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November 15, 2010

Via Electronic Filing
Rosemary Chiavetta, Secretary
PA Public Utility Commission
PO Box 3265
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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:

On behalf of the Retail Energy Supply Association ("RESA") enclosed please find the original of its Reply Brief along with the electronic filing confirmation page. Copies are being served in accordance with the attached Certificate of Service.

Sincerely yours,

Deanne M. O'Dell, Esq.

DMO/lww
Enclosure

cc: Hon. Wayne Weismandel, w/enc.
Hon. Mary Long, w/enc.
Cert. of Service, w/enc.

CERTIFICATE OF SERVICE

I hereby certify that this day I served a copy of RESA's Reply Brief and upon the persons listed below in the manner indicated in accordance with the requirements of 52 Pa. Code Section 1.54.

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Dated: November 15, 2010

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 No. A-2010-2176520 Docket No. A-2010-2176732

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I. INTRODUCTION

Despite the fact that ignoring something never makes it go away, Joint Applicants[1] try to do exactly that regarding competitive retail market issues and ask the Commission to do the same despite the Commission's clear statutory duty to the contrary. First, Joint Applicants try to contort the Commission's statutory duties in way that removes competitive retail market issues from consideration. Then, in the face of substantial record evidence showing why this proposed merger is likely to result in anticompetitive or discriminatory behavior that will prevent consumers from receiving the benefits of a properly functioning and workable competitive market, Joint Applicants attack the evidence as "speculative" but provide nothing of substance to successfully rebut it. Finally, just in case the Commission rejects these two tactics (which it should), Joint Applicants offer a Partial Settlement and make the outrageous claim that the terms of the Partial Settlement address all competitive retail market concerns to justify approval of the proposed merger.

Notwithstanding Joint Applicants self-serving attempt to either excise or marginalize competitive retail market issues from this proceeding, the Commission is required by statue to analyze them to make sure that consumers are not harmed as a result of the proposed merger. The specific "harm" that the Commission is required to address is to make sure that consumers will not be prevented from taking advantage of a fully functional and workable competitive retail market after the merger. There is no dispute that Joint Applicants' proposed merger will significantly increase the size and scope of FirstEnergy in Pennsylvania to permit it to expand its current business plan of maximizing profit through generation revenue (regardless of what

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[1] "Joint Applicants" refers to the following entities: West Penn Power Company, d/b/a Allegheny Power ("West Penn" or "Allegheny Power"), Trans-Allegheny Interstate Line Company ("TrAILCo") and FirstEnergy Corp. "FirstEnergy").

affiliated FirstEnergy company provides that revenue). The dispute lies in whether such a strategy is likely to lead to anticompetitive and discriminatory conduct that will prevent consumers from receiving the benefit of a fully functional and workable competitive market. The Retail Energy Supply Association ("RESA")[2] submits that the answer to that question is a resounding "yes." And, because of this, anything other than an outright rejection of the proposed merger must include Joint Applicants' commitment to significant mitigation measures aimed at preventing the harm consumers will suffer if they are denied the benefits of a fully functional and workable competitive retail market.

As discussed further below, Joint Applicants' positions that competitive retail market issues are irrelevant and/or that harm must first occur before the commission can do anything are inconsistent with the commission's statutory duties, contrary to the public interest and must be rejected Further, the substantial record evidence in this proceeding shows that this proposed merger is likely to result in anticompetitive or discriminatory behavior and Joint Applicants have not rebutted this evidence nor have they shown that the Partial Settlement reasonably addresses these concerns. For these reasons, the proposed merger must either be rejected or conditioned on the Joint Applicants commitment to comply with the following mitigation measures:

(1) revise and strengthen the combined companies' code of conduct;

(2) implement a comprehensive program to inform customers about specific and available retail offers;

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[2] RESA's members include ConEdison *Solutions*; Constellation NewEnergy, Inc.; Direct Energy Services, LLC; Energy Plus Holdings, LLC; Exelon Energy Company; GDF SUEZ Energy Resources NA, Inc.; Green Mountain Energy Company; Hess Corporation; Integrys Energy Services, Inc.; Just Energy; Liberty Power; NextEra Energy Services; Noble Americas Energy Solutions LLC; PPL EnergyPlus; Reliant Energy Northeast LLC. The comments expressed in this filing represent the position of RESA as an organization but may not represent the views of any particular member of RESA.

(3) implement a properly structured Purchase of Receivables ("POR") program for the service territory of Allegheny Power and expand the current POR program for Met-Ed, Penelec and Penn Power to large C&I customers;

(4) prohibit FirstEnergy from implementing its municipal aggregation programs in Pennsylvania until the Commission issues a final adjudication regarding the legality of such programs;

(5) require that each affiliated company incorporate certain changes in their next default service program filing, including a supplier load cap, so that default service is properly structured to encourage development of the competitive market;

(6) require that all affiliated companies update and revise their operational rules; and

(7) require FirstEnergy and Allegheny Power to retain an independent cost allocation expert to audit the companies' cost allocation practices and affiliate relationships to identify and remove any direct or indirect cross subsidies that provide a benefit to either default service or an affiliated retail supplier.

All of the above proposed merger conditions and the reasons for them are fully addressed in RESA's main brief and will not be restated here. The purpose of this reply brief is to respond to the specific issues raised by the Joint Applicants and, regarding default service procurement plans, the Office of Small Business Advocate ("OSBA"). As explained below, none of these arguments are persuasive and all should be rejected.

II. JOINT APPLICANTS' POSITIONS THAT COMPETITIVE RETAIL MARKET ISSUES ARE IRRELEVANT AND/OR THAT HARM MUST FIRST OCCUR BEFORE THE COMMISSION CAN DO ANYTHING ARE INCONSISTENT WITH THE COMMISSION'S STATUTORY DUTIES, CONTRARY TO THE PUBLIC INTEREST AND MUST BE REJECTED

Two separate sections of the Public Utility Code are applicable in this case – Chapter 11, which is the Commission's "standard" authority regarding public utility mergers, and Chapter 28, which addresses the Commission's authority when the merger involves electric distribution companies ("EDCs"). Joint Applicants take the position that Chapter 28 "does not confer any authority upon the Commission to approve mergers or consolidations of public utilities or a

change in control of a public utility beyond the authority the Commission otherwise possesses under Chapter 11 of the Code."[3] This position, however, is fundamentally flawed. First, Joint Applicants' attempt to create a "precondition" to the applicability of Chapter 28 is not consistent with the clear language of the statute and the Commission's statutory duty to take steps to prevent anticompetitive or discriminatory conduct and the unlawful exercise of market power from occurring. Second, Joint Applicants do not escape the requirement to prove an affirmative benefit to the competitive market through their effort to remove Chapter 28 from the analysis because Section 1103 requires its own separate analysis of competitive issues.

A. There is no legal basis for Joint Applicants' claim that Section 2811 requires conclusive evidence of anticompetitive or discriminatory behavior before it can be applied

Joint Applicants argue that Section 2811(e) only comes into play if the Commission finds that the proposed merger "**would result** in anticompetitive or discriminatory conduct, **would lead** to the unlawful exercise of market power, or **would prevent** customers from obtaining the benefits of a properly functioning and workable competitive retail natural gas and electricity markets."[4] To summarize Joint Applicants' position, the record does not "prove" that they have ever engaged in these activities, there is no reason to believe they will have any greater incentive or opportunity to engage in these activities as a result of the merger and, therefore, there is no "proof" that they "would" engage in these activities in the future so Chapter 28 does not apply.[5] In other words, Joint Applicants attempt to use their ultimate position that "there are no

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3 Joint Applicants Initial Brief ("I.B.") at 14.

4 *Id.* (emphasis added).

5 *See, e.g., Id.* at 21 ("the Commission's focus is on whether the proposed merger will disrupt *competitive retail* markets")(emphasis original); 34 ("the Merger will have no adverse effect on Pennsylvania's competitive retail electric and natural gas markets."); 71("RESA has nothing whatsoever to support its allegations other than suspicion and innuendo.")(footnote omitted).

concerns" with this merger to cut off the Commission's required review of Chapter 28 in the first instance.

Setting aside for a moment the flaws with Joint Applicants position that the record does not prove the likelihood of anticompetitive or discriminatory behavior post-merger, Section 2811 is clear that the Commission is required to "monitor the market for the supply and distribution of electricity to retail customers and **take steps . . . to prevent anticompetitive or discriminatory conduct** and the unlawful exercise of market power."[6] The Commission is specifically charged with this duty when EDCs request "approval of proposed mergers, consolidations, acquisitions or dispositions" as the Joint Applicants are requesting here.[7] Pursuant to this statutory duty, the Commission is required to "consider whether the proposed [transaction] **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."[8] In other words, the Commission is not required to conclude that the Joint Applicants have engaged in anticompetitive or discriminatory behavior or that they absolutely will engage in such behavior as a precondition to taking "steps" to "prevent" such actions from occurring in the future as required by Chapter 28.

If Joint Applicants' position was accurate, then Chapter 28 would do nothing to benefit consumers because they would have to first be harmed by anticompetitive and discriminatory behavior before the Commission could address it. Such a result would harm the public interest

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6 66 Pa.C.S. § 2811(a)(emphasis added).

7 66 Pa.C.S. § 2811(e).

8 66 Pa. C.S. § 2811(e)(1)(emphasis added).

and would place the Commission in the helpless position of not being any to take proactive steps to prevent such a result from occurring. Clearly, Section 2811 is intended to prevent the harm to consumers before it happens and Joint Applicants' narrow and restrictive view of the Commission's review of EDC mergers like the one in this case cannot be accepted.

Further, Joint Applicants also too narrowly define what the Commission is empowered to do by claiming that all the Commission can do is "prevent" a proposed transaction from compromising the functioning of an existing market and to "preserve" the benefits already available in that market.[9] Section 2811 has no such requirement nor would such a requirement make any sense from the perspective of the consumers and the overall goals of the Choice Act. Rather, Section 2811 states that it applies to any anticompetitive or discriminatory conduct that is likely to "result" after the merger to deprive consumers of the benefit of a fully functional and workable competitive market. Contrary to Joint Applicant's contortion of the statute, Section 2811 does not state that if a non-fully functional and competitive retail market existed before the merger all the Commission is empowered to do is preserve such a broken market after the merger. Rather, the plain directive of Section 2811 is that the Commission must take action to "preserve the benefits" of a properly functioning and workable competitive market. By logical extension, if that "properly functioning and workable competitive market" did not exist before the merger and is not likely to exist after the merger, then the Commission must take steps to address the anticompetitive and/or discriminatory behavior likely to occur to thwart its development.

By its clear text, Section 2811(e) applies when the Commission is considering the request of EDCs to merger their operations. This case involves the merger of four of Pennsylvania's

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[9] Joint Applicants I.B. at 39.

EDCs which will provide distribution service to more than a third of Pennsylvania's electric customers in a combined service territory covering approximately 70% of the Commonwealth.[10] Therefore, the Commission has a statutory duty to consider whether the proposed transaction **is likely to result** in anticompetitive or discriminatory conduct and to **take steps** to prevent it from occurring post-merger. While parties may present merger conditions for the Commission's consideration, the burden of proof does not shift to the party challenging a merger or proposing conditions to a merger.[11]

Here, Joint Applicants have the ultimate burden of proving that the requirements of Chapter 28 are satisfied and they have not met this burden because they have failed to rebut clear record evidence showing that anticompetitive and discriminatory conduct is likely to result post merger. Consistent with Section 2811(e)(2), the Commission must either reject the merger or impose "such terms and conditions as it finds necessary to preserve the benefits of a properly functioning and workable competitive retail electricity market."[12]

B. <u>There is no legal basis to support Joint Applicants' position that Section 1103 requires no analysis of competitive market issues or the anticompetitive concerns established on the record can be ignored</u>

Even if one were to assume that Chapter 28 does not apply (which it does), Joint Applicants do not satisfy the requirements of Section 1103 with their claim that the merger will

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10 RESA St. No. 1 at 6.

11 While the burden of production may shift back and forth in proceeding, the burden of establishing "affirmative public benefits" and the allowing the existence of "properly functioning and workably competitive" markets always remains on the Joint Applicants. *Milkie v. Pennsylvania Public Utility Commission*, 768 A.2d 1217 (Pa. Cmwlth. 2001); *Riedel v. County of Allegheny*, 159 Pa.Cmwlth. 583; 591, 633 A.2d 1325; 1328 n. 11 (1993) ("[T]he burden of persuasion never leaves the party on whom it is originally cast, but the burden of production may shift during the course of the proceedings.")

12 66 Pa. C.S. § 2811(e)(2).

not "disrupt" and have no "adverse" effect on Pennsylvania's competitive retail electric markets.[13] They also fail to satisfy their burden under Section 1103 by claiming that the Pennsylvania Supreme Court excuses them from "describ[ing] with specificity the public benefits" anticipated by the merger.[14] Joint Applicants' reasoning is flawed and must be rejected.

Satisfying the standards of Section 1103 requires an analysis of the effect of a proposed merger on competition as material to the assessment of public benefit and "anticompetitive effects may offset or negate advantages and result in a denial of regulatory approval."[15] Despite this, Joint Applicants offer nothing in their initial application to show how the proposed merger will affirmatively benefit the competitive retail market. Then, in the face of clear record evidence showing how the proposed merger is likely to result in anticompetitive or discriminatory behavior, Joint Applicants choose to either ignore or flippantly dismiss as "speculative" the evidence. As discussed below, Joint Applicants did not successfully rebut the evidence showing that the proposed merger is likely to result in anticompetitive or discriminatory behavior which will prevent consumers from receiving the benefit of a fully functional and workable competitive retail market and, therefore, pursuant to Section 1103, the merger must be rejected.

Only at the eleventh hour, did Joint Applicants make a meager attempt to create the impression that they were taking competitive retail market concerns seriously by proffering the Partial Settlement which, according to just a few sentences in their seventy-eight page brief, they

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13 Joint Applicants I.B. at 21 and 34.

14 *Id.* at 14.

15 *Popowsky v. Pa. PUC*, 937 A.2d 1040, 1056 (Pa. 2007)

claim fully satisfies competitive retail market issues. As discussed further below, however, the Partial Settlement is woefully inadequate to address these concerns. Since neither the merger as proposed nor as modified by the Partial Settlement offer any affirmative potential benefits to the competitive retail market and neither provides any meaningful mitigation measures to prevent the likely anticompetitive and discriminatory conduct that may occur as a result of this merger, the proposed transaction fails to satisfy the standards of Section 1103.

III. JOINT APPLICANTS HAVE NOT SUCCESSFULLY REBUTTED THE RECORD EVIDENCE SHOWING THAT THE PROPOSED MERGER IS LIKELY TO RESULT IN AN ANTICOMPETITIVE AND DISCRIMINATORY RETAIL ELECTRICITY MARKET TO THE DETRIMENT OF CONSUMERS REQUIRING THE IMPOSITION OF THE MARKET MITIGATION MEASURES SET FORTH BY RESA

Joint Applicants discount the record evidence showing that the proposed merger is likely to result in anticompetitive and discriminatory behavior as "speculative" because there is no conclusive evidence showing that Joint Applications have engaged in such conduct in the past and will engage in such conduct in the future.[16] As discussed above, however, the Commission's statutory duty is to determine whether the proposed transaction **"is *likely* to result"** in anticompetitive or discriminatory conduct and the burden of proof rests with Joint Applicants to show that the merger is <u>not likely</u> to result in anticompetitive or discriminatory conduct. Joint Applicants have failed to meet this burden.[17]

As discussed more fully in RESA's main brief, the record showed that the proposed merger is likely to result in anticompetitive or discriminatory conduct based on the following three undisputed facts. First, the proposed merger will reduce the number of competitors in

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16 *Id.* at 70.

17 66 Pa. C.S. § 2811(e).

Pennsylvania's retail electricity market.[18] Second, the transition of Allegheny Power's billing and customer information system to the FirstEnergy platform almost a year and a half after generation rate caps expire will disrupt the ability of competitive suppliers to provide service.[19] Finally, a significant increase in the combined entity's market power coupled with its avowed retail marketing strategy with the goal of achieving market "dominance" will present greater opportunity and greater incentive for post-merger First Energy companies to pursue actions to maximize profit to shareholders, at the risk of consumer welfare and competitive market development in the merged company's Pennsylvania service territories.[20] Joint Applicants have presented nothing to successfully rebut these facts.

Instead, Joint Applicants have chosen to focus on attacking and badly mischaracterizing just a few of RESA's proposed merger conditions in an effort to evade all responsibility for proving that their proposed merger is not likely to result in anticompetitive or discriminatory behavior to deprive consumers the benefit of a fully functional and workable retail competitive market. As discussed below, these criticisms are not factually nor reasonably sound and should be rejected.

A. <u>The record shows that Joint Applicants' current EDC interactions with EGSs are deficient and, post-merger, these problems will only be exacerbated</u>

1. Description of the issue: the post-merger retail market needs a variety of competitors and cooperative, fair and operationally reasonable interactions between the EDCs and the EGSs

Two ways to make the post-merger retail markets more competitive in light of the decades-long monopoly of EDCs over all facets of electricity service to consumers are simple in

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18 *See* RESA M.B. at 12-13.

19 *See Id.* at 13-14.

20 *See Id.* at 15- 23.

concept though they can be more difficult in execution. First, there needs to be a significant number of competitors in the market who – through competing with one another – will offer the most competitively priced and value added services possible. Second, the EDCs – who will always maintain the customer relationship through the provisioning of distribution service – must work cooperatively with the EGSs to ensure a smooth transition for the customer to alternative generation supply. There is substantial record evidence showing that the proposed merger threatens to negatively impact both of these.

First, the proposed merger will remove one competitor, Allegheny Energy Supply Company, LLC ("AE Supply") from the market even though, absent the merger, there are no structural reasons preventing AE Supply from expanding its competitive market share.[21]

Second, Joint Applicants propose to transition Allegheny Power's billing and customer information system to the SAP platform used by the FirstEnergy companies which they cannot guarantee will not detrimentally impact the supplier operational support functions of Allegheny Power.[22] Further, numerous concerns related to FirstEnergy's current supplier support operational systems – both the physical systems and the human interactions – were identified on the record and, in at least one case, the record showed that Allegheny Power's current system is better than the one FirstEnergy plans to implement.[23]

2. RESA's proposed condition to require Joint Applicants to commit to a collaborative to address operational and supplier support issues is a fair and reasonable way to address concerns related to EDC-EGS interactions

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21 *Id.* at 12-13.

22 *Id.* at 13-14.

23 RESA St. No. 1 at 22-26.

To address these concerns, and to at least ameliorate some of the anticompetitive aspects of the merger, RESA recommended that the merger be conditioned on the Commission requiring Joint Applicants to commit to a collaborative that will be overseen by Commission staff to address these concerns:

- Provide for the timely creation of new rate codes and a timely process for updating rate codes. First Energy's supplier tariff allows for up to 90 days to implement rate codes which is unworkable from an EGS perspective.

- Create an interval meter flag that would identify whether an account has an interval or summary meter. The flag would be included in all EDI historical usage requests as well as on the EDI 814 enrollment response.

- Consistent with recent Commission orders, EDCs should not require an LOA in order to provide historical usage data to licensed EGSs.

- Supplier tariffs should be updated to provide that all historical usage information will be made available to EGSs for free through EDI.

- For interval metered accounts, each EDC should create a process that allows the supplier to elect, at the time of customer enrollment, to receive only summary data if that is the supplier's preference.

- Both current and future transmission and capacity Peak Load Contribution factors should be provided to suppliers in the 814 enrollment response, in EDI historical usage transactions, and on the customer list. New PLCs should also be transmitted to EGSs for their current set of customers when the new values become available.

- Each EDC should implement the EDI Advance Notice of Drop transaction that provides EGSs with advance notice prior to the EDC's termination of service to a customer

- Historic Interval data should be available to EGSs via EDI

- EDCs should be required to provide budget billing for EGS charges for customers on EDC consolidated billing if requested by customer. EGSs should be paid for the current actual charges and the EDC should calculate and present the budgeted amount on the customer's bill.

- The enrollment confirmation letters should not imply a right of a customer to rescind a contract with an EGS. The right to rescind is 3-days from execution of the contract, consistent with 52 Pa. Code § 54.5(d). The enrollment confirmation period is separate from this 3-day rescission period.

- The EDCs must develop a clear procedure for the treatment of an EGS customer moving to another location who wishes to continue to be served by the EGS.

- The EDCs must develop a customer focused procedure for addressing a variety of situations that may inadvertently result in the customer being dropped to default service as a result of an account attribute change. Currently, in many situations when a customer requests an account number, tax ID or customer name change, the EDC considers the change to result in the creation of a new customer and this results in the customer being dropped from EGS service.

- The EDCs should provide suppliers with historical information on Unaccounted For Energy values.[24]

Further, RESA recommended that the FirstEnergy and Allegheny EDCs should (1) appoint a high-level employee to oversee the supplier support function, (2) implement monthly operational calls with suppliers to assist with the wide range of technical and operational issues that will inevitably come up as EGSs enter the market later this year and in 2011 and, (3) adopt a specific culture of cooperation in responding to EGS concerns.[25]

3. Joint Applicants have failed to successfully show that real concerns about the post-merger EDCs interactions are unwarranted or that they are committed to addressing or satisfactorily resolving them as they increase their scope and power in Pennsylvania

Joint Applicants' response to the concerns raised by RESA consist of outright ignoring them, making misleading statements or attempting to redirect the focus of the Commission. Noticeably absent is any sincere effort to resolve these concerns to enable consumers to receive the benefit of a fully functional and workable competitive retail market. For example, Joint Applicants state that "RESA has acknowledged that Met-Ed, Penelec, and Penn Power are *already* implementing a variety of the retail market enhancements it proposes (consistent with

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24 *Id.* at 25-26.

25 *Id.* at 23-24.

settlements previously agreed to by RESA)."[26] This is neither factually correct nor a reasonable characterization of RESA Witness Hudson's testimony which actually states that the Met-Ed, Penelec and presumably Penn Power "tariffs do not fully address the concerns raised."[27] In claiming that the Partial Settlement addresses "many of the supplier issues identified by RESA in a manner consistent with the default service settlements" for Met-Ed, Penelec and Penn Power,[28] Joint Applicants are merely attempting to redirect focus to cover the fact that there are serious retail market concerns with the FirstEnergy supplier support systems which they threaten to transition into the Allegheny Power system. Examples include the difficulty EGSs face in attempting to reach FirstEnergy's supplier support staff and the unreasonably lengthy time FirstEnergy EDCs need to create and update new rate codes.[29] These problems, despite Joint Applicants' claim to the contrary, will affect the ability of EGSs to enter Pennsylvania retail market and will have an adverse impact on the ability of EGSs to serve retail customers.[30]

Moreover, Joint Applicants claim that the "FirstEnergy makeover" of Allegheny Power will somehow benefit the competitive retail market by implementing the provisions of the FirstEnergy EDC default service settlements is completely undercut by the fact that Allegheny Power recently proposed a more attractive Purchase of Receivables ("POR") program that the Partial Settlement threatens to downgrade by limiting the customers classes that would be eligible to participate.[31] Joint Applicants offer no real explanation regarding this proposed

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26 Joint Applicants I.B. at 73 (emphasis original).

27 RESA St. No. 1 at 26 (emphasis added).

28 Joint Applicants I.B. at 74.

29 RESA St. No. 1 at 23, RESA St. No. 1-SR at 20, RESA M.B. at 14.

30 Joint Applicants I.B. at 34.

31 RESA M.B. at 29-30.

downgrade of the POR program for Allegheny Power beyond stating – in a footnote – that they oppose expanding POR to large commercial customers because there is "no need" for it.[32] Apparently, pre-merger Allegheny Power saw the "need" in applying the POR program to all customers and concluded that its system would be able to accommodate this program feature but, because FirstEnergy "sees no need for it," it will simply erase the program feature going forward while at the same time making the outrageous claim in this case that the result is a retail market enhancement sufficient to justify approval of the proposed merger.

Likewise, in a footnote, Joint Applicants misleadingly claim that "only" three of RESA's operational issues are "not addressed entirely, or in large part" by the Partial Settlement and Joint Applicants "oppose" them.[33] This is not a factually accurate statement as the reality of the Partial Settlement is that it addresses very few of the concerns raised by RESA, and addresses none of them entirely.[34] As aptly explained in RESA's main brief:

> What is needed is a comprehensive commitment by FirstEnergy to work with EGSs in a cooperative manner to address the myriad of operational issues needed to support a vibrant competitive market. The mediocre commitments made in [the] Partial Settlement are indicative of the apathetic and even antagonistic attitude that FirstEnergy has taken with respect to competitive market issues and supplier support.[35]

Permitting FirstEnergy to extend this way of doing business to Allegheny Power, as it proposes to do as a result of this merger, will not result in a fully functional and workable competitive retail market. On the contrary, it threatens to achieve the exact opposite result which will only harm consumers.

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32 Joint Applicants I.B. at 74, n. 37.

33 *Id.*

34 RESA M.B. at 31-36.

35 *Id.* at 33.

B. The record shows that the combined company will have an increased ability to artificially distort the price of default service thereby making it impossible for competitors to enter the market

1. Description of the issue: default service rates must include all costs of providing service otherwise distribution revenues are unfairly subsidizing generation service and EGSs have no ability to offer competitive service

Consumers receive generation services through either the EDC's default service or an EGS' competitive supply. As unquestionably demonstrated by the existence of generation rate caps, when the default service rate is priced below market, competitive suppliers cannot offer a competitive price and, therefore, will not enter the market. Therefore, to ensure a fully functional and workably competitive retail market, it is important that the default service rate include all the costs of providing generation service.[36]

2. RESA's proposed condition to require a cost allocation audit will ensure that distribution customers are not improperly subsidizing the default service rate or the operations of any unregulated affiliates.

In this proceeding, FirstEnergy proposes to acquire another Pennsylvania EDC and to finance its operations through the FirstEnergy business model which Joint Applicants concede does not include recovering the costs of billing and other management service through the default service rate.[37] To address this issue, RESA recommends that Commission order an independent cost allocation and affiliate relationship audit to mitigate concerns regarding the ability and incentive of the combined entity to misallocate costs between and among the affiliated companies or to bundle default service costs with distribution rates to advantage the

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[36] 52 Pa. Code § 69.1808. Similarly, FirstEnergy has expressed its intent to grow the operations of its EGS affiliate, FES. FES must be appropriately assigned its related costs as well as company-wide related costs to ensure that distribution revenues are not being used to fund the operations of an EGS. RESA M.B. at 36.

[37] Tr. at 517-518.

EDCs (through default service) or the affiliated-EGS.[38] RESA also noted that its proposal would address the issues raised by the Office of Consumer Advocate ("OCA") and OSBA to implement ring-fencing measures to ensure the proper separation between the combined company's regulated and unregulated business operations.[39]

3. Joint Applicants have failed to show why a cost allocation audit would provide no benefit to distribution customers or that it is unnecessary after full consideration of the record

While Joint Applicants state that the combined company will not be able to "control the market price of energy that retail electric suppliers use to meet their retail service obligations,"[40] this statement fails to account for the undisputed ability of the combined company to undercut the default service rate which will have the impact of creating an artificially lower rate against which EGSs will be unable to compete.

In response to RESA's concerns about cost allocation, Joint Applicants claim that there has been no "proof" that the FirstEnergy companies are currently misallocating costs.[41] Joint Applicants admitted that they are currently being audited by the Federal Energy Regulatory Commission ("FERC") for years 2008 and 2009 and that this audit as well as the ones performed by the Commission's Bureau of Audits provide sufficient safeguards to address cost allocation concerns.[42] Further, Joint Applicants state that "many of the costs incurred for service to

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38 *See* RESA M.B. at 37-39 with supporting record cites.

39 RESA St. No. 1-R at 6-8.

40 Joint Applicants I.B. at 35.

41 *Id.* at 75.

42 Tr. at 510-511; Joint Applicants I.B. at 76.

unregulated subsidiaries are directly billed to those subsidiaries."[43] Noticeably, they do not claim that **all** such costs are billed to the unregulated subsidiaries.

The purpose of a cost allocation audit would be to ensure that there is no inappropriate misallocation of costs in the post-merger company. In consideration of the fact that the combined company would provide service to an increase portion of Pennsylvania ratepayers over an enormous geographic area, such an audit is a reasonable merger condition and, frankly, Joint Applicants' opposition to it is puzzling.

C. The record shows that the current default service plans of the Joint Applicants are deficient and post-merger the combined company will have the ability and incentive to extend over a greater area the deficient default service plans to advantage its affiliated generation-owning retail energy supplier

1. Description of the issue: default service procurement plans in the post-merger retail market must not be structured to favor the affiliated EGS and must be reasonably calculated to stimulate retail competition

The FirstEnergy EGS affiliate, FirstEnergy Solutions ("FES"), controls the electric generation assets of FirstEnergy and submits bids to its affiliated EDCs to provide wholesale generation for the EDC's default service customers.[44] This relationship creates an obvious incentive for the affiliated EDC to propose default plan structures which advantage the ability of the affiliated wholesale supplier to submit and win the bid to supply default generation service because their common parent will receive revenue from the purchase by the EDC of the generation and from default service customers who pay for default service generation.[45] Such a result limits the ability of other wholesale suppliers to provide generation services to the

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43 Joint Applicants I.B. at 75.

44 Joint Applicants St. No. 1SR at 3.

45 RESA M.B. at 21-23.

FirstEnergy affiliated EDCs and can result in default service rates that are not reflective of the market price of energy.

2. RESA's proposed condition to require Joint Applicants to commit to propose various program features in future default service plans is a reasonable and necessary way to address concerns related to the ability to improperly use default service procurement plans

As the structure of an EDC's default service procurement plan has a direct and significant impact on the success or failure of competitive retail market development and the result of this proposed merger will be to increase the size and reach of the FirstEnergy companies into the Pennsylvania market, RESA proposed that the post-merger EDCs be required to purse the following changes in their next default service plans submitted to the Commission for approval:

> (1) the post-merger EDCs should be required to implement hourly priced service for all customers with peak demand greater than 100 kW as a condition for approving the merger.
>
> (2) lowering the amount of supply that can be served by any single wholesale supplier to 33 1/3%[46]

By requiring the post-merger EDCs to propose these changes in their next default service procurement plans, the Joint Applicants will be providing some reassurance that they will not use the default service plans of their affiliated-EDCs to provide an advantage to their affiliated wholesale supplier.[47] The result will give all wholesale suppliers a fair and equal opportunity to submit bids to supply default service which will result in a default service rate that is market-reflective and against which EGSs will be able to provide competitive retail offers for the benefit of consumers.

3. Joint Applicants have failed to show that they have no ability to control default service procurement plans to create an unfair

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46 RESA. St. No. 1 at 20-22.

47 RESA St. No. 1-SR at 14.

advantage or why RESA's proposed merger condition regarding future default service procurement plans is not a reasonable way to ameliorate these concerns

Joint Applicants claim that the merger will not have "any adverse impact" on the provision of default service as "many suppliers compete to provide supply" and the timing and "the timing and definitions of products are established through a Commission proceeding."[48] Further, Joint Applicants claim that its affiliate's ownership of low-cost generation resources "does not provide it with an unfair pricing advantage in retail electricity markets and . . . there is no basis to conclude that the proposed Merger would result in reduced competition in default service supply auctions."[49] Finally, OSBA opposes RESA's recommendations claiming that expanding hourly pricing is only intended to "make the default service rate more volatile" and that load caps will increase default service rates.[50] All of these criticisms are unfounded.

First, the record clearly demonstrates that a core purpose of this merger is to increase FirstEnergy's profit by increasing the amount of revenue received for generation services. Further, the record is clear that a part of this revenue is derived from the provisioning of generation service to affiliated-EDCs to supply default service plans. While the Commission does approve the default service procurement plans, given the unique circumstances of this case which include the ownership of generation by the FirstEnergy affiliate, requiring the post-merger EDCs to propose future default service plans ensuring that the affiliated wholesale generation supplier does not get an advantage is a reasonable condition that would promote retail market development.

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48 Joint Applicants I.B. at 35.

49 *Id.*

50 OSBA M.B. at 63-66.

Second, OSBA's criticisms of RESA's proposals are unfounded. RESA's proposals are consistent with the goals of the Choice Act to promote competition as the best way of controlling energy costs and hourly pricing is effective at promoting robust retail market development.[51] Regarding the load cap, OSBA and RESA both agreed in the Met-Ed and Penelec default service cases that the current 75% threshold needed to be lowered.[52] While the Commission ultimately rejected this view, it did so based on a balancing of the competing interests of supplier diversity and attaining the lowest cost bids possible.[53] Requiring the future default service plans of the EDCs to propose a reduction of the load cap is an appropriate condition in consideration of the fact that Joint Applicants propose to reduce wholesale competition and consolidate further control of Pennsylvania EDCs in the hands of a single corporate entity only exacerbating the competitive market concerns previously addressed despite Joint Applicants protestations to the contrary.[54] Moreover, there is no load cap for Allegheny Power.[55] As RESA's proposed rate cap will increase participation in the default service auction process resulting in enhanced competition to place downward pressure on pricing, it should be adopted.

Finally, it should be reiterated that RESA's proposal is that the post-merger EDCs be required to make these proposals in their next default service filing with the understanding that all parties would have an opportunity to support or reject the proposals in the context of those

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51 RESA St. No. 1-SR at 16-18.

52 *Joint Petition of Metropolitan Edison Company and Pennsylvania Electric Company for Approval of Their Default Service Programs*, Docket No. P-2009-2093053, P-2009-2093054, Opinion and Order entered November 6, 2009 at 16.

53 *Id.* at 20.

54 Joint Applicants I.B. at 72.

55 RESA St. No. 1-SR at 18-19.

future cases. As the Partial Settlement is devoid of any meaningful commitments to address these issues,[56] RESA's proposals should be adopted.

D. The record shows that implementation of an enhanced code of conduct is an appropriate merger condition to address concerns related to the corporate structure of FirstEnergy and its expansion into a greater area in the Commonwealth

1. Description of the issue: through its EDC affiliates, generation assets and EGS affiliate, and its avowed intent to grow its generation revenues, FirstEnergy has the incentive and opportunity to engage in anticompetitive and discriminatory conduct

The relationship of the affiliated FirstEnergy companies is not in dispute. There are FirstEnergy EDC affiliates and a FirstEnergy EGS affiliate. There is no dispute that the FirstEnergy EGS affiliate controls the generation assets of FirstEnergy and that it provides generation to both default service customers by successfully winning EDC default service procurement bids and to retail customers who select FES as their competitive alternative generation supplier. The record shows that FirstEnergy intends to increase its profits through FES' sales of generation.[57] Given the current market structure in Pennsylvania and the dependence of EGSs on cooperative and non-discriminatory actions of the EDCs, this corporate relationship creates both the opportunity and incentive to engage in anticompetitive and discriminatory behavior to improperly favor FES.

2. RESA's proposed enhanced code of conduct is a reasonable and narrowly tailored way to address concerns related to this proposed merger and in consideration of the corporate structure of the Joint Applicants

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56 RESA M.B. at 30-31.

57 *See* RESA M.B. at 15-23 with supporting record cites.

In addition to requiring the post-merger EDCs to implement various retail market friendly enhancements to their supplier operational support systems, RESA also proposed to address the potential for anticompetitive and discriminatory conduct in favor of FES through imposition of an enhanced code of conduct. RESA's recommendations were made given the specific facts and relationships present in this case and in consideration of how the specific provisions of the Commission's currently effective Code of Conduct could be strengthened to address these concerns.[58] If the dominance of FirstEnergy in Pennsylvania is permitted to grow through approval of the merger, an enhanced code of conduct specifically tailored to address the concerns related to this entity is a reasonable way to mitigate against anticompetitive and discriminatory behavior which will harm all consumers in the form of less competition and, potentially, increased prices.

3. Joint Applicants have failed to show that the proposed merger does not raise concerns related to the business strategy and corporate structure of FirstEnergy or that RESA's proposed enhanced code of conduct is not a reasonably merger condition that may mitigate these concerns

Joint Applicants have stubbornly refused to offer any type of real assurances that the post-merger entity is committed to ensuring that its corporate relationships and business structure do not lead to anticompetitive and discriminatory behavior by lamenting that there is "nothing improper" about these relationships.[59] Joint Applicants also state that there has been no evidence of *any* improper conduct of the FirstEnergy companies to date.[60] In an effort to divert attention, Joint Applicants claim that other EGSs – such as ConEdison *Solutions* and PPL EnergyPlus –

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58 *Id.* at 23-25.

59 Joint Applicants I.B. at 50.

60 *Id.* at 76 (emphasis original).

"clearly play off the name of an incumbent EDC to promote retail sales" unlike the use of the "FirstEnergy" name in relation to the EDC and EGS affiliates.[61]

First, as discussed above in Section II, there is no evidentiary requirement for opponents of a proposed merger to prove that anticompetitive or discriminatory conduct has occurred as a condition precedent for the Commission to impose conditions ensuring that they do not occur in the future. Given the facts of this case, Joint Applicants have failed to prove that anticompetitive and discriminatory behavior is not likely to occur as a result of this merger.

Second, Joint Applicants attempt to analogize or somehow suggest that RESA members are doing the "very same thing" as FirstEnergy is absurd at best. Joint Applicants argument is that because the EDC-affiliated company names, i.e. Allegheny Power, Met-Ed, Penelec and Penn Power – do not appear in the corporate name of FES it is not using the name of the EDC affiliate to promote its EGS business. This position ignores the indisputable fact that every one of these EDCs as well as the EGS interrelate their business names with the "FirstEnergy" corporate name. As set forth in the unrebutted testimony of Direct Energy Witness Morey, all of the affiliated-EDCs reinforce the fact that they are FirstEnergy companies.[62] In fact, all information related to all of the FirstEnergy EDCs is located within the FirstEnergy corporate website. There is simply no factual basis to support Joint Applicants attempt to claim that the EDC business names and the corresponding EGS affiliate names are somehow divorced from their association to the FirstEnergy corporate name.

Likewise absurd and wholly irrelevant are Joint Applicants' claims regarding other EGS' names. There is no comparison between the corporate entities of the referenced EGSs and the

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61 *Id.* at 46 and 76.

62 Direct Energy St. No. 1-SR at 43-45, Exh. No. MJM-5.

powerful behemoth that FirstEnergy would become in Pennsylvania as a result of this merger. Moreover, the referenced EGSs are not seeking Commission approval to expand their operations nor has there been any record evidence showing that the corporate business plans of these EGSs is to seek to become an unregulated monopoly provider of generation service to customers in the merged EDC Pennsylvania markets. Joint Applicants' arguments in this respect are simply an attempt to divert attention away from the real issues of this case.

Finally, the Joint Applicants ignore (once again) the statutory language of section 2811. That section does not merely prohibit "unlawful" conduct, but also conduct that "prevents" the development of a workably competitive market. The record clearly shows that the business strategy and interrelationship of corporate affiliates combined with the structure of Pennsylvania's electricity market create a situation where Joint Applicants are likely to engage in anticompetitive or discriminatory behavior post-merger which will prevent the development of the kind of market mandated by the Choice Act in a post-merger environment. Anything short of a rejection of the merger must be conditioned on implementation of an enhanced code of conduct for the post-merger entities which will at least address to some extent the anticompetitive and discriminatory potential that this merger portends.

IV. CONCLUSION

For all the reasons set forth above, the market that would result from approval of this merger without conditions (or with the conditions proposed by the recently filed Joint Petition for Partial Settlement) will not be a properly functioning and workable competitive retail electricity market as required by the Public Utility Code. At a minimum, the following competitive market enhancements proposed by RESA must be implemented:

(1) revise and strengthen the combined companies' code of conduct;

(2) implement a comprehensive program to inform customers about specific and available retail offers;

(3) implement a properly structured Purchase of Receivables ("POR") program for the service territory of Allegheny Power and expand the current POR program for Met-Ed, Penelec and Penn Power to large C&I customers;

(4) prohibit FirstEnergy from implementing its municipal aggregation programs in Pennsylvania until the Commission issues a final adjudication regarding the legality of such programs;

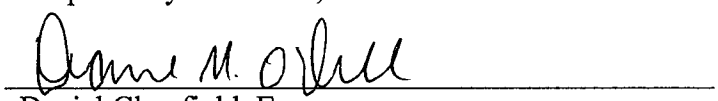
(5) require that each affiliated company incorporate certain changes in their next default service program filing, including a supplier load cap, so that default service is properly structured to encourage development of the competitive market;

(6) require that all affiliated companies update and revise their operational rules; and

(7) require FirstEnergy and Allegheny Power to retain an independent cost allocation expert to audit the companies' cost allocation practices and affiliate relationships to identify and remove any direct or indirect cross subsidies that provide a benefit to either default service or an affiliated retail supplier.

Without the imposition of these meaningful and substantial conditions to provide customers with a properly functioning and workable competitive market, the merger must be rejected.

Respectfully submitted,



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