSION

For the reasons set forth above, the OSBA respectfully requests that the Commission:

1. Reject the proposed direct or indirect transfer of control of Allegheny Energy to FirstEnergy, unless the Commission imposes the following additional conditions:

a. First Energy Corporation and its affiliates shall not engage in municipal aggregation in the Met-Ed, Penelec, Penn Power, and West Penn service territories prior to the enactment and implementation of authorizing legislation or June 1, 2013, whichever is later; and

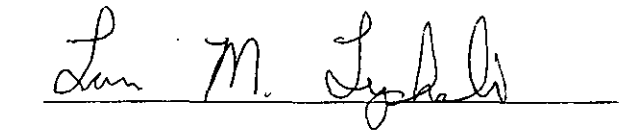
b. FirstEnergy shall administratively locate the generating assets of FirstEnergy and Allegheny Energy, in separate subsidiaries that shall not coordinate regarding whether to bid in a particular default service procurement and regarding what price to bid.

2. Reject Direct Energy's proposal to auction off the non-shopping customers of Met-Ed, Penelec, Penn Power, and West Penn to EGSs on an opt-out basis.

3. Reject Direct Energy's proposal to base the default service rates of Met-Ed, Penelec, Penn Power, and West Penn entirely on spot market prices.

4. Reject RESA's proposals to change the design of default service for Met-Ed, Penelec, Penn Power, and West Penn.

Respectfully submitted,



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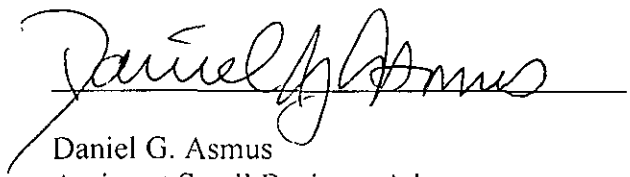

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APPENDICES

APPENDIX A—PROPOSED FINDINGS OF FACT

APPENDIX B—PROPOSED CONCLUSIONS OF LAW

APPENDIX C—PROPOSED ORDERING PARAGRAPHS

APPENDIX D—TWELVE QUESTIONS POSED BY THE COMMISSION

Proposed Findings of Fact

1. FirstEnergy and its affiliates support the adoption of "Municipal Opt-Out Aggregation," which would automatically enroll residential and Small C&I customers with a single EGS unless the customers affirmatively opt-out of such service. Constellation Statement No. 1 at 13 and Direct Energy Cross-Examination Exhibit No. 9.

2. FirstEnergy's retail marketing strategy in Pennsylvania is to target three retail sales channels: 1.) Direct Sales, 2.) Municipal Aggregation; and 3.) Sales into the Provider of Last Resort ("POLR") Auctions. Hearing Transcript at 261- 262.

3. FirstEnergy's retail marketing in Pennsylvania currently is limited because of the shortage of generation, but acquiring Allegheny Energy's generation assets will help FirstEnergy overcome that limitation. Hearing Transcript at 262.

4. The principal benefit of this merger to FirstEnergy is the acquisition of Allegheny Energy's generation so that FirstEnergy can expand its opportunities in Pennsylvania's retail markets. Hearing Transcript at 262.

5. FirstEnergy intends to expand its opportunities in Pennsylvania's retail markets through municipal aggregation. Joint Application at 17, ¶28 and Joint Applicants Statement No. 1 at 17.

6. FirstEnergy's affiliate, FES, has solicited Meadville to enter an agreement under which FES will provide electric generation service (beginning January 1, 2011) to all residential and Small C&I customers within the municipality that do not opt-out of the aggregation pool. Direct Energy Cross Examination Exhibit No. 5 and Hearing Transcript at 278.

APPENDIX A

7. Part of FirstEnergy's business model is to market its retail operations actively in states in which FirstEnergy has regulated distribution companies. Hearing Transcript at 273.

8. FirstEnergy focuses its retail operations close to where it owns generation. Direct Energy Statement No. 1-SSR at 3 and Hearing Transcript at 273-274.

9. Other EGSs do not have equal presence in FirstEnergy service territories to compete with FES to provide municipal aggregation. Hearing Transcript at 562.

10. Opt-out takes advantage of inertia. Hearing Transcript at 953-955.

11. Opt-out municipal aggregation will have a negative impact on the rates paid by default service customers. Hearing Transcript at 561; Constellation Statement No. 1 at 13-14; and Constellation Statement No. 1-SR at 11.

12. Implementing municipal aggregation prior to June 1, 2013, will increase the risk to wholesale suppliers of full-requirements contracts, thereby increasing the risk premium in wholesale supplier bids and increasing default service rates. Constellation Statement No. 1-SR at 10-11.

13. Under current default service plans in the Met-Ed, Penelec, Penn Power, and West Penn service territories, a customer receives default service if the customer makes no choice. Hearing Transcript at 938.

14. Spot market pricing can benefit default service customers in a period of declining market prices, but spot market pricing can have an adverse effect on default service customers when market prices are rising. Hearing Transcript at 942.

15. Unique circumstances led to the use of the spot market as the exclusive source of default service in the Pike service territory. OSBA Statement No. 3 at 8.

16. Direct Energy's proposals will not take effect until the default service period beginning June 1, 2013. Hearing Transcript at 1030.

17. Direct Energy's proposal will not cure the problems Direct Energy contends will exist with the wholesale and retail markets because of the merger. Hearing Transcript at 823.

18. Direct Energy's proposal will allow FES to obtain as many retail contracts (including through both direct sales and municipal aggregation) as possible prior to June 1, 2013. Hearing Transcript at 1030.

19. Under Direct Energy's proposal, any of the retail customers that FES obtains by June 1, 2013, will be kept by FES and will not be auctioned off. Hearing Transcript at 1030.

20. FES will be able to compete with other EGSs to provide generation to customers in FirstEnergy's service territories from now until June 1, 2013. Hearing Transcript at 1030.

21. Direct Energy's proposal will have no impact on the markets between January 1, 2011 through May 31, 2013. Hearing Transcript at 1037.

22. RESA recommended that future default service procurement for Met-Ed, Penelec, Penn Power, and West Penn be modified to require each EDC to purchase a larger share of default service electricity on the spot market, to shorten the length of any full-requirements contracts, to subject more customers to hourly pricing, and to reduce the amount of default service load that can be served by any one wholesale bidder. RESA Statement No. 1 at 21-22.

23. The objective of most of RESA's proposals is to increase the number of shopping customers. OSBA Statement No. 3 at 10.

24. RESA's default service proposals would not become effective until the default service period beginning June 1, 2013. OSBA Statement No. 3 at 9.

25. Because rate caps are still in place for Met-Ed, Penelec, and West Penn Power, the Commission has little relevant information regarding shopping in those EDCs' service territories. However, by the time their default service procurement plans are up for renewal, much more relevant information will be available. OSBA Statement No. 3 at 9.

26. If the Commission locks in changes in default service procurement now, the Commission may preempt options that will look more attractive two years from now. OSBA Statement No. 3 at 9-10.

Proposed Conclusions of Law

1. Control of Allegheny Energy, Inc., may not be transferred, directly or indirectly, to FirstEnergy Corporation, unless the Commission first grants a certificate of public convenience approving the transfer. Section 1102(a).of the Public Utility Code, 66 Pa. C.S. §1102(a).

2. The Commission may not grant a certificate of public convenience for the direct or indirect transfer of control of Allegheny Energy, Inc., to FirstEnergy Corporation, unless the Commission finds that "the granting of [that] certificate of public convenience is necessary or proper for the service, accommodation, convenience, or safety of the public." Section 1103(a) of the Public Utility Code, 66 Pa. C.S. §1103(a).

3. The Commission may not grant a certificate of public convenience for the direct or indirect transfer of control of Allegheny Energy, Inc., to FirstEnergy Corporation unless the Commission finds "affirmatively that public benefit will result from the [transfer]." *City of York v. Pennsylvania Public Utility Commission*, 449 Pa. 136, 141, 295 A.2d 825, 828 (Pa. 1972).

4. The Joint Applicants have the burden of proving that the direct or indirect transfer of control of Allegheny Energy, Inc., to FirstEnergy Corporation "will affirmatively promote the 'service, accommodation, convenience, or safety of the public' in some substantial way." *City of York v. Pennsylvania Public Utility Commission*, 449 Pa. 136, 141, 295 A.2d 825, 828 (Pa. 1972).

5. The Joint Applicants are required to meet their burden of proof under *City of York v. Pennsylvania Public Utility Commission*, 449 Pa. 136, 141, 295 A.2d 825, 828

(Pa. 1972), by a preponderance of the evidence. *Popowsky v. Pennsylvania Public Utility Commission*, 594 Pa. 583, 611, 937 A.2d 1040, 1057 (Pa. 2007).

6. The Joint Applicants have the burden of proving that the direct or indirect transfer of control of Allegheny Energy, Inc., to FirstEnergy Corporation is not likely to result in anticompetitive or discriminatory conduct which will prevent retail customers from obtaining the benefits of a properly functioning and workable competitive retail electricity market. Section 2811(e)(1) of the Public Utility Code, 66 Pa. C.S. §2811(e)(1).

7. The Joint Applicants are required to prove that any affirmative benefits arising out of the Joint Petition for Partial Settlement are sufficient to produce "net public benefits," *i.e.*, that any affirmative benefits are sufficient to offset or negate the anticompetitive effects of the direct or indirect transfer of control of Allegheny Energy, Inc., to FirstEnergy Corporation. *Popowsky v. Pennsylvania Public Utility Commission*, 594 Pa. 583, 610-611, 937 A.2d 1040, 1056-1057 (Pa. 2007).

8. The Joint Applicants have failed to meet their burden of proving, by a preponderance of the evidence, that the direct or indirect transfer of control of Allegheny Energy, Inc., to FirstEnergy Corporation "will affirmatively promote the 'service, accommodation, convenience, or safety of the public' in some substantial way."

9. The Joint Applicants have failed to meet their burden of proving that the direct or indirect transfer of control of Allegheny Energy, Inc., to FirstEnergy Corporation is not likely to result in anticompetitive or discriminatory conduct which will prevent retail customers from obtaining the benefits of a properly functioning and workable competitive retail electricity market.

10. The Joint Applicants have failed to meet their burden of proving that the affirmative benefits arising out of the Joint Petition for Partial Settlement are sufficient to offset or negate the anticompetitive effects of the direct or indirect transfer of control of Allegheny Energy, Inc., to FirstEnergy Corporation.

11. The Commission "may impose such conditions as it may deem just and reasonable" on the direct or indirect transfer of control of Allegheny Energy, Inc., to FirstEnergy Corporation. Section 1103(a) of the Public Utility Code, 66 Pa. C.S. §1103(a), and *Popowsky v. Pennsylvania Public Utility Commission*, 594 Pa. 583, 611, 937 A.2d 1040, 1057 (Pa. 2007).

12. A customer who does not affirmatively choose service from an electric generation supplier receives default service. Sections 2803 and 2807(e)(3.1) of the Public Utility Code, 66 Pa. C.S. §§2803 and 2807(e)(3.1).

13. There is currently no legal authority for a municipality, including a home rule municipality, to engage in opt-out municipal aggregation. Sections 2803, 2807(d)(1), and 2807(e)(3.1) of the Public Utility Code, 66 Pa. C.S. §§2803, 2807(d)(1), and 2807 (e)(3.1); and Sections 2962(c)(1) and 2962(c)(2) of the Home Rule Charter and Optional Plans Law, 53 Pa. C.S. §§2962(c)(1) and 2962(c)(2).

Proposed Ordering Paragraphs

1. The Joint Application for a certificate of public convenience for the direct or indirect transfer of control of Allegheny Energy, Inc., to First Energy Corporation is approved, as modified by the Joint Petition for Partial Settlement, and as further modified to include the following conditions:

a. First Energy Corporation and its affiliates shall not engage in municipal aggregation in the service territories of the Metropolitan Edison Company, the Pennsylvania Electric Company, the Pennsylvania Power Company, and the West Penn Power Company prior to the enactment and implementation of authorizing legislation or June 1, 2013, whichever is later; and

b. FirstEnergy Corporation shall administratively locate the generating assets of FirstEnergy Corporation and Allegheny Energy, Inc., in separate subsidiaries that shall not coordinate regarding whether to bid in a particular default service procurement and regarding what price to bid.

2. Direct Energy's proposal to auction off the non-shopping customers of the Metropolitan Edison Company, the Pennsylvania Electric Company, the Pennsylvania Power Company, and the West Penn Power Company to electric generation suppliers on an opt-out basis is rejected.

3. Direct Energy's proposal to base the default service rates of the Metropolitan Edison Company, the Pennsylvania Electric Company, the Pennsylvania Power Company, and the West Penn Power Company entirely on spot market prices is rejected.

4. RESA's proposals to change the design of default service for the Metropolitan Edison Company, the Pennsylvania Electric Company, the Pennsylvania Power Company, and the West Penn Power Company are rejected.

Twelve Questions Posed by the Commission

1. How will the merger impact employment levels in Pennsylvania, particularly, but not limited to, those employees not covered by collective bargaining agreements? What will the impact be on Allegheny Energy's corporate headquarters in Greensburg, PA, as well as the operating companies' offices?

   The Joint Applicants have committed to specific employment levels, as outlined in the Settlement at ¶14.

2. How will the merger affect the customer service and system reliability of West Penn Power and the FirstEnergy Pennsylvania utilities? How will the merger affect West Penn Power and the FirstEnergy Pennsylvania utilities ability to respond to outages and other emergencies?

   Service quality and reliability issues have been addressed in the Settlement at ¶¶49-52.

3. Review the impact of the initially proposed corporate structure of the merger versus the alternately proposed corporate structure. Which corporate structure will better protect the public interest?

   The generating assets of Allegheny Energy should be administratively located in a subsidiary which operates independently of the generating assets of FES and is prohibited from coordinating with FES regarding whether or not to bid in a particular default service procurement and regarding what price to bid.

4. What, if any, ring-fencing mechanisms are presently in place, or proposed as part of this transaction, to protect West Penn Power, Met-Ed, Penn Power, and Penelec from the business and financial risk of the parent and other non-regulated affiliates? Are any changes or additions necessary to better protect the public interest and make the regulated electric distribution subsidiaries bankruptcy remote?

   Ring-fencing has been addressed in the Settlement at ¶35.

5. How will the merger impact the Act 129 smart meter and energy efficiency implementation plans of West Penn Power and First Energy's regulated utilities, Met- Ed, Penelec and Penn Power?

   These issues are addressed in the Settlement at ¶¶18 and 23.

6. How will the merger affect the capital structure of FirstEnergy Corporation? Will the merger create a more leveraged organization? How will the proposed merger impact the credit rating of FirstEnergy?

These issues have been addressed in the Settlement at ¶¶35 and 36.

7. Will West Penn Power and the other Allegheny Energy subsidiaries that currently issue their own debt maintain their own external borrowing authority and separate bond rating?

   These issues have been addressed through the ring-fencing measures set forth in the Settlement at ¶35.

8. Will West Penn Power participate in the FirstEnergy Utility money pool? If, yes, please provide an updated agreement.

   This issue has been addressed through the ring-fencing measures set forth in the Settlement at ¶35.

9. How will the proposed merger savings benefit Pennsylvania ratepayers? Will cost savings benefit ratepayers or only shareholders?

   The Joint Applicants have provided for some sharing of the projected cost savings. *See, e.g.*, Settlement at ¶¶16-22, 28, and 29.

10. Are the proposed affiliated interest agreements and cost allocation proposals reasonable and consistent with the public interest under Section 2102(b) of the Public Utility Code?

    The generating assets of Allegheny Energy should be administratively located in a subsidiary which operates independently of the generating assets of FES and is prohibited from coordinating with FES regarding whether or not to bid in a particular default service procurement and regarding what price to bid.

11. Investigate the impact the proposed merger may have on the potential for anticompetitive behavior per 66 Pa. C.S. § 2811(e)(1). How will the merger affect wholesale and retail competition for power/electric generation and transmission?

    As proposed, and as modified by the Settlement, the anticompetitive effects of the merger will offset or negate any affirmative benefits arising from the merger.

12. How will transmission projects in the western part of the state be affected by the merger?

    The OSBA defers to the Joint Applicants to answer this question.

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Joint Application of West Penn Power Company doing business as Allegheny Power, Trans-Allegheny Interstate Line Company, and FirstEnergy Corp. For a Certificate of Public Convenience Under Section 1102(a)(3) of the Public Utility Code Approving a Change of Control of West Penn Power Company and Trans- Allegheny Interstate Line Company	:	**Docket Nos. A-2010-2176520 A-2010-2176732**

CERTIFICATE OF SERVICE

I certify that I am serving two copies of the Main Brief, on behalf of the Office of Small Business Advocate, by e-mail and first-class mail (unless otherwise noted) upon the persons addressed below:

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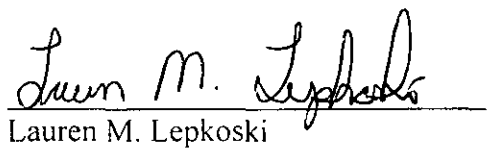

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