

PENNSYLVANIA PUBLIC UTILITY COMMISSION
Uniform Cover and Calendar Sheet

1. <u>REPORT DATE:</u> January 18, 2006	2. <u>BUREAU AGENDA NO.</u> JAN-2006-OSA-0037* (REV)
3. <u>BUREAU:</u> Office of Special Assistants	5. <u>PUBLIC MEETING DATE:</u> January 27, 2006 <div style="text-align: right; font-size: 2em; font-weight: bold;">DOCUMENT FOLDER</div>
4. <u>SECTION(S):</u>	
6. <u>APPROVED BY:</u> Director: C.W. Davis 7-7466 Mgr/Spvr: R. A. Marinko 3-3930 K. Sophy 7-8108	
7. <u>PERSONS IN CHARGE</u> K. House 2-8495 K. Barrow 2-8840 R. Carran 3-1001	9. <u>EFFECTIVE DATE OF FILING:</u> N/A
8. <u>DOCKET NO.:</u> A-110550F0160	<div style="text-align: center; font-size: 2em; font-weight: bold; border: 1px solid black; padding: 5px;">DOCKETED</div> MAR 13 2006

- 10. (a) CAPTION (abbreviate if more than 4 lines)**
(b) Short summary of history & facts, documents & briefs
(c) Recommendation

(a) Joint Application of PECO Energy Company (PECO) and Public Service Electric and Gas Company (PSE&G) for approval of the Merger of Public Service Enterprise Group, Inc. with and into Exelon Corporation.

(b) On February 4, 2005, PECO and PSE&G (collectively, the Joint Applicants) filed with the Commission the above referenced Joint Application for Merger. The matter was assigned to Administrative Law Judge (ALJ) Marlane R. Chesnut who granted the requests of several interested Parties to intervene in the proceeding. On September 12, 2005, the Joint Applicants and several interveners filed a Joint Petition for Settlement (Joint Petition). The PPL Companies, the City of Philadelphia (City) and the Philadelphia Gas Works (PGW) opposed the Joint Petition. Evidentiary hearings were held before the ALJ on September, 22, 23 and 26, 2005. On November 30, 2005, ALJ Chesnut issued an Initial Decision wherein she recommended that the Joint Petition be accepted, without modification. PPL, the City and PGW filed Exceptions to the Initial Decision on December 20, 2005. Several Parties filed Reply Exceptions on December 29 and 30, 2005.

(c) The Office of Special Assistants recommends that the Commission adopt the attached proposed Opinion and Order which denies the Exceptions and adopts the ALJ's Initial Decision.

Order Doc. No. 586068v1

Cal. Sheet Doc. No. 588892v1

11. MOTION BY: Commissioner Chm. Holland
SECONDDED: Commissioner Cawley
 Commissioner Shane - Yes
 Commissioner Pizzingrilli - Yes
 Commissioner Fitzpatrick - Yes

CONTENT OF MOTION: Staff recommendation adopted.

Statement of Chairman Wendell F. Holland attached.

PENNSYLVANIA PUBLIC UTILITY COMMISSION
HARRISBURG, PENNSYLVANIA 17105-3265

Joint Application of PECO Energy
Company and Public Service Electric
And Gas Company for Merger

Public Meeting held January 27, 2006
JAN-2006-OSA-0037
Docket No. A-110550F0160

STATEMENT OF CHAIRMAN WENDELL F. HOLLAND

Today, the Commission considers the Joint Application of PECO Energy Company (PECO) and Public Service Electric and Gas Company for approval of the merger of Public Service Enterprise Group Inc. with and into Exelon Corporation. With the combined legal and technical efforts of the Commission's multi-faceted resources, we are presented with a high-quality assessment and recommendation of a complex merger application. I would like to extend many thanks to our Office of Administrative Law Judge as well as the Office of Special Assistants, Office of Trial Staff and all of the other parties to the proceeding for their contributions.

When I became Chairman, I said this Commission would focus on rates, reliability and choice, so we can protect the public interest, promote economic development and preserve the environment. As I considered this case, I was pleased to find that its terms and conditions balance the responsibility to protect the public interest with the need to ensure the viability of utility companies. This settlement protects the public interest, encourages economic development and safeguards the environment.

Perhaps most important to all consumers is that the settlement caps the company's rates through December 2010, shielding consumers from the spikes in energy prices that negatively impact family budgets. Families and seniors will be able to better predict and budget for their energy usage for years to come. I want to underscore this point: PECO's rates have remained virtually the same since 1996 and will stay frozen through 2010.

PECO also made significant commitments to enhance its Consumer Assistance Program by agreeing to increase the amount of usage subject to discounted rates and to add a special needs component that will make bills more affordable for consumers at the lowest levels of poverty. The company agreed to increase its efforts to reach out to our neighbors in need, spending an additional \$1.2 million during the next four years to educate low-income consumers about the programs available to help them pay their bills.

Consumers also will reap the benefits from PECO supporting an extension to its commitments regarding reliability and customer service. PECO agreed to performance thresholds in eight areas that are critical in providing safe and reliable service and reasonable customer service.

Beyond making a commitment to renewable power and energy efficiency initiatives as well as economic development, the company also made a commitment to the City of Philadelphia and its residents. PECO pledged to maintain its corporate headquarters for its distribution business in the city through at least 2010. The company also agreed that many key workforce positions that affect reliability and customer service will not be reduced prior to January 2011.

The Public Utility Code requires that this Commission must affirmatively determine that the "public benefit will result" from any merger under consideration and that the merger will promote the "service accommodation, convenience or safety of the public" in some substantial way. I believe that the merged entity we approve today result in better service, reliability and rates for Pennsylvania's consumers.

January 27, 2006
DATE

Wendell F. Holland
Wendell F. Holland, Chairman

PENNSYLVANIA PUBLIC UTILITY COMMISSION
HARRISBURG, PENNSYLVANIA 17105-3265

DOCUMENT
FOLDER

Initiation of a fact-finding investigation to examine issues related to a potential consolidation of the operations of Philadelphia Gas Works with and into the natural gas distribution business of Exelon Electric & Gas Corporation.

Public Meeting January 27, 2006
JAN-2006-C-0002

Docket No. I-

MOTION OF CHAIRMAN WENDELL F. HOLLAND

This Commission approved the Joint Petition for Settlement (Joint Petition) of the Joint Application of PECO Energy Company and Public Service Electric and Gas Company for Approval of the Merger of Public Service Enterprise Group, Inc. with and into Exelon Corporation at Docket No. A-110550F0160. In pertinent part the Joint Petition provides :

The Joint Petitioners agree that the commission, acting within its authority, may initiate a separate fact-finding investigation following the consummation of the Merger to examine issues related to a potential consolidation of the operations of PGW with and into the natural gas distribution business of EEG. The Commission may assign such investigation to the Office of Administrative Law Judge for the preparation of a report on such issues. PECO agrees to fully cooperate in such fact-finding and other Joint Petitioners may participate in the proceeding if they so elect.

(Joint Petition at 31).

I believe the Commission should initiate this Investigation

THEREFORE, I MOVE:

1. That upon consummation of the merger PECO Energy Company immediately notify the Commission of the effective date.
2. That a fact finding Investigation as described in the Joint Petition for Settlement be initiated thirty (30) days following the effective date of the Merger.
3. That the Investigation be assigned to the Office of Administrative Law Judge for preparation of a Report.

4. That the Office of Special Assistants prepare an Opinion and Order consistent with this Motion.

January 27, 2006

DATE

Wendell F. Holland

WENDELL F. HOLLAND, CHAIRMAN



COMMONWEALTH OF PENNSYLVANIA
PENNSYLVANIA PUBLIC UTILITY COMMISSION
P.O. BOX 3265, HARRISBURG, PA 17105-3265

IN REPLY PLEASE
REFER TO OUR FILE

February 1, 2006

A-110550 F0160

PAUL BONNEY ESQUIRE
KENT D MURPHY ESQUIRE
PECO ENERGY COMPANY
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DOCUMENT
FOLDER

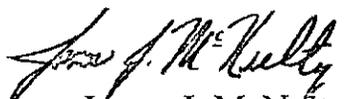
Joint Application of PECO Energy Company and Public Service
Electric and Gas Company for Approval of the Merger of Public
Service Enterprise Group, Inc., with and into Exelon Corporation.

To Whom It May Concern:

This is to advise you that the Commission in Public Meeting on January 27, 2006
has adopted an Opinion and Order in the above-entitled proceeding.

An Opinion and Order has been enclosed for your records.

Very truly yours,


James J. McNulty
Secretary

Enclosure
Certified Mail
LJM

See attached list for additional parties of record

**PENNSYLVANIA
PUBLIC UTILITY COMMISSION
Harrisburg, PA 17105-3265**

Public Meeting held January 27, 2006

Commissioners Present:

Wendell F. Holland, Chairman, Statement attached
James H. Cawley, Vice Chairman
Bill Shane
Kim Pizzingrilli
Terrance J. Fitzpatrick

Joint Application of PECO Energy Company : A-110550F0160
And Public Service Electric and Gas :
Company for Approval of the Merger :
of Public Service Enterprise Group, Inc. :
with and into Exelon Corporation :

OPINION AND ORDER

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BY THE COMMISSION:

Before the Commission for consideration and disposition are the Initial Decision of Administrative Law Judge (ALJ) Marlane R. Chesnut, issued November 30, 2005, relative to the above-captioned matter and the Exceptions and Replies filed with respect thereto.

Exceptions to the Recommended Decision were filed on December 20, 2005, by the PPL Companies (PPL)¹, the Philadelphia Gas Works (PGW) and the City of Philadelphia (City). Reply Exceptions were filed on December 29, 2005, by the PECO Energy Company (PECO) and Public Service Electric and Gas Company (PSE&G) (collectively, the Joint Applicants). Reply Exceptions were filed on December 30, 2005, by both the Office of Consumer Advocate (OCA) and the Office of Small Business Advocate (OSBA).

I. HISTORY OF THE PROCEEDING²

On February 4, 2005, the Joint Applicants filed with the Pennsylvania Public Utility Commission (Commission) a Joint Application requesting that the Commission issue an order approving, to the extent necessary, the merger of Public Service Enterprise Group Incorporated (PSEG), PSE&G's corporate parent, with and into Exelon Corporation (Exelon), PECO's ultimate parent corporation. Exelon, as the surviving company, will change its name to Exelon Electric & Gas Corporation (EEG).

¹ The PPL Companies include PPL Electric Utilities Corporation; PPL EnergyPlus, LLC; PPL Brunner Island, LLC; PPL Holtwood, LLC; PPL Martins Creek, LLC; PPL Montour, LLC; PPL Susquehanna, LLC; PPL University Park, LLC; and Lower Mount Bethel Energy, LLC.

² This history is taken, in large part, from ALJ Chesnut's Initial Decision at 1-6.

PECO notified its customers of the filing of the Joint Application by bill inserts, and served it on the Commission's Office of Trial Staff (OTS), the OCA, the OSBA and on all of the active Parties at Docket Nos. A-110550F0147 (the 2000 Unicom merger proceeding) and R-00994787 (PECO's natural gas restructuring proceeding). Pursuant to a Secretarial Letter dated February 8, 2005, the Joint Applicants published notice of the proposed merger in the *Philadelphia Inquirer* the week of February 14, 2005. In addition, notice of the Joint Application was published in the *Pennsylvania Bulletin* on February 19, 2005. Numerous entities filed Protests or Petitions to Intervene.

The active Parties, in addition to the Joint Applicants, included the OCA; OSBA; OTS; the Philadelphia Area Industrial Energy Users Group (PAIEUG); Citizens for Pennsylvania's Future, Joy Bergey and Lisa Z. Leighton (PennFuture Parties); Department of Environmental Protection (DEP); Exelon Utility Coordinated Council, Locals 614 and 777 of the International Brotherhood of Electrical Workers and Frank Kuders (Labor Parties); PPL; the City; Metropolitan Edison Company (Met-Ed), Pennsylvania Electric Company (Penelec), Pennsylvania Power Company (Penn Power) and FirstEnergy Solutions, Corp. (FES) (collectively, FirstEnergy Companies); Action Alliance of Senior Citizens of Greater Philadelphia, Association of Community Organizations for Reform Now and Tenants' Action Group (Action Alliance *et al.*); The Reinvestment Fund, through its Sustainable Development Fund (TRF/SDF); PGW; and Pennsylvania State Senator Anthony H. Williams (Sen. Williams).

Inactive parties included the New Jersey Large Energy Users Coalition; Amerada Hess Corporation; Energy Coordinating Agency of Philadelphia, Inc.; Strategic Energy LLC; Direct Energy Services LLC; the Retail Energy Supply Association (formerly Mid-Atlantic Power Supply Association); and Edison Mission Energy, EME Homer City Generation LP, Edison Mission Marketing & Trading, Inc. (collectively, the EME companies). By Petition dated July 5, 2005, and granted by Order dated July 6, 2005, Pepco Holdings, Inc. and subsidiaries Conectiv Energy Supply, Inc., Pepco Energy

Services, Inc., Potomac Electric Power Company, Delmarva Power & Light Company and Atlantic City Electric Company (collectively, PHI), which had been an active party, withdrew from the proceeding. By Opinion and Order entered July 18, 2005, the Commission denied the Petition to Intervene and dismissed the Protest of Eric Epstein.

A prehearing conference was held on March 29, 2005. Pursuant to the schedule adopted at the prehearing conference, direct written testimony was submitted on or about June 28, 2005 by Sen. Williams, PGW, OTS, the City, Action Alliance *et al.*, TRF/SDF, OCA (proprietary and nonproprietary), the FirstEnergy Companies, OSBA, PPL, DEP, the Labor Parties, and the PennFuture Parties.

By Public Input Hearing Notice dated May 31, 2005, public input hearings were scheduled for June 30, 2005, at the Philadelphia Senior Center and Philadelphia Community College West Regional Center. Various statements presented at those sessions were made part of the record by Order Admitting Statements into the Record dated July 18, 2005.

By Secretarial Letter dated July 15, 2005, Vice-Chairman Cawley and Commissioner Shane posed a series of questions (Directed Questions) to be answered by the Parties. The first four questions inquired into whether the synergies to be unlocked by the proposed merger could be harnessed to enhance economic development, and they specifically raised the issue of a “set aside” of “virtually divested generation” to be dedicated to that purpose. The fifth question asked the Parties to consider the viability of combining the natural gas operations of PECO and PSE&G with the operations of PGW in a viable, profitable, shareholder-owned public utility.

Rebuttal testimony was submitted by PECO, the OSBA, and the OCA. Surrebuttal testimony was submitted by TRF/SDF, the Labor Parties, the OSBA, the FirstEnergy Companies, the OCA, the OTS, the City, Action Alliance *et al.*, PGW

(proprietary and nonproprietary), the PennFuture Parties and PPL. Supplemental direct testimony relating to the Directed Questions was submitted by the OSBA, the FirstEnergy Companies, the OCA, PECO, the OTS, the City, PGW, the PennFuture Parties, PPL, and DEP.

As the result of settlement negotiations among various Parties, the hearings scheduled for September 12, 13, 15 and 16, 2005, were cancelled, and a further telephonic prehearing conference was held on September 9, 2005. The schedule was revised to reflect the settlement that had been reached among certain of the Parties.

On September 12, 2005, a Joint Petition for Settlement (Joint Petition or Settlement) was filed with the Commission. The Joint Petitioners included PECO, PSE&G, OTS, OCA, OSBA, DEP, the PennFuture Parties, Action Alliance *et al.*, ECA, PAIEUG, TRF/SDF, and Sen. Williams.

By letter dated September 13, 2005, the Labor Parties indicated that they did not oppose the Settlement and reserved the right to participate in further proceedings should the Commission reject or modify the Settlement and also reserved the right to participate in proceedings in other jurisdictions. On September 13, 2005, PAIEUG filed and served a Statement in Support of the Settlement. On September 14, 2005, Statements in Support of the Settlement were filed by TRF/SDF, Action Alliance *et al.*, OTS, OSBA, OCA, PennFuture Parties and DEP. Also on September 14, 2005, PECO submitted further supplemental testimony in support of the Settlement. A statement in opposition to the Settlement was filed on September 19, 2005, by the City. On September 20, 2005, PPL filed a statement explaining that they were neither opposing nor supporting the Settlement since it specifically does not address market power issues, citing a Stipulation filed with the Commission on September 16, 2005, and requesting that the Commission address those issues. On September 20, 2005, PGW submitted supplemental testimony opposing the Settlement.

Hearings were held on September 22, 23 and 26, 2005. Witnesses were presented by the Joint Applicants and PGW. Main Briefs were filed on October 14, 2005, by the Joint Applicants, PGW (both proprietary and public versions), OCA, OTS, OSBA, the FirstEnergy Companies, PPL, the PennFuture Parties, TRF, and the City. DEP did not file a brief, but did file proposed Findings of Fact and Conclusions of Law. Action Alliance *et al.* also did not file a brief but submitted proposed Findings of Fact and Conclusions of Law. Reply Briefs were filed on October 21, 2005, by OTS, the FirstEnergy Companies, PPL, OCA, OSBA, the City, PGW, and the Joint Applicants.

By Initial Decision issued November 30, 2005, ALJ Chesnut recommended that the Joint Petition for Settlement be accepted, without modification, by the Commission. The ALJ also recommended that the proposed merger be approved, as conditioned, and found that, to the extent market power concerns existed, appropriate mitigation steps had been proposed. Exceptions and Replies thereto were filed as noted above.

II. DESCRIPTION OF THE PARTIES AND THE PROPOSED TRANSACTION

At issue is the proposed agreement that PSEG, the parent of PSE&G, will merge with and into Exelon Corporation, the parent of PECO, pursuant to an Agreement and Plan of Merger entered on December 20, 2004.

As explained in the Application, PECO is a jurisdictional utility regulated by the Commission that provides electric and gas service in southeastern Pennsylvania as a “public utility,” a “natural gas distribution company” and an “electric distribution company” as respectively defined by Sections 102, 2202 and 2803 of the Public Utility Code (Code), 66 Pa.C.S. §§ 102, 2202 and 2803.

Pursuant to Commission Order entered June 22, 2000, at Docket No. A-00110550F0147, PECO became a wholly-owned subsidiary of Exelon, and Unicom (the parent of Commonwealth Edison Company, or ComEd) was merged with and into Exelon. Both PECO and ComEd are second-tier subsidiaries of Exelon through their immediate parent, Exelon Energy Delivery Company.

PSE&G is a New Jersey corporation that provides electric and natural gas service in New Jersey, in a corridor that runs diagonally across the state, including its six largest cities. As a consequence of its fractional ownership interest in an electric transmission line that runs from the Conemaugh Generating Station to the Maryland border, PSE&G holds a certificate of public convenience, issued on April 24, 1986 at Docket No. 94234, but it is not authorized to serve any customers in Pennsylvania.

PSEG is the parent of PSE&G. It has four principal first-tier subsidiaries: (1) PSE&G; (2) PSEG Power LLC (a wholesale energy supply company that operates through three principal subsidiaries: PSEG Nuclear LLC, PSEG Fossil LLC and PSEG Energy Resources & Trade LLC); (3) PSEG Energy Holding LLC; and (4) PSEG Services Corporation.

Under the terms of the merger, each PSEG shareholder will be entitled to receive 1.225 shares of Exelon common stock for each PSEG share held, with cash paid in lieu of any fractional shares. Exelon will be the surviving company and will remain the corporate parent of PECO and all other current Exelon subsidiaries and will become the ultimate corporate parent of PSEG and all other PSEG subsidiaries.

Mr. John W. Rowe, the current Chairman, Chief Executive Officer and President of Exelon, will serve as Chief Executive Officer and President of EEG following the merger. Mr. James E. Ferland, the current Chairman, Chief Executive Officer and President of PSEG, will become the non-executive Chairman of the EEG

Board of Directors after the merger and will serve in that capacity until March 31, 2007, unless he leaves the board sooner. When Mr. Ferland's tenure ends, EEG's Chief Executive Officer will be appointed Chairman. Mr. Dennis P. O'Brien, the current President of PECO, will remain in that position and will continue to be responsible for PECO's day-to day operations.

III. LEGAL STANDARD OF REVIEW

We note that any issue or Exception, which we do not specifically address herein, has been duly considered and will be denied without further discussion. It is well settled that we are not required to consider expressly or at length each contention or argument raised by the parties. *Wheeling & Lake Erie Railway Co. v. Pa. PUC*, 778 A.2d 785, 794 (Pa. Cmwlth. 2001), also see, generally, *University of Pennsylvania v. Pa. PUC*, 485 A.2d 1217 (Pa. Cmwlth. 1984).

Section 332(a) of the Public Utility Code (Code), 66 Pa. C.S. § 332(a), provides that the party seeking a rule or order from the Commission has the burden of proof in that proceeding. It is axiomatic that "[a] litigant's burden of proof before administrative tribunals as well as before most civil proceedings is satisfied by establishing a preponderance of evidence which is substantial and legally credible." *Samuel J. Lansberry, Inc. v. Pa. PUC*, 578 A.2d 600, 602 (Pa. Cmwlth. 1990).

Section 1102(a) of the Code requires that the Commission issue a certificate of public convenience as a legal prerequisite to offering or abandoning public utility service. Public utilities also must seek Commission approval prior to transferring certain property. The statute provides, in pertinent part:

Upon 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 affiliated interest of a public utility as defined in section 2101 . . . to acquire from, or transfer to, any person or corporation . . . by any method or device whatsoever, including the sale or transfer of stock, 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

66 Pa.C.S. § 1102(a)(3).

In *City of York v. Pa. PUC*, 449 Pa. 136, 295 A.2d 825 (Pa. 1972), the Pennsylvania Supreme Court provided the legal standard for consideration in public utility mergers. In *City of York*, 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, 449 Pa. 136, 141, 295 A.2d 825, 828 (1972).

“In 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 (June 20, 2001). Section 1103(a) of the Code provides in part:

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. The commission, in granting such certificate, may impose such conditions as it may deem to be just and reasonable.

66 Pa. C.S. § 1103(a).

Pursuant to 66 Pa. C.S. § 2811(a), the Commission generally has responsibility for “monitor[ing] the market for the supply and distribution of electricity to retail customers and tak[ing] steps as set forth in this section to prevent anticompetitive or discriminatory conduct and the unlawful exercise of market power.” With regard to electric utility mergers, 66 Pa. C.S. § 2811(e)(1) specifically requires the Commission to:

consider whether a 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 electricity market.

The Commission must also consider whether the proposed merger is likely to result in anticompetitive or discriminatory conduct, including the unlawful exercise of market power, which would prevent retail gas customers from obtaining the benefits of a properly functioning and effectively competitive retail natural gas market. 66 Pa. C.S. § 2210(a)(1). Furthermore, the Commission must consider the effect of the proposed merger on the employees of the natural gas distribution company or any other authorized collective bargaining agent representing those employees. 66 Pa. C.S. § 2210(a)(2). The Commission is also authorized to impose necessary terms and conditions to preserve the benefits of the properly functioning and effectively competitive retail natural gas market. 66 Pa. C.S. § 2210(b).

IV. MAJOR TERMS AND CONDITIONS OF THE JOINT PETITION FOR SETTLEMENT

The Joint Petition for Settlement contains the settlement terms and conditions. Appendix A attached to it contains the distribution tariffs and proof of revenue. While we will not repeat each and every term and condition contained in the Joint Petition (*see*, Joint Petition at ¶¶14-61), we have summarized the major terms and conditions below:

A. Rate Reductions/Rate Cap Protections

PECO agreed to reduce its retail electric distribution rates by \$120 million over a four year period. The rate reductions will commence approximately one month after consummation of the merger and will remain in effect for four years. In the first two years, rates will be reduced by \$40 million each year from the levels that would otherwise be in effect pursuant to the Commission's June 22, 2000 Order approving the 2000 Unicom Merger Settlement and in the December 19, 2002 Order approving the roll-in to base rates of the Revenue Neutral Reconciliation Gross Receipts Tax. In the next two years, rates will be reduced by \$20 million in each year. (Joint Petition at ¶14). In addition to the rate reductions, PECO agreed to an extension of its transmission, distribution and generation rate caps through December 31, 2010, subject to certain exceptions. (Joint Petition at ¶¶15-17). PECO agreed to amortize the costs and expenses of achieving the merger during this extended rate cap period, so that the costs will not be deferred or claimed in a subsequent base rate case. (Joint Petition at ¶18).

B. Recovery of Nuclear Costs

The Joint Petition confirms PECO's commitment made in the 2000 Unicom Merger Settlement, and in its testimony here, that PECO's ratepayers will only be

responsible for nuclear costs, including nuclear decommissioning costs that are associated with the ownership and operation of nuclear plants that PECO held on December 31, 1999 (Pre-Existing Nuclear Interests). (Joint Petition at ¶19).

C. Reliability and Customer Service

PECO agreed to a Quality of Service Plan (Service Plan) designed to maintain or improve reliability and customer service provided by PECO over the levels committed to in the 2000 Unicom Merger Settlement. In the 2000 Unicom Merger Settlement, PECO agreed to a Quality of Service Plan that was set to expire at the end of 2005.

PECO agreed to extend its reliability and customer service commitments through a new Service Plan. (Joint Petition at ¶¶20-32). In the Service Plan, PECO agreed to performance thresholds in eight areas that are important to providing safe and reliable service and reasonable customer service. The Joint Petition also provides that the Service Plan metrics and thresholds are a part of the annual performance appraisal and compensation for certain managerial and supervisory employees. (Joint Petition at ¶21).

Additionally, PECO agreed to a number of reporting requirements that will assist the Commission and the parties in monitoring many aspects of the provision of reliable service, as well as quality customer service, each year. (Joint Petition at ¶¶22, 24, 25). As to reliability, PECO will continue to report on its efforts to improve reliability of its five worst-performing circuits each year, its storm management efforts for major storms, its efforts to reduce repeat outages experienced by customers, and its SAIDI (System Average Interruption Duration Index) and MAIFI (Momentary Average Interruption Frequency Index) statistics. As to customer service, PECO will continue to report on the number of residential customer disputes not issued a company report in thirty days, its justified consumer complaint rate, its PUC Infraction Rate, the number of

residential bills not rendered each month, the number of residential meters not read every month, and its customer satisfaction survey results.

The Joint Petition also provides a process for addressing any performance failures or non-compliance with the Service Plan. All parties also retain their rights to pursue complaints for other failures not measured by the Service Plan, or to respond to individual or community complaints. PECO also agreed that the Joint Petition does not limit or eliminate its responsibility to address reliability and customer service problems in its service territory and that it does not limit the authority of the Commission or any of its bureaus. (Joint Petition at ¶¶25-30).

Finally, the Joint Petition sets forth a process to be followed by PECO in informing the Commission and interested parties about its impending billing system conversion. PECO agreed that if customers are subject to billing errors or billing delays associated with the implementation of the new billing system, customers will be given an opportunity for an affordable payment arrangement without regard to the limitations contained in Chapter 14 of the Public Utility Code. (Joint Petition at ¶ 32).

D. Universal Service

PECO made a number of significant commitments that will enhance its universal service programs as well as the operation of those programs. (Joint Petition at ¶¶33-37). PECO has for many years operated a Customer Assistance Program (CAP) through which it provided discounted rates to customers who were low income. As a result of the 2000 Unicom Merger Settlement, PECO entered into negotiations with the interested parties and agreed to the addition of a Special Needs Component to its CAP program to try to make bills more affordable for those customers at the very lowest levels of poverty. PECO agreed to increase the amount of kilowatt-hour usage that is subject to the discounted rate for all CAP Rate participants. For CAP Rates B (85% discount), C

(75% discount), D (50% discount) and E (25% discount), PECO will increase the monthly usage levels eligible for the discount from 500 kwh to 650 kwh effective January 1, 2007.

PECO also agreed to increased efforts to reach customers most in need and to efficiently certify customers eligible for participation. PECO agreed to increase its own efforts and spending on outreach and education. PECO will spend an additional \$1.2 million over the next four years on its outreach and education efforts. PECO also agrees to provide funding to local community-based organizations in the amount of \$100,000 per year for four years to assist PECO in better identifying and reaching eligible households. PECO reaffirmed its commitment to work with its Advisory Committee in soliciting input in these endeavors, and specific procedures have been put in place to ensure that this process works efficiently.

In addition to its own efforts to enhance its universal service programs, PECO agreed to provide additional funding through its Matching Energy Assistance Fund (MEAF) from 2007 through 2010 to be used by the county agencies in assisting PECO customers. PECO will provide \$500,000 in additional energy assistance each year to the county fuel fund agencies beyond its current matching of contributions and reimbursement of administrative costs for those agencies. Over the four years, this will provide an additional \$2 million to assist PECO customers with their energy needs. PECO also agreed to restore the monthly bill check-off box option for MEAF contribution on customer bills when it implements its new customer billing and information system, and to provide for MEAF contributions from electronic bill payment customers, if technically feasible and not substantially uneconomical, and to provide bill inserts on MEAF on a regular basis so that customers are fully informed about the program and how to make contributions.

E. Environmental Provisions/Economic Development

PECO agreed to provide funding for renewable power and energy efficiency initiatives. PECO will provide a total of \$12 million to the Pennsylvania Energy Development Authority (PEDA) (\$3 million each year in 2007, 2008, 2009, 2010) to be used for the purpose of funding renewable energy, energy efficiency and energy conservation projects with emphasis on energy conservation projects of benefit to the PECO service territory. Of the \$12 million, a total of \$500,000 (\$125,000 each year in 2007, 2008, 2009, 2010) will be set aside, subject to approval of PEDA's board of directors, for PEDA qualified Low Income Usage Reduction Programs (LIURP) in PECO's service territory.

In addition to these amounts, PECO will provide a total of \$8 million to PEDA (\$2 million each year in 2007, 2008, 2009, 2010) to be used for energy-related economic development projects and initiatives of benefit to PECO's service territory. PECO also agreed to continuation of funding of the Sustainable Development Fund (SDF). PECO will provide \$7.2 million in a lump sum within three months of the consummation of the merger to be used for projects in accordance with the goals and by-laws of the SDF. (Joint Petition at ¶¶38, 52).

F. Corporate Structure Protections

As in the 2000 Unicom Merger Settlement, PECO agreed to a number of corporate protections to ensure that PECO customers will be protected from the risks of affiliated businesses not regulated by the Commission. In addition, the corporate protections provide for accounting and pricing protocols and ensure that the Commission and interested parties have reasonable access to books, records and personnel of affiliates so as to perform regulatory oversight functions. The Joint Petition also provides for

advanced notice of certain dividend payments and transfers of funds so that the interested parties can properly monitor any changes. (Joint Petition at ¶¶40-48).

G. Corporate and Community Presence

PECO committed to maintaining its corporate headquarters for its distribution business in Philadelphia through at least December 31, 2010. PECO also agreed to continue its charitable giving and sponsorships at least at its historic level of \$3 million per year each year from 2007 through 2010. (Joint Petition at ¶¶49, 50).

H. Staffing

PECO agreed that for many of the key workforce positions that affect reliability and customer service, PECO will not reduce forces prior to January 1, 2011, and that it will reduce certain workforce positions as a result of the merger by no more than the number of reductions identified as part of this merger proceeding. (Joint Petition at ¶51).

I. Competitive Electric Markets

PECO agreed to certain reporting requirements from 2007 through 2012 so that the Commission and the Parties can better monitor the PJM wholesale markets, and to support the ability of Default Service Providers to offer fixed-price retail service to large customers for at least a 12-month term in the Commission's Default Service Provider rulemaking proceeding at Docket No. L-00040169. While the Joint Petitioners have agreed to no longer pursue market power issues in this proceeding as part of this comprehensive settlement, the Joint Petitioners retain their rights to participate in the proceeding at the Federal Energy Regulatory Commission (FERC) regarding appropriate mitigation plans. Additionally, the Joint Petition does not impact the right of non-

signatory parties to continue to litigate matters related to market power at the Pennsylvania Commission. (Joint Petition at ¶¶52-54).

J. Consolidation of Natural Gas Operations

The Joint Petitioners recognized that the Commission may initiate a separate fact-finding investigation after the consummation of the merger to examine the issues related to the consolidation of PGW operations into the natural gas business of Exelon. PECO agreed to fully cooperate in that investigation. (Joint Petition at ¶55).

In addition to the specific terms described above, the settlement contains general provisions, such as the effectiveness of the settlement, the statement of resolution of issues, participation by interveners in other actions, and the precedential value of the settlement.

V. ALJ RECOMMENDATION

The ALJ recommended approval of the Joint Application, as modified by the Joint Petition. In addition, the ALJ recommended that the merger be further conditioned on the Joint Applicants agreeing to any additional market power mitigation steps directed by the FERC in a final, unappealed Order arising out of the FERC proceeding.

VI. DISPOSITION OF EXCEPTIONS

We reiterate that any issue or Exception, which we do not specifically address herein, has been duly considered and will be denied without further discussion. It is well settled that we are not required to consider expressly or at length each contention or argument raised by the parties. *Wheeling & Lake Erie Railway Co. v. Pa. PUC*, 778

A.2d 785, 794 (Pa. Cmwlth. 2001), also *see, generally, University of Pennsylvania v. Pa. PUC*, 485 A.2d 1217 (Pa. Cmwlth. 1984). We also note that we will adopt each of the findings and conclusions of the ALJ unless expressly or by necessary implication a finding or conclusion has been rejected or modified by this Opinion and Order.

A. Burden of Proof Issues

PPL excepts to the Initial Decision, arguing that the ALJ improperly placed the burden of proving whether the proposed merger would result in anticompetitive or discriminatory conduct on the intervening Parties, instead of on the Joint Applicants. (PPL Exc. at 13-15). PPL points to the following language in the Initial Decision to support its argument:

As correctly noted by joint applicants in their Main Brief at 17-18, no party asserted or presented evidence that the proposed merger is likely to directly increase the joint applicants market power in any competitive retail market in Pennsylvania. PECO's retail electric and gas operations are limited to Pennsylvania, while PSE&G's retail and electric gas operations are in New Jersey. PECO Exh. WHH-1 at Exh. J-1, pp. 19-22. No competitor will be eliminated as a result of the proposed merger because "Exelon's retail marketing affiliate is not active in PJM East while PSE&G does not even engage in competitive retail marketing." Joint Applicants Main Brief at 18.

(I.D. at 41).

The City, in its Exceptions, takes issue with the ALJ's decision not to address the Applicants' failure to present any evidence (to meet their burden of proof) vis-à-vis the proposed merger's impact on retail competition. (City Exc. at 4-7).

PECO replies that the Initial Decision applied the correct legal standards to the market power issues. (PECO R. Exc. at 3). PECO notes that the Joint Applicants

submitted evidence that the merger would not have any direct impact on retail markets in Pennsylvania given that: (1) the Joint Applicants are located in different states; (2) Exelon does not market in PJM East; and (3) PSEG does not engage in retail marketing at all. (*Id.*).

ALJ Chesnut stated that, “[t]o be found to be in the public interest, the joint applicants must demonstrate by a preponderance of the evidence that the merger will ‘affirmatively promote the service, accommodation, convenience or safety of the public in some substantial way’.” (I.D. at 11). The ALJ continued, “[t]he Commission must review the merger to determine if it is in the public interest, provides substantial, affirmative benefits, and is not likely to result in anticompetitive or discriminatory conduct or the unlawful exercise of market power in the retail electric and natural gas markets.” (I.D. at 12).

We have carefully considered the ALJ’s remark that no Party presented evidence that the proposed merger is likely to directly increase the Joint Applicants’ market power in any competitive retail market in Pennsylvania. We are unable to discern how this could be seen as an attempt to shift the burden of proof in this proceeding from the Joint Applicants to the Intervenors, especially given the ALJ’s thorough explanation of the legal standards, including the burden of proof, to be applied in reviewing the matter. (I.D. at 8-12). The ALJ considered the Joint Applicants’ position that the merger would not increase their market power in Pennsylvania. Moreover, the record supports the ALJ’s statement that no Party rebutted the facts that (1) the Joint Applicants are located in different states; (2) Exelon does not engage in retail marketing in PJM East; and (3) PSEG does not engage in retail marketing. PPL and the City’s Exceptions regarding the ALJ shifting the burden of proof are without merit and will be denied.

B. Asserted Public Benefits Issues

- 1. City Exception 2: The ALJ Erred in Finding that the Merger, as Modified by the Joint Petition, is in the Public Interest and that the Commission Should Approve it Without Modification.**

PGW Exception 2: The Joint Petition for Settlement does not Adequately Protect the Public and the Commission Should not Approve it.

- a. Positions of the Parties**

As noted above, the Joint Petition provides for \$120 million in electric rate reductions over four years for the benefit of PECO's ratepayers and extends the rate caps on PECO's transmission and distribution (T&D) charges until January 1, 2011. PECO has also agreed to amortize the expenses of achieving the merger, thereby protecting PECO's ratepayers from having to bear these costs in future rate cases. (Joint Petition at ¶¶14-18). According to the OCA, these provisions provide a reasonable and appropriate level of merger savings for PECO ratepayers. (OCA M.B. at 9).

The Joint Applicants further agreed to a comprehensive and detailed Quality of Service Plan to maintain or improve reliability and customer service provided by PECO over the levels committed to in the 2000 Unicom Merger Settlement. Additionally, the Settlement provides that the performance thresholds will be included as part of the annual performance appraisal and compensation for applicable managerial and supervisory employees. The Joint Petition also contains provisions relating to corporate structure protections, the maintenance of PECO's headquarters in Philadelphia through at least December 31, 2010, and PECO's agreement to fund charitable giving and sponsorship at a level of at least \$3 million per year in each of the years 2007 through 2010. With regard to staffing, PECO agreed not to make any reductions in field forces levels prior to January 1, 2011. (Joint Petition at ¶¶20-32).

Universal service and customer service issues are a significant aspect of the Settlement. The Settlement is designed to improve on PECO's existing universal service programs by enhancing PECO's CAP Rate Program with a higher usage discount level and more customer-friendly payment agreement practices by providing for additional funds to and promotion of the MEAF, by expanding CAP enrollment outreach, by providing outreach funding to community based organizations that serve low-income utility customers, by streamlining the CAP application and recertification process, and by providing additional training to community organizations about PECO's low-income programs. (Joint Petition at ¶¶33-37).

The Settlement contains a number of provisions relating to economic development. PECO agreed to provide a total of \$8 million to PEDDA (\$2 million each year for the years 2007, 2008, 2009 and 2010) to be used for energy-related economic development projects and initiatives of benefit to PECO's service territory. In addition, PECO agreed to continue funding the SDF by providing \$7.2 million in a lump sum within three months of the consummation of the merger to be used for projects in accordance with the goals and by-laws of the SDF. (Joint Petition at ¶¶38, 52).

The Settlement also ensures that the provisions of the 2000 Unicom merger settlement for sharing the risk of future increases in the costs of decommissioning PECO's pre-existing nuclear units will remain in effect and reaffirms PECO's commitment not to seek recovery of decommissioning costs associated with any nuclear units it did not own as of December 31, 1999. (Joint Petition at ¶ 19). This ensures that costs from the PSEG plants will not be charged to PECO's ratepayers, and that no portion of PECO ratepayer-supplied funding of PECO Pre-Existing Nuclear Interests will be diverted to pay costs associated with acquired plants.

Additionally, the Settlement provides important environmental initiatives, as PECO also agreed to contribute \$12 million (\$3 million per year in 2007, 2008, 2009 and 2010) to PEDA to be used for the purpose of funding renewable energy, energy efficiency, and energy conservation projects with the emphasis on energy conservation projects of benefit to the PECO Service territory. Of the \$12 million, \$500,000 (\$125,000 per year in each year 2007, 2008, 2009 and 2010) will be set aside for funding PEDA-qualified LIURP projects in PECO's service territory. PECO has also agreed to provide \$7.2 million in a lump sum payment to the SDF, which finances projects that promote renewable energy and energy efficiency. (Joint Petition at ¶38).

Finally, PECO agreed to support, in the Commission's Default Service Provider rulemaking proceeding at Docket No. L-0040169, the ability of default service providers to offer, as part of the procurement of power through wholesale auctions, fixed-price retail service to large customers (i.e., those with demand of 1000 KW or greater) for at least a 12-month term. (Joint Petition at ¶54).

The City contended that the rate concessions are not substantial because the duration of the rate reductions is only four years and the duration of the rate caps is only five years. According to the City, these benefits are only short-term benefits that do not outweigh the long-term detriments of the merger. The City opined that in order to find net public benefit, the Commission must ensure that PECO ratepayers are protected beyond 2010, when rate decreases, rate caps and most customer service initiatives will expire under the Joint Petition. (City M.B. at 13). The City further maintained that the Quality of Service commitments do not confer a substantial public benefit because they do not extend beyond what the Public Utility Code already requires and that there are no corresponding enforcement mechanisms. (City M.B. at 16-18).

Also, the City contended that the corporate, community and charitable provisions of the settlement fail to provide any substantive benefits to ratepayers over the

status quo. The City opined that the Commission should require PECO to increase its charitable giving to \$8 million per year for at least five additional years through 2014, maintain its headquarters in Philadelphia through 2014, and maintain minimum staffing levels post-deregulation. (City M.B. at 23-29).

In regard to the universal service provisions, the City claimed that they do not constitute substantial benefits because they expire in 2010. The City opined that in order to ensure that the Joint Petition provides adequate benefit to ratepayers, the Commission must require that the low-income provisions be revised to expand the benefits beyond 2010. (City M.B. at 14-15).

The City further asserted that the economic development commitments within the Settlement do not directly benefit PECO's ratepayers because the majority of these funds may potentially flow to entities outside of the PECO service territory. The City opined that the Commission should instead require a set-aside of energy via the virtual divestiture to provide economic development for the City and others within the service territory. (City M.B. at 14-15).

b. ALJ's Recommendation

The ALJ recommended that the proposed merger as described in the Merger Agreement and the Joint Application and subject to the terms and conditions of the Settlement will affirmatively promote the service, accommodation, convenience, or safety of the public in a substantial way and should be approved by the Commission without modification. The ALJ stated that there can be no doubt that the terms and conditions agreed to be the Joint Applicants and the other settling parties will produce substantial affirmative benefits, as required by the *City of York* standard, for PECO's customers, the economy of PECO's service territory and the Commonwealth generally. (I.D. at 20-23).

As a result, the ALJ recommended that each of the City's positions be rejected. The ALJ stated that while the City's concerns may reasonably reflect the specific interest of the City, they do not provide any basis for the Commission to disapprove or modify the proposed transaction as reflected in the Settlement. The ALJ noted that there can be no question that the Settlement contains a number of terms that provide significant benefit to the City and the fact that the City thinks they are insufficient does not lead to the conclusion that the Settlement is not in the public interest. (I.D. at 20-36).

c. Exceptions and Replies

The City excepts to the ALJ's recommendation and states that the public interest is not served merely because a number of Parties have agreed to compromise their positions in order to avoid litigation. The City maintains that the Commission cannot approve a merger unless the merger would convey substantial public benefits overall, and if the Joint Applicants cannot prove this, then the Commission may impose conditions on the merger approval in order to ensure that the proposed merger is in the public interest. The City opines that the merger initially presented no benefits whatsoever to ratepayers and the concessions brought under the Settlement are minor, short-term and are only slightly more beneficial than the initial proposal. (City Exc. at 7-8).

The City states that, with respect to these issues, it is the bearer of the public interest and it is the City's opinion that, to advance the public interest adequately, the terms of any merger should require PECO to provide substantial and long-term benefits. As an example, the City requests that PECO increase its charitable giving to \$8 million for at least five years, maintain its corporate headquarters in Philadelphia through 2014, and implement concrete commitments regarding staffing levels irrespective of whether changes can be proven to be merger-related. (City Exc. at 7-9).

The City also excepts to the ALJ's recommendation because the ALJ fails to recognize that the short-term rate protections within the Joint Petition do not meet the level of substantial public benefit when weighed against the overall detriments of the merger. According to the City, the Parties to the Settlement were willing to sacrifice any potential long-term benefits for short-term gain that will do little to offset the harm that ratepayers may later experience due to the merger. The City notes that under the Settlement, PECO would reduce its retail electric distribution rates by about \$1.26 per month for the average 700-kilowatt-hour-per-month customer for two years and then by about \$0.63 a month for two more years. In the City's opinion, this decrease pales in comparison to the \$500 million in gross savings that the newly merged entity would achieve prior to 2010. (City Exc. at 11-12).

In reference to the T&D rate cap extension, the City notes that because the majority of the costs to achieve the merger would have been incurred prior to 2009, the Joint Applicants will enjoy the full benefits of the merger at the exact time that PECO ratepayers are subject to uncertain market prices for generation service and increases to T&D rates. The City opines that while the Code does not extend the rate caps beyond the transition period, neither does the Code prohibit a utility from capping its rates voluntarily. The City contends that it is not suggesting an "indefinite" extension of the cap, but rather, a prescribed extension for an additional period until customers have had an opportunity to transition to the competitive market. Contrary to the ALJ's claim, the City notes that considering the significant benefits the Joint Applicants and their shareholders will reap from the merger, there is no substantial evidence that requiring an additional extension of the rate caps could "seriously harm" PECO's financial health. The City requests that to avoid shortsighted judgment, the Commission should not approve the merger without requiring PECO to implement rate protections that truly protect customers from the harm the merger may cause post-2010. (City Exc. at 12-14).

PGW excepts to the ALJ's recommendation because the analysis presented by the ALJ in support of the Joint Petition focuses entirely on the benefits, which PGW believes are shallow and short-term in nature, without any analysis of the potential long-term detriments that will occur. PGW opines that this is inconsistent with applicable precedent as the Commission is required to measure the benefits and the detriments of the proposed merger. *Middletown Township v. Pa. PUC*, 482 A.2d 674, 682 (Pa. Cmwlth. 1984). PGW maintains that the Commission must expand its analysis of the proposed merger and consider the potential detriments resulting from the merger. (PGW Exc. at 31-33).

PGW states that nominal rate reductions, contributions to various organizations and reporting of wholesale prices are not substantial affirmative public benefits sufficient to support the proposed merger. PGW maintains that the Settlement offers the typical residential customer a rate reduction of just \$1.26 per month for two years, and just \$0.63 per month for an additional two years which are inconsequential and of no real benefit to the public. PGW claims that such rate reductions will have no substantial impact on the ability of struggling Philadelphia customers to better afford their monthly living expenses. (PGW Exc. at 33).

In reply, the Joint Applicants state that, while they do not question the City's interest in this proceeding, the City seriously misconstrues relevant Commission and appellate court precedent by assuming that *City of York's* affirmative benefit test requires the Commission to find that a proposed merger provide individualized benefits to each allegedly affected party. The Joint Applicants note that in *Middletown Township*, the Commonwealth Court, in addressing the standards for Commission approval of an acquisition, held:

Further, when the "public interest" is considered, it is contemplated that the benefits and detriments of the acquisition be measured as they impact on *all affected parties*, and not merely on one particular group or geographic

subdivision as might have occurred in this case. (Emphasis in original).

(Joint Applicants R.Exc. at 21-22).

The Joint Applicants also note that the Commission has held that once a merger is determined to produce overall substantial, affirmative public benefits, there is no basis for attaching conditions to its approval in order to assure specific benefits to particular parties. *Joint Application of Pennsylvania-American Water Company and Thames Water Aqua Holding*, 2002 Pa. PUC LEXIS 32 (2002). (Joint Applicants R.Exc. at 22).

The Joint Applicants also note PGW's assertion that the claimed benefits of the merger are insufficient, but states that PGW does nothing to develop this argument other than to restate concerns over the "potential detriments" of Joint Applicants' alleged market power. (Joint Applicants R.Exc. at 22).

The Joint Applicants maintain that the benefits of the Joint Petition are real and tangible, contrary to the assertions of the City and PGW. They cite to \$120 million of rate relief, rate stability for an additional four years, an enforceable Quality of Service Plan with specific performance metrics, a significant expansion of universal service coverage, and substantial funding of environmental, energy efficiency and economic development initiatives among the many benefits of the Joint Petition. The Joint Applicants opine that the concessions to which they have agreed guarantee benefits far in excess of those the Commission has deemed sufficient to warrant its approval of other utility mergers. (Joint Applicants R.Exc. at 23).

The OCA, in its replies, states that these challenges to the Settlement fail to demonstrate that the merger, as conditioned by the Settlement, should not be approved. OCA opines that the Settlement reaches a fair balance of a wide array of interests, is

supported by diverse parties, and meets the substantial affirmative benefit standard articulated by the Pennsylvania Supreme Court in the *City of York* case. The OCA further submits that the fact that the Joint Petition was forged through compromise by a diverse array of Parties is a strength of the Settlement, not a flaw. OCA contends that the provisions of the Settlement that the City challenges are fully supported by the record and provide substantial benefits to ratepayers, the community and employees. (OCA R.Exc. at 3-9).

The OSBA states in its reply that compromise is the essence of any settlement and that this Settlement provides many benefits that are in the public interest. The OSBA contends that the totality of the Settlement results in a proposed merger that meets the “affirmative benefit” test under the *City of York* case and should be approved. The OSBA states that the Settlement provides \$120 million in rate reductions over four years in addition to \$43.6 million in other quantifiable ratepayer benefits for a total of \$163.6 million of concrete benefits, in addition to the unquantifiable benefit of rate cap extensions, all of which are legally enforceable. The OSBA opines that the City refuses to recognize the considerable benefits provided by the Settlement because the City believes that it should have received more from PECO in the way of contributions and commitments. The OSBA contends that the benefits, which might not have materialized if the merger were litigated, provide affirmative public benefit and should be approved. (OSBA R.Exc. at 12-19).

d. Disposition

Based upon the evidence of record, the Exceptions of the City and PGW shall be denied. We agree with the recommendation of the ALJ that the Joint Petition for Settlement will produce substantial affirmative benefits for PECO’s customers and the economy of PECO’s service territory and therefore, the proposed merger as modified by the Joint Settlement meets the *City of York* standard. In addition to \$120 million of

electric rate reductions provided within the Settlement, the Settlement includes: caps on PECO's T&D charges until January 1, 2011; a Quality of Service Plan designed to require PECO to improve reliability; specific commitments to the City to maintain its corporate presence and charitable giving; specific commitments to PECO's employees that provide workforce protections; extensive improvements to PECO's universal service and customer assistance programs; a contribution of \$8 million over four years to PEDDA to be used for energy-related economic development projects; a contribution of a lump sum of \$7.2 million to continue funding the SDF; protections for PECO's customers with respect to decommissioning costs; and a contribution of \$12 million over four years to PEDDA to be used for funding renewable energy and energy conservation projects.

The Commission finds that these provisions of the Settlement, taken as a whole, provide substantial, affirmative public benefits and are in the public interest. We are particularly impressed that this Settlement is supported by a wide range of distinct interests that includes the Commission's OTS, representatives of the residential, commercial and industrial classes, the Commonwealth of Pennsylvania (through DEP), advocacy groups for low-income customers and senior citizens, as well as organizations dedicated to environmental protection and community and economic development, and is not opposed by the Labor Parties.

The Commission also finds it significant that only the City and PGW argue that the benefits provided within this Settlement are not substantial. However, analysis of each of their positions reveals that they are without merit and should be denied. The City's position that the rate concessions are not long enough is rejected because none of the settling parties testified in favor of capping rates after 2010 as this would be counter to the goals of the Competition Act. The City's position that the reliability commitments do not confer a substantial public benefit is rejected as the performance thresholds established by the Service Plan are considerably more stringent than the standards that would otherwise apply to PECO. The City's request that PECO be required to maintain

its corporate headquarters in Philadelphia through 2014 is rejected as this is improper and would unreasonably restrict the flexibility PECO needs to operate its business efficiently and could interfere with PECO's obligation to provide adequate and reasonable service.

Additionally, the City's position that the Commission should direct PECO to increase its charitable giving is rejected as it is important to note that PECO is currently under no such commitment to make any charitable contributions, therefore, a commitment to give at least \$12 million over a four-year period represents a substantial, guaranteed public benefit. The City's position with regard to minimum staffing levels to be maintained by PECO is rejected as this is inconsistent with the interest of PECO's customers as a whole and would eliminate one of the advantages of the proposed merger to eliminate unnecessary and duplicative positions. Similarly, the positions of PGW are without merit and are also rejected.

C. Market Power Issues

1. Relevance of FERC Decision

The potential impact of the proposed merger on the wholesale electricity market was examined by the FERC in *Exelon Corp.*, 112 FERC ¶61,022, Order Authorizing Merger under Section 203 of the Federal Power Act, issued July 1, 2005 (Merger Order). The FERC recently reaffirmed its Merger Order subsequent to the issuance of the Initial Decision in this proceeding in *Exelon Corp.*, 113 FERC ¶61,299 (2005) (Rehearing Order). In the Initial Decision, the ALJ recommended that the Commission "come to the same conclusion as did FERC concerning market power

issues.” (I.D. at 47). In PPL’s Exception No. 2 and PGW’s Exception No. 1, these two Parties claim error in the ALJ’s reliance on the Merger Order.³

a. Positions of the Parties

At various points in PPL’s arguments, PPL asserted that the Merger Order could not be relied upon in this proceeding. PPL argued that FERC’s Merger Order was inadequate because it was “made without the benefit of full discovery and an evidentiary hearing – is inadequate due to factual issues that remain unresolved.” (Kalt Surrebuttal Testimony at 2; PPL M.B. at 11-12, 14). PPL also argued that the Merger Order was not final, subject to several Petitions for Rehearing and was otherwise flawed. (PPL M.B. at 15).

PGW similarly argued that the FERC Merger Order was not final. Also, PGW asserted that this Commission must decide this proceeding under Pennsylvania standards. Finally, PGW argued that the Merger Order failed to consider the testimony of PGW’s witness filed in that proceeding. (PGW R.B. at 9).

b. ALJ’s Recommendation

In the ALJ’s discussion of market power issues generally, and the standards to be applied in this case, she presented a thorough analysis of the issues before her and the standards to be applied. She noted that two provisions of the Code apply here: Sections 2811(e)(1) and 2210(a)(1), 66 Pa. C.S. §§ 2811(e)(1) and 2210(a)(1). She then discussed the specific methodology which the Commission uses in analyzing market power issues and, citing *Re DQE, Inc.*, 186 PUR4th 39 (1998), determined that the

³ As noted by the ALJ, each of the Parties herein that addresses market power issues (PPL, First Energy, PGW and the City of Philadelphia) were also party to the FERC proceeding. (I.D. at 44, n. 16).

Commission had adopted the FERC merger guidelines which incorporate a series of screens. Those screens use concentration statistics based on the Herfindahl-Hirshman Index (HHI).⁴ (I.D. at 38-39).

The ALJ described the HHI screens as follows:

An HHI below 1,000 is considered unconcentrated and will have no adverse competitive effect. An HHI between 1,000 and 1,800 is considered moderately concentrated and if the HHI increases 100 or more points from the pre-merger level, there may be competitive concerns depending on other competitive factors. An HHI above 1,800 is considered highly concentrated, and the merger guidelines provide that mergers in this range producing an increase in the HHI of more than 50 points raise significant competitive concern and further presumes that mergers producing an increase of more than 100 points are “likely to create or enhance market power or facilitates its exercise.” *DQE, id.*, citing 57 Fed. Reg. at 41, 558.

(I.D. at 39).

The ALJ then noted that the focus of the market power evidence before her involved the “wholesale electric and natural gas markets, which will indirectly affect retail markets.” (I.D. at 43). The ALJ found that FERC has exclusive jurisdiction over the wholesale electric and natural gas markets and that FERC had determined that the proposed merger, with the mitigation measures proposed in the FERC proceeding, would not adversely impact competition in the wholesale market. (*Id.* citing the Merger Order at ¶10). The ALJ agreed with the FERC that the merger passed the HHI screens when the

⁴ An HHI is computed by squaring each market share and then adding the squared shares. For example, a market consisting of four firms with market shares of 30%, 30%, 20% and 20% has a HHI of 2,600 (900 + 900 + 400 + 400). The HHI approaches zero if there are a large number of very small competitors and equals 10,000 if there is just one firm in the market. *DQE*, fn. 4.

proposed mitigation proposal was considered. (I.D. at 47). The ALJ noted that this Commission is not bound by the Merger Order and stated:

While the Commission is not bound by any decision issued by FERC, it is appropriate for the Commission to recognize that FERC in fact is the agency that developed and has applied the market screen analysis [adopted by this Commission in *Re DQE, Inc.*] in numerous merger proceedings. As stated in Joint Applicants Reply Brief at 22, “It would be especially inappropriate to second-guess FERC here, given that the arguments raised are essentially that the wholesale market analyses performed by the Joint Applicants do not conform to FERC’s merger regulations and merger precedent. The parties raising these arguments in essence are asking the Commission to hold that it is in a better position than FERC to conduct FERC’s own review of the impact of the Merger on wholesale markets.”

(I.D. at 44).

After reviewing the Parties arguments presented to her and referencing the disposition of those same arguments in the Merger Order, the ALJ recommended that the Commission come to the same conclusions as did the FERC. She noted that several parties argued that the FERC reached its decision without hearings, but stated that “the fact remains that FERC is in the best position to determine what record was necessary for it to make its ruling.” (I.D. at 47).

c. Exceptions and Replies

PPL introduces its Exception by noting that the ALJ properly cited to the applicable legal standards, including *Re DQE*. However, PPL then argues that the ALJ relied exclusively on the Merger Order and failed to make detailed findings on specified subjects and failed to base her decision on record evidence. (PPL Exc. at 17). PPL points to four specific flaws in the Merger Order which, according to PPL, render its use inappropriate here. PPL argues that FERC reached its conclusions without discovery or

an evidentiary hearing on many of the issues raised by the parties opposing the merger. PPL also argues that the FERC ignored many of the issues raised by the parties opposing the merger. PPL then asserts that FERC accepted “an unprecedented, untested and highly suspect ‘virtual’ divestiture mitigation scheme that is contrary to this Commission’s standards adopted in *DQE*.” (PPL Exc. at 17).

PGW also argues that the FERC Merger Order was not final at the time of the Initial Decision and will be the subject of further litigation and/or appeal. PGW asserts that the standards used by FERC in the Merger Order are different than those which must be applied under the Public Utility Code, that the FERC record was “dramatically different” than that before this Commission, and that FERC did not consider the testimony of PGW’s witness, Dr. Carpenter, while the record before us does contain that testimony. (PGW Exc. at 5-13).

The Joint Applicants respond that, at this point in time, the Merger Order is final and has been reaffirmed by the FERC in the Rehearing Order. In addition, because this Commission has adopted FERC’s methodology in *Re DQE*, it was entirely appropriate for the ALJ to use the Merger Order as her starting point. The Joint Applicants also note that the Commonwealth Court has referenced a prior FERC merger order with approval in *ARRIPA v. PUC*, 792 A.2d 636 (Pa. Cmwlth. 2002). (Joint Applicants R.Exc. at 6-8).

d. Disposition

We will deny each of these Exceptions. In doing so, we specifically note that PPL’s argument, on Exception at pages 17 through 18, details the potential for harm to retail competition which can occur if market power is exercised *in the wholesale markets*. As found by the ALJ and argued by the Joint Applicants, PPL and PGW have focused solely on market concentrations in the wholesale markets and have used the

FERC HHI screens to support their arguments on these issues. Having found that the issues before her were focused on the wholesale markets, and after noting that this Commission's market power methodology adopted the FERC approach, it was entirely appropriate for the ALJ to reference the Merger Order in her deliberations. Under these circumstances, the ALJ would have been remiss had she failed to at least acknowledge the Merger Order.

We also find that the various arguments ascribing error to the FERC process are unconvincing. These identical arguments were advanced to the FERC in the rehearing proceeding. We will quote the FERC on this point:

The Commission [FERC] has broad discretion regarding when to set matters for hearing. If the Commission can resolve disputed issues based on the written record, then the Commission is not required to establish an evidentiary hearing to address disputed issues of fact. No party has shown why the voluminous written record in this case was inadequate.

Rehearing Order at ¶17.

The FERC also addressed PGW's argument that the testimony of its witness, Dr. Carpenter, was not considered. After noting that the comments were filed very late in the proceeding, the FERC stated that it had reviewed the material and determined that "it did not provide new information that would have assisted the Commission in its decision-making process However, we note that Philadelphia Gas' [PGW] arguments actually duplicated arguments raised by FirstEnergy, NJ Ratepayer Advocate and Pennsylvania Office of Consumer Advocate, among others, and those arguments were addressed." Rehearing Order at ¶33.

Based upon the foregoing, it was appropriate for the ALJ to look to the Merger Order in rendering her decision. It was clearly relevant to the issues before her and before this Commission. We do not find, as argued by PPL and PGW, that the ALJ

relied on the Merger Order without reference to the record before her. However, as noted by the Joint Applicants, many of the arguments and facts before this Commission are identical to those advanced before the FERC. Thus, there is inevitably some overlap. However, that is not to say that the ALJ, or this Commission, have not considered the record before us simply because the ALJ has referenced and recommended coming to similar conclusions as did the FERC in the Merger Order.

As will be seen throughout this Opinion and Order, our decision here is based upon the record developed in this proceeding. While we have certainly looked to the Merger Order and the Rehearing Order in the context of market power issues, our determinations are grounded in this record and the standards applicable in this Commonwealth. Recall that, at least for market power issues, the methodology adopted by this Commission is that adopted and applied by the FERC. *Re DQE*. For these reasons, the Merger Order and the Rehearing Order are relevant to this proceeding and should be examined for any appropriate guidance they may provide.

2. Market Power Mitigation Measures

The ALJ determined that based upon the Merger Order and the record before her, absent some form of market power mitigation, the resulting merger would not pass the applicable market screen test. (I.D. at 40). Accordingly, some form of mitigation must either be proposed by the Joint Applicants or imposed by the Commission in order to find that the proposed merger would not adversely impact competition in the Commonwealth. 66 Pa. C.S. §§ 2811(e)(1) and 2210(a)(1).

a. Positions of the Parties

The Joint Applicants acknowledged that, absent mitigation of some type, the proposed merger would not pass the applicable HHI screens. Accordingly, the Joint

Applicants proposed a plan by which the merged entity would divest 6,600 MW of generation through the outright sale of 4,000 MW of fossil generation and virtual divestiture of 2,600 MW of nuclear generation. (PECO Exh. WHH-1a). The virtual divestiture consists of the sale of energy on a firm, twenty-four hours a day, seven days a week basis. (PECO Exh. WHH-1a, Exch. J-1, pp. 7-9). The ALJ agreed with PECO that the amount of generation involved represents more than the total generating capacity owned by any other generation owner in PJM East, is almost equal to the amount of Exelon's generation located in PJM East prior to the merger, and is by far the largest amount of generation ever proposed to be divested in connection with a merger. (I.D. at 40).

PPL argued that the proposed mitigation plan was insufficient to address the market power concerns. PPL stated that, because the plan relies in part on virtual divestiture, PECO will retain ownership control over the plants in question and still retain the ability to exercise market power. (PPL M.B. at 37-38). According to PPL, because the proposal involves control of the plants and sales at auctions in a rolling three year process, this creates incentives for the merged entity to “discover means to repeatedly affect near-term forward market electricity prices.” (*Id.* at 39).

Similarly, PPL argued that retention of control of the merged entity's nuclear assets “will provide a strong incentive to withhold other, more flexible generating facilities to affect price.” (PPL M.B. at 40). PPL also argued that both the virtual nature of the divestiture and the fact that the identities of the involved plants are as yet unknown will require constant post-merger supervision and intervention. PPL asserted that this post-merger involvement ignores this Commission's often stated preference for market solutions and the general notion that post-merger regulatory involvement is far less effective than structural remedies prior to merger consummation. (PPL M.B. at 40-45).

b. ALJ's Recommendation

The ALJ recommended that the Commission come to the same conclusions on these points as did the FERC in the Merger Order. Each of PPL's arguments was raised at the FERC and each one was rejected. (I.D. at 44-46). The ALJ stated, "[a]s FERC's analysis and resolution of the relevant issues is clearly reasonable and thorough, the Commission should afford its Merger Order considerable weight." (*Id.* at 47).

c. Exceptions and Replies

PPL argues that the mitigation plan offered by the Joint Applicants "is vague, uncertain, insufficient, and will not cure the Merged Entity's market power, and thus should not be accepted by the Commission." (PPL Exc. at 19). PPL begins its arguments on Exceptions by noting that the Joint Applicants have not identified with any specificity the units to be sold in the 4,000 MW fossil generation divestiture. Accordingly, PPL argues that one cannot know the impact of any such sales on competition. In addition, since the sales will take place in the future, the identities of the buyers are unknown, further raising questions of the efficacy of any sale to mitigate market power. PPL argues that the ALJ merely left this issue to the FERC. (*Id.*)

PPL also argues that the virtual divestiture is flawed for a number of reasons. As it argued before the ALJ, retention of ownership and control over the involved plants gives the merged entity the incentive and the opportunity to exercise market power. In addition, the identities of the recipients of the auctioned power are unknown at this time. Accordingly, the virtual divestiture will require continued regulatory oversight for a long period of time. PPL argues that this type of result was discussed with disfavor in *Re DQE*, which favored that all mitigation be in place at the time of merger consummation. (PPL Exc. at 21-23). PPL also argues against that part of

the mitigation plan that permits the merged entity to reduce the divestiture obligation when capacity is retired. We will address that argument separately, below.

The Joint Applicants rejoin that FERC dealt “exhaustively” with this issue and “no one raised any reason to reconsider FERC’s holding on this issue.” (Joint Applicants’ R.Exc. at 12). The Joint Applicants then assert that FERC’s conclusion is fully supported by the record before this Commission. With regard to the virtual divestiture, the power is to be sold on a firm basis, twenty-four hours a day, seven days a week. Accordingly, regardless of any maintenance decisions or operations concerns for a particular unit, the energy must be produced. The Joint Applicants assert that this means that “the virtually-divested energy cannot be withheld from the market even if the Joint Applicants” wished to do so. (*Id.*) The Joint Applicants also argue that the FERC has held “that there is not much risk that nuclear units will be used to execute a withholding strategy.” (*Id.*) Simply put, the cost and efficiency characteristics of a nuclear plant make it the least likely unit to be withheld.

The Joint Applicants also address PPL’s concerns that fossil units could be withheld in order to drive up the prices in the three-year virtual divestiture auctions. The Joint Applicants argue that an attempt to raise prices in the near-term markets by withholding fossil units would have little or no impact on the longer term auction markets. Further, the evidence before this Commission indicates that the longer term auction markets are competitive and should not be influenced by any attempted market power in the short-term and near term markets. (PECO St. No. 3-R at 38). This is further buttressed by the FERC’s finding in the Merger Order at ¶136. (Joint Applicants’ R.Exc. at 13).

The Joint Applicants also respond to PPL’s arguments regarding the failure of the mitigation plan to identify the specific units involved. The Joint Applicants argue that the record evidence is contrary to PPL’s characterization of the identification of the

units involved. The record before this Commission contains a specific list of mitigation-eligible units. (PECO Exh. WHH-1 at Exhs. J-3, J-12). The record also contains a chart that specifies: (1) the market in which the divested generation units must be located; (2) the cost characteristics of the divested generation; and (3) the amount of divested capacity that must fit into each cost characteristic and each location. (Joint Applicants' R.Exc. at 14). According to the Joint Applicants, the information provided was sufficient to determine that market power will be mitigated. (*Id.* at 15).

d. Disposition

We will deny this Exception. Based upon the record before us, we agree with both the FERC and the Joint Applicants that PPL's arguments regarding the efficacy of the proposed mitigation plan simply do not carry any weight. As noted by the Joint Applicants and the FERC, the design of the virtual auction eliminates any incentive for the merged entity to attempt to withhold generation to affect price. In addition, even if the merged entity would endeavor to withhold generation, it is unlikely that such an action in the short term markets would have an impact on the longer term markets in which the auctions will take place.

With regard to the lack of identity of the specific plants involved, we have reviewed the record evidence and believe that the FERC succinctly stated the correct determination in its Rehearing Order:

As we stated in the Merger Order, under the Commission's Appendix A analysis, we need to know the general location (*i.e.*, the control area or sub-region of an regional transmission organization (RTO) and cost characteristics of the generators being divested – not the actual units – in order to calculate the post-merger-and-divestiture Herfindahl-Hirschman Indexes (HHI) to determine market concentration. Applicants provided that information.

Rehearing Order at ¶45.

In addition, we are not persuaded by PPL's assertion that the proposed mitigation plan will require burdensome post-merger review or that we would be required to erroneously yield to the FERC if additional post-merger mitigation were required. First, based upon our review of the record as outlined above, we have determined that the proposed mitigation plan serves to sufficiently mitigate post-merger market power concerns to meet the requirements of Sections 2811(e)(1) and 2210(a)(1) of the Code. PPL is correct that the FERC provided for a post-merger compliance filing. In addition, the ALJ recommended that we require the Joint Applicants to agree to implement any further mitigation steps directed by the FERC upon review of the compliance filing. However, as argued by the Joint Applicants, the compliance filing merely provides for surety that the Joint Applicants are following through on the mitigation plan which we have found to be sufficient in this proceeding. The requirement that the Joint Applicants meet any additional mitigation requirements the FERC may require provides for added certainty.⁵

To the extent that this Commission will monitor the ongoing proceedings at the FERC, this neither inappropriately shifts our role to the FERC nor requires a burdensome post-merger regulatory intervention as suggested by PPL. This Commission has never abrogated our responsibility for retail market oversight under Chapter 28 of the Code and we have no intention of doing so here. Thus, we will certainly monitor any ongoing proceedings at the FERC, as well as the periodic state of the market reports from the PJM Market Monitoring Unit and the market reports provided for in the Joint Settlement. In the event we determine that market power issues exist, we will act using the full panoply of authority provided to us by the Code. In addition, nothing in this Opinion and Order or the Joint Petition prevents any person from raising market power issues with this Commission at any time. Should any Party in this proceeding, including

⁵ In addition, the opportunity for additional mitigation requirements further addresses PPL's concerns regarding what it perceives to be open questions within the mitigation plan.

PPL and PGW, perceive that market power problems exist in the Commonwealth's retail markets, they can and should bring those concerns to this Commission for appropriate redress.

3. Geographic Market

This issue is raised in PPL's Exception No. 4 and revolves around the question of which geographic markets should be used in the application of the HHI screens. The basic question is whether the Commission should have required an analysis of a geographic market within PJM which PPL terms "PJM Classic" instead of a geographic market presented by the Joint Applicants identified as "PJM Pre-2004."

a. Positions of the Parties

As noted by PPL in its Exceptions, analysis of whether a merger will lessen competition requires that the relevant geographic market be properly defined. (PPL Exc. at 27). The Joint Applicants presented an analysis of three separate geographic markets within the PJM Interconnection. They were: PJM Expanded, which encompassed all of PJM including American Electric Power Service Corporation, Dayton Power & Light and ComEd; PJM East, which included all of PJM east of the Eastern Interface; and PJM Pre-2004, which included the traditional (pre-expansion) PJM companies and the Allegheny Power System (APS) which joined PJM in 2002. (PECO Exh. WHH-1a at Exh. J-17 at 46-50; PECO Exh. WHH-1a at Exhs. J-18; J-19, J-27, J-28 and J-29). The Joint Applicants' analyses of these three geographical markets supported their theory that, with the proposed mitigation plan, the merger would pass the necessary HHI thresholds. (I.D. at 47).

PPL agreed that PJM Expanded and PJM East were appropriate and relevant geographical markets. However, PPL asserted that PJM Pre-2004 was not a

relevant market because of its inclusion of APS as a competitor. (PPL St. 1 at 16-19). PPL argued that a more appropriate geographical market was “PJM Classic” which includes the original PJM members prior to the inclusion of APS. (*Id.*).

Before the ALJ, PPL argued that APS must be excluded from the relevant geographic market (thus producing PJM Classic) because PJM’s Western Interface “still creates congestion that separates APS’ service territory from the PJM Classic market.” (PPL M.B. at 25). In its argument, PPL noted that the FERC had determined that the Bedington-Black-Oak line, a pathway between APS and the PJM Classic market, was the most constrained facility in PJM during 2004. (*Id.* at 25-26). Because of the constraints between APS and the PJM Classic market, PPL argued that there is significant price separation between PJM Classic and the rest of PJM for sustained periods. Accordingly, PPL argues that it is inappropriate to include APS as a competing generator due to the limited access the APS generation has to PJM and the price separation, both factors significantly limiting the ability of APS to actually act as a competitor in PJM Classic. (PPL M.B. at 27)..

The Joint Applicants responded that PPL focused solely on price separation involving a single aspect of APS’ operation (the APS – Pepco zone) in its PJM Classic market analysis. According to the Joint Applicants, when the totality of the PJM Classic market is reviewed, the price separation between APS and the rest of PJM Classic is not nearly as significant or as sustained. (Joint Applicants’ M.B. at 27-28). Similarly, the Joint Applicants note that PPL references a single transmission line to support its argument that constrained access limits APS’ ability to compete in the PJM Classic market. However, the Joint Applicants note that the primary interface between APS and PJM Classic is the Western Interface. That interface was shown to have been congested for seventy-eight hours in 2004, which indicates that any ability to influence price due to that congestion would not be sustainable. (*Id.* at 28).

b. ALJ's Recommendation

The ALJ noted the dispute over this issue and recommended that the Commission conclude as the FERC did and reject consideration of PJM Classic as a separate market. (I.D. 42, 45 and 47).

c. Exceptions and Replies

In its Exception No. 4, PPL reiterates the arguments it made before the ALJ and adds that the FERC was in error when it determined that PJM Classic was not a relevant geographic market in this proceeding. PPL initially argues that the FERC erred in its analysis because the FERC misconstrued a report by the PJM Market Monitoring Unit. Also, PPL argues that the FERC failed to consider the price differential data before it. (PPL Exc. at 28-29). PPL then argues that the Joint Applicants have not succeeded in rebutting PPL's evidence regarding price separation, particularly when seasonal price differentiation is examined. When seasonal fluctuations are considered, PPL argues that the price differentials between APS and PJM Classic are larger and sustained for longer periods of time further negating APS' ability to compete in PJM Classic. (*Id.* at 29-31).

The Joint Applicants respond that PPL mischaracterizes FERC's disposition of this issue. The Joint Applicants note that the FERC considered PPL's arguments and rejected them, independent of any reference to PJM's Market Monitoring Unit. (Joint Applicants' R.Exc. at 9). In addition, the Joint Applicants assert that the record here demonstrates the price differentials relied upon by PPL in separating APS from PJM are isolated and misleading. Further, to the extent that PPL cites congestion as limiting APS' access to PJM, PPL ignores the main interface between APS and PJM. The constraint which PPL examines is on the line between APS and Pepco, not the main Western Interface. (*Id.* at 10).

d. Disposition

We will deny this Exception. First, independent of the Merger Order and the Rehearing Order, the record before us clearly demonstrates that PJM Pre-2004 is an appropriate and relevant geographical market for analysis in this proceeding. PPL has not convinced us that their proposed “PJM Classic” market is in any manner indicative of operations, power flows and competitive access in the post-merger PJM. We agree with the Joint Applicants that PPL’s support for its proposed PJM Classic market is narrowly focused and ignores price differentials in other PJM zones and the Western Interface to such an extent as to carry little, if any, weight.

Conversely, the Joint Applicants have supported the use of PJM Pre-2004 as a relevant market. We find the testimony and arguments of the Joint Applicants on this issue to be more than sufficient (*See*, PECO Exh. Whh-1a J-17 at 46-50; PECO Exh. WHH-1a at Exhs. J-18, J-19, J-27, J-28, and J-29; Joint Applicants’ M.B. at 24-28). Clearly, when viewed in its entirety and not parsed into isolated segments, PJM Pre-2004 is a relevant geographic market. To exclude APS, as PPL proposes here, is to ignore a significant competitive factor and has the effect of improperly skewing any HHI analysis.

4. Allocation of Import Capacity

a. Positions of the Parties

In order to calculate market concentration levels in PJM East, it is necessary to add imported generation to the generation physically located in PJM East and then assign the use of that capacity to specific entities. (Joint Applicants M.B. at 29; PECO Exh. WHH-1 J-1 at 38-40). Joint Applicants’ witness, Dr. Hieronymus, used the “*pro rata*” or “squeeze down” methodology of allocating import capacity. This methodology allocates import capacity to owners of generation *pro rata* based on the

total amount of capacity that they own outside of the market that can meet the delivered price test (can deliver energy at the market price plus five percent). (*Id.*).

According to PPL, import capacity into PJM East should be allocated based on ownership of Financial Transmission Rights (FTR), instead of on a *pro rata* basis. (PPL St. at 28-29). FTRs entitle a holder to receive payment from PJM equal to the cost of congestion, which is defined as the difference in the PJM Locational Marginal Price (LMP) between the two points covered by the FTR. (Joint Applicants M.B. at 31). Because the Joint Applicants own a significant amount of FTRs, PPL's witness, Dr. Kalt, opines that, "FTRs create a strong incentive for the Merging Parties to withhold, as both their generation and their FTRs will increase in value from such withholding. Accounting for this incentive in the competitive screen analysis is essential." (PPL St. 1-SR at 14).

The City posits that the Applicants' market power analysis has significant shortcomings including the use an unrealistic allocation of import transmission capacity and a failure to evaluate the importance of FTRs. (City M.B. at 11). The City opines that the Applicants' proposed mitigation measures fail to provide concrete assurances that the Applicants will not be able to exercise market power to the detriment of PECO ratepayers and the PJM market in general. (*Id.*).

b. ALJ's Recommendation

The ALJ determined that PPL's argument that the PJM East transmission import capacity should be allocated based on FTRs rather than on a *pro rata* basis was considered and rejected by FERC in the Merger Order. The ALJ recommended that the Commission come to the same conclusion. (*I.D.* at 45).

c. Exceptions and Replies

PPL argues that the Initial Decision erred in rejecting the use of FTR ownership in assessing market shares in PJM East. (PPL Exc. at 32). PPL further argues that the Joint Applicants failed to meet their burden of proving that FTRs have no impact on the incentive and ability to exercise market power. (*Id.* at 33). According to PPL, the use of FTRs to assess market share provides a more accurate picture of the Joint Applicants' ability to exercise market power, even in a mitigated post-merger PJM East market. (PPL Exc. at 32). PPL contends that when generation imports into PJM East are assigned based on FTR ownership, rather than the *pro rata* method used by the Joint Applicants, the result is a marked increase in market power concentration due to the merger. (PPL Exc. at 38).

The Joint Applicants rejoin that FTRs do not confer firm transmission rights as they are financial instruments unrelated to the generation or transmission of energy. (Joint Applicants R.Exc. at 11). PECO contends that there is no basis for allocating imports into PJM East based on FTR ownership because, "ownership of FTRs provides no rights whatsoever to preferential access to scarce transmission, nor do they allow the holder to limit or otherwise control the level of imports into PJM East." (*Id.*, PECO St. No. 3-R at 21).

d. Disposition

PPL is correct in its assertion that when generation imports into PJM East are assigned based on FTR ownership, rather than the *pro rata* method, the result is a marked increase in market power concentration due to the merger. However, FTRs and load obligations create equal and opposite incentives for market participants to attempt to change market prices. (Tr. at 384). As explained by the Joint Applicants, if an entity owned 1,000 FTRs:

To the extent that prices in PJM East increase by \$1/MWh, then the FTR holder would benefit by \$1,000 – which is the incentive that Dr. Kalt references. However, to the extent that the FTR holder must serve 1,000 MW of load, the cost to the FTR holder of purchasing power to serve that load also would increase by \$1,000, thereby canceling out the FTR holder’s incentive to increase prices created as a consequence of its ownership of the FTRs.

(*Id.*). Dr. Kalt’s analysis is not convincing in that it failed to consider how the Joint Applicants’ load obligation affects any possible incentive to exercise market power.

Moreover, PPL’s position on import allocation is based on an assumption that FTR ownership is static. We disagree. Dr. Hieronymus testified that, “the grandfathered FTRs that Dr. Kalt focused on in his analysis are allocated to load serving entities based on who now serves the load that existed in 1998. As load moves to other retail providers, the rights to the FTRs automatically move to the new entity that serves the load.” (Tr. at 384-385). There will be movement of FTRs due to market forces, including changing market power due to any divestiture resulting from the mitigation proposal. As stated by the Joint Applicants, “[i]t is a simple matter to allocate long-term firm transmission capacity to holders of long-term firm contracts. However, it is more difficult to allocate short-term firm and non-firm transmission capacity. By its very nature, it is not possible to know today who will be using short-term and non-firm transmission capacity in 2006 and beyond.” (Joint Applicants’ M.B. at 29). Based on our review of the record evidence, PPL’s Exception on this issue is denied.⁶

⁶ As noted by ALJ Chesnut, FERC approved the *pro rata* analysis in the Merger Order stating, “We are not convinced that Applicants should have used an economic (i.e. least cost) allocation rather than a *pro rata* allocation of scarce transmission transfer capacity in their analysis. We have accepted the *pro rata* allocation methodology in numerous merger cases, and believe it reasonably models suppliers’ ability to compete in a given destination market.” (I.D. at 45; Merger Order, 112 FERC ¶ 61, 011 at P 129).

5. Reduction in Required Divestiture

The Joint Applicants' mitigation plan provides that they may reduce the required amount of virtually divested generation when they retire nuclear generation units. The issue raised here is whether such a reduction reduces the efficacy of the mitigation plan.

a. Positions of the Parties

PPL argued that the proposed reduction in virtually divested generation in response to unit retirements "is the equivalent of withholding, and will allow the merged entity to artificially inflate prices in a given market to its own advantage." (PPL M.B. at 46). PPL added "allowing the Joint Applicants to reduce divestiture on a megawatt for megawatt basis with the retirement of units provides the merged entity with the ability to eliminate competition for these virtually divested units, which would remain in the merged entity's control." (*Id.* at 47).

The Joint Applicants responded that when clearly understood, the reduction piece of its proposal provides no opportunity for the exercise of market power at all. The Joint Applicants asserted that PPL completely ignores the primary precondition for the reduction. That is, the Joint Applicants must first put the unit to be retired up for auction. The unit may only be retired if they receive no bid in excess of the value of the alternative (non-generation) use of the unit. "This means that the retired units most likely would have been retired even if they had been physically divested to a third party, and in no sense can be deemed 'withheld' from the market." (Joint Applicants' R.B. at 35).

The Joint Applicants further argued that the primary market power issue with nuclear facilities is not that the nuclear facilities will be withheld, but that the Joint Applicants would use other units in an effort to increase market prices enjoyed by all

units. According to the Joint Applicants, retiring a nuclear unit eliminates that incentive in the same fashion as selling the unit to a third party. “[I]n either event the Joint Applicants will not be able to sell power from the unit and reap the benefits of increased market prices.” (*Id.*).

b. ALJ’s Recommendation

The ALJ adopted the Joint Applicants’ position on this issue, noting that the FERC agreed with the Joint Applicants’ analysis.

c. Exceptions and Replies

PPL reiterates its position that retirements of nuclear units “can be a form of withholding that increase market prices in a manner that is profitable for the Merged Entity.” (PPL Exc. at 26). PPL argues further that since there is no limit on the reduction, “Joint Petitioners could reduce their obligation to divest even ‘virtual’ base load energy by retiring largely uneconomic peaking facilities.” (*Id.* at 27).

The Joint Applicants rejoin that the entire concept of the reduction is predicated on the notion that the retired plant would be retired regardless of ownership and thus cannot be artificially withheld from the market. (Joint Applicants’ R.Exc. at 13-14). The Joint Applicants reiterate their argument that the nature of nuclear plant operations is such that the market power concern is not that nuclear plant generation will be withheld, but that other, more expensive units will be withheld to increase the price obtained by the lower cost nuclear plants. (*Id.* at 14).

d. Disposition

We will deny this Exception. We agree with the Joint Applicants that PPL's argument on this point ignores two fundamental aspects of the reduction proposal. First, the auction piece of the plant retirement ensures that the generation unit would have been retired in any event and not artificially withheld from the market. Second, PPL's position ignores the cost and operational characteristics of nuclear units. It is not likely that a nuclear unit would be artificially withheld from the market in order to exercise market power. While our determination here is based upon the record before us, we agree with the FERC's perspective on this issue:

As we stated in the Merger Order, Applicants made a convincing argument that a decrease in their nuclear capacity would mitigate market power, because the incentive to exercise market power is directly related to the amount of inframarginal capacity they control that could benefit from higher prices. For the numerous reasons discussed in the Merger Order (e.g. operational realities, regulatory oversight, and profit-maximization) the merger did not increase the Applicants' ability or incentive to withhold *nuclear* capacity; rather, it increased their incentive to withhold *marginal* capacity in order to increase their profits from baseload sales. Even if operationally feasible, withholding output from low cost nuclear units would rarely be profitable.

Rehearing Order at ¶64.

6. Price Monitoring Report

a. Positions of the Parties

In order to address concerns about market power the Joint Petitioners agreed within the Settlement to create a wholesale electricity market reporting and monitoring system to remain in place through 2012, with reports to be filed with the

Commission and provided upon request to any of the signatory Parties and the public. (Joint Petition at ¶53.a).

PGW discounts the inclusion of this reporting requirement as being sufficient to determine whether Exelon's affiliates have been exercising market power in the PJM East electricity market. (PGW St. No. 1-S at 4-5). The City is also critical of these market reports. (City M.B. at 18).

b. ALJ's Recommendation

The ALJ recommended adoption of the Settlement as submitted without modifications, additional reporting requirements or conditions. (I.D. at 20-21).

c. Exceptions and Replies

In its Exceptions, PGW criticizes the pricing report to be provided by the Joint Applicants as it involves electricity prices but not natural gas prices. PGW maintains that this report does not give the Commission any information it does not already have access to on the PJM website, nor does it give the Commission access to any additional information that would be useful in determining whether Exelon's affiliates were exercising market power. PGW alleges that the other information necessary to assess price trends in the PJM markets to be included within the report is so vague as to be meaningless. (PGW Exc. at 33-35).

The City notes in its Exceptions that the market reports neglect the retail markets as required under the Competition Acts. (City Exc. at 6).

The OSBA replies to this Exception by stating that the price monitoring report will enhance the Commission's ability to prevent anticompetitive behavior,

discriminatory conduct and unlawful exercise of market power. The OSBA maintains that the report will assist the Commission in fulfilling the monitoring responsibility under Section 2811(a), and will assist the OSBA in determining whether to request a Commission investigation under section 2811(b). OSBA opines that contrary to the City's and PGW's contentions, the Settlement will serve to discourage the unlawful exercise of market power by Exelon or an affiliate. (OSBA R. Exc. at 8-11).

d. Disposition

Based upon the positions of the Parties, the Commission supports this aspect of the Joint Petition for Settlement providing for additional electric market reporting requirements to be placed upon PECO. We conclude that the concerns expressed by PGW and the City are without merit and should be dismissed. Accordingly, the Exceptions are denied.

7. Vertical Market Power

a. Positions of the Parties

PGW claimed that the proposed merger is likely to adversely impact the competitive retail gas market by creating vertical market power. PGW has defined a vertical merger as one which involves entities that have positions in two product markets, where one product supplies or is an important input to the production of the second product. In the instant merger, PGW alleged that this allows the Joint Applicants to increase electric prices by increasing the price of natural gas in PJM East. PGW recommended that the Commission direct the divestiture of the Joint Applicants' natural gas distribution operations.⁷ (PGW M.B. at 12, 19-20).

⁷ The City adopted PGW's arguments on this issue. (City M.B. at 19-21).

The Joint Applicants disagree with the allegations regarding vertical market power made by PGW and stated that the PGW theory, at most, goes to the ability of the Joint Applicants to raise natural gas prices in PJM East. The Joint Applicants noted that because PGW has rights to more than enough transportation capacity to move gas to its customers from the gas producing areas that are beyond the reach of the Joint Applicants' market power, PGW and its retail sales customers will never have to pay elevated natural gas prices in the event the Joint Applicants somehow were able to increase natural gas prices in PJM East. They further stated that because local distribution companies (LDCs) located in PJM generally have sufficient natural gas transportation rights to meet their loads, any attempt by the Joint Applicants to raise natural gas prices in PJM East would have very little impact on retail sales customers of the LDCs, even if the Joint Applicants were successful. (Joint Applicants M.B. at 37).

In regard to PGW's allegations that higher natural gas prices would lead to higher electric prices, the Joint Applicants maintained that PECO has an electric rate cap in place through 2010, and that any impact of the merger thereafter would depend on how the market changes between 2006 and 2010. Therefore, the Joint Applicants stated that PGW would not suffer from any increase in electric prices either. The Joint Applicants opined that FERC has already considered and rejected PGW's claims in regard to vertical market power. Additionally, the Joint Applicants contended that PGW conceded that the maintenance of separate gas procurement functions will address its alleged vertical market power problems. The Joint Applicants, in order to clear any lingering concerns on this issue, committed that they will not combine their natural gas procurement functions after the merger is closed without obtaining the Commission's approval. (Joint Applicants M.B. at 37-38, 47-48).

b. ALJ's Recommendation

The ALJ dismissed the vertical market power issues and noted that the FERC thoroughly considered and discussed the vertical market issues and found that the merger of the Joint Applicants will not harm competition as their presence in the natural gas storage market is small enough not to raise competitive concerns. The ALJ recommended that the Commission come to the same conclusion as did FERC concerning this market power issue. Additionally, the ALJ noted that the concern that the merged entity will be able to increase gas price volatility through the discretionary use of selected storage injection and withdrawal strategies can be addressed in PECO's annual 1307(f) gas cost proceedings where PECO has to establish that it uses its gas assets in a manner consistent with a least cost gas procurement policy. (I.D. at 46-49).

c. Exceptions and Replies

PGW excepts to the recommendation of the ALJ and submits that the Joint Application should be denied unless the merger were further modified to provide for the divestiture of those assets that create the market power problem, the PECO Gas and PSE&G's gas distribution assets. PGW contends that it would be a mistake for the Commission to believe that FERC thoroughly considered the vertical market power issue as suggested by the ALJ because FERC did not have the benefit of a fully developed record on which to base its decision. PGW further asserts that, rather than deferring to FERC, the Commission, having conducted its own independent review of the evidence, should conclude that the proposed merger will result in impermissible market power and is not in the public interest. (PGW Exc. at 3-13).

PGW contends that the Commission should rely on the evidence of record in this proceeding regarding the vertical market power analysis and concerns presented by its witness, Dr. Carpenter. PGW submits that the proposed merger of Exelon and

PSEG raises significant vertical market power concerns because the merged entity would possess market power in the upstream market for delivered natural gas and opines that the Joint Applicants' vertical market power analysis contains several errors. PGW alleges that the incentive of the merged entity to raise the price of gas derives from its substantial baseload power generation capacity that will remain in its possession after the proposed divestitures. (PGW Exc. at 18-19).

PGW submits that the cleanest, easiest and most effective remedy for this alleged vertical market power problem in this proceeding is to require, as a condition for approval of the merger, the divestiture of PECO Gas and PSE&G's gas distribution company. It is PGW's position that divestiture would eliminate the vertical market power problem. PGW also offers an alternative remedy which would require that the upstream transportation contracts and storage contracts held by PECO and PSE&G be placed in the hands of third parties that are independent of the merged entity and subject to oversight by Pennsylvania and New Jersey regulators; respectively. However, PGW opines that divestiture is not an extreme remedy in this case and is no more extreme than the divestiture of the 6,600 MW of generating capacity that Joint Applicants have already proposed to address the substantial market power that they acknowledge will occur as a result of this large merger. (PGW Exc. at 16-17).

Next, PGW excepts to the ALJ's recommended reliance on rate caps as this is contrary to Commission precedent as articulated in *Re DQE*. In that case, the Commission rejected the use of a rate cap as a mitigation strategy as it was found to be "clearly inadequate" to deal with the substantial market power found to exist in that case. PGW opines that a rate cap is no more an appropriate market power remedy in the instant merger than it was in *Re DQE* as a rate cap of short duration is no answer to the long-term market power concerns raised by the proposed merger. (PGW Exc. at 26-27).

PGW also excepts to the ALJ's reliance on the Joint Applicants' commitment not to combine their natural gas procurement functions without Commission approval as this commitment was proposed for the first time in their Main Brief and leaves control of the natural gas assets in the hands of the merger partners. PGW submits that this commitment does nothing to remedy the Joint Applicants' vertical market power as the proposed merger creates vertical market power even if the Joint applicants' gas procurement functions are not combined. (PGW Exc. at 28).

Finally, PGW excepts to the ALJ's suggestion that PECO's annual 1307(f) proceedings will protect the public from the merged entities market power. PGW alleges that the Commission will have no information about the gas market activities of PSE&G or its unregulated affiliate available to it when it conducts its annual 1307(f) review of PECO, therefore the Commission will not be in a position to use these proceedings to monitor storage or other gas asset manipulation by the merged entity. PGW maintains that reliance on regulatory proceedings might be appropriate if it were coupled with placement of the upstream transportation and storage contracts held by PECO and PSEG in the hands of third parties, per its alternative recommendation in this proceeding. (PGW Exc. at 28-29).

In reply, the Joint Applicants first state that FERC made clear in its Rehearing Order that it had in fact considered the arguments advanced by PGW's witness Dr. Carpenter in performing its analysis of the natural gas vertical competition issues:

After reviewing Philadelphia Gas' June 27, 2005 filing, the Commission determined that it did not provide new information that would have assisted the Commission in its decision-making process. Therefore, the Commission properly declined to accept the late-filed comments. However, we note that Philadelphia Gas' arguments actually duplicated arguments raised by FirstEnergy, NJ Ratepayer Advocate and Pennsylvania Office of the Consumer Advocate, among others, and those arguments were addressed.

Rehearing Order at ¶33. The Joint Applicants contend that PGW is wrong when it argues that FERC failed to consider PGW's arguments when it found that no natural gas-related vertical market power issues were raised by the merger. (Joint Applicants R.Exc. at 15-16).

The Joint Applicants claim that the primary issue that was contested in this proceeding was whether the relevant natural gas market was unconcentrated or moderately concentrated as the Joint Applicants contended, or highly concentrated, as PGW's witness contended. According to the Joint Applicants, under FERC's merger analysis, vertical market power issues relating to natural gas are present only when there is a highly concentrated market with an HHI over 1800. The Joint Applicants note that as the ALJ found, FERC concluded that the natural gas market was not highly concentrated, and thus that no natural gas vertical market power issues are raised by the merger. (Merger Order at ¶¶182-85, 187-91, 193-96, 200, 202). (Joint Applicants R.Exc. at 16).

The Joint Applicants next claim that the record in this proceeding supports the conclusion made by FERC. They note that the sole difference between PGW's calculations showing a market problem, and the Joint Applicants' calculations showing no market power problem, is in the definition of the geographic market. They opine that PGW achieved a higher market concentration level by excluding from its PJM East calculation all transportation contracts for delivery in PJM East into pipelines serving New York or New England and, with one glaringly inconsistent exception, contracts that have primary delivery points in New York or New England even if that capacity also is deliverable in PJM East. The Joint Applicants believe that PGW was inconsistent in his approach by not excluding PSEG's capacity on the Transco pipeline with delivery points north of the Linden constraint which can command the New York price rather than the PJM East price. As a result, the Joint Applicants contend that PGW utilized an overly narrow and invalid market definition, and applied that definition in an inconsistent and

biased manner in order to show that a market power problem exists. (Joint Applicants R. Exc. at 16-20).

The Joint Applicants further assert that the record demonstrates that the market power problem alleged by PGW has absolutely nothing to do with PGW's proposed remedy, which is the divestiture of the Joint Applicants' natural gas distribution operations. The Joint Applicants allege that this proposed remedy is extreme as PGW's own witness conceded it is the Joint Applicants' interstate natural gas pipeline transportation contract rights, not their distribution assets, which cause the alleged market power problems. (Tr. at 493). The Joint Applicants note that divestiture is not necessary to solve this alleged problem and would potentially cause PECO, PSE&G and their customers substantial economic harm (\$410 million annually) from the complex task of unwinding the synergies presently benefiting them from being part of the same enterprise. (Joint Applicants R.Exc. at 20-21):

The Joint Applicants also submit that to the extent that the Commission has any concerns regarding natural gas issues, that concern is addressed by the fact that Joint Applicants have committed not to combine their natural gas procurement functions in the future without the Commission's approval, and thus cannot act in the concerted manner alleged by PGW. They opine that this commitment fully mitigates any possible natural gas market power concern as a result of the merger. (Joint Applicants R.Exc. at 21).

In its Reply Exceptions, the OSBA states its agreement with the ALJ's conclusion that PGW's concerns over the merged entity's influence on natural gas prices can be addressed in the context of PECO's annual gas cost proceedings under Section 1307(f) of the Code, 66 Pa. C.S. § 1307(f). The OSBA notes that any failure by PECO to use its gas assets in a manner consistent with a least cost procurement policy could be pursued in these proceedings. The OSBA counters PGW's argument that these proceedings are an inadequate oversight tool because the Commission would not have

information about PECO's non-jurisdictional affiliates by asserting that, if the market price of gas were to rise as PGW alleges, the effect of that increase would be visible in PECO's purchased gas costs. (OSBA R.Exc. at 11-12).

The OSBA further notes that, as affirmed in a recent Commission decision, PECO would be required to seek relief on behalf of its customers for any adverse effect under PECO's gas contracts caused by market manipulation by Exelon, PSE&G or any affiliated interest. *Pa. PUC v. The Peoples Natural Gas Company, t/a Dominion Peoples*, Docket No. R-00050267, (Order entered September 30, 2005). (OSBA R.Exc. at 12).

d. Disposition

Based upon the record of evidence we conclude that the allegations regarding vertical market power made by PGW are without merit and should be dismissed. We agree with the ALJ's recommendation that the Commission come to the same conclusion as did FERC concerning the market power issues. While we find that FERC's analysis of the vertical market issues was reasonable and thorough and should be accepted, we also find, based upon our own independent analysis of the evidence presented within this proceeding, that there are no vertical market power issues associated with this merger. We find that the evidence presented by PGW concerning alleged vertical market power is flawed and as a result, we find that PGW's recommendation concerning divestiture of the Joint Applicants' natural gas distribution operations as unnecessary.

Furthermore, the Commission is in agreement with the position of the Joint Applicants and the OSBA that there are sufficient safeguards within the Joint Petition and within our existing regulatory requirements to monitor the effect on the natural gas market on Pennsylvania customers from the proposed merger. First, we note that the

Joint Petition explicitly recognizes the right of any party to request a Commission investigation when the party reasonably believes that PECO's affiliated generation company (or any other affiliated entity) has unlawfully exercised market power in any PJM market, or for any other reason as set forth in 66 Pa. C.S. § 2811. (Joint Petition at ¶53b).

The Joint Petition also requires PECO to file annually for the next six years a report addressing wholesale market prices and price trends in the PJM markets, which will assist the Commission in fulfilling its monitoring responsibilities under Section 2811(a). (Joint Petition at ¶ 53a). We also find it significant that the Joint Applicants have committed to separate natural gas procurement functions unless they obtain the Commission's prior approval for combined functions. Additionally, PECO will continue to be required to annually establish under Section 1307(f) of the Code that it purchases gas in a manner consistent with a least cost gas procurement policy.

Accordingly, the Exceptions of PGW are denied.

D. Other Issues

As noted *infra*, by Secretarial Letter of July 15, 2005, a series of questions (Directed Questions) were posed to the parties by Vice Chairman Cawley and Commissioner Shane. Several of the parties submitted supplemental direct testimony to specifically address the Directed Questions.

1. Directed Questions 1 – 4

The first four questions inquired into whether the synergies to be unlocked by the Merger could be harnessed to enhance economic development. These four

questions specifically raised the issue of a “set aside” of virtually divested generation” to be dedicated to the purpose of economic development.

a. Positions of the Parties

A majority of the parties agreed that a set aside of the type apparently envisioned by the Directed Questions should not be ordered by the Commission. First, PECO states that comparable programs in other states have been implemented on a state-wide basis and funded by customers or the state. (PECO St. 1-DQ at 10). Second, PECO maintains that a set aside could complicate the mitigation plan, could have the inadvertent effect of increasing the price of energy sold at the virtual divestiture auction and could expose the Commonwealth, or a designated competitive electric generation supplier, to substantial market risk. (PECO St. 3-DQ). Third, PECO states there are serious constitutional “taking” issues if the divested generation were to be appropriated for less than the fair market value, and a set aside appears inconsistent with the policy and principles of electric restructuring in Pennsylvania. (PECO St. 12-DQ).

The First Energy Companies state that setting aside a pool of low cost energy would impact market prices by introducing an artificial limit to market availability, would need to be agreed to by both the Joint Applicants and FERC, and the selection of winners and losers among Pennsylvania business and industry consumers would be a constant source of debate and litigation. (Met-Ed/Penelec/Penn Power St. 1-S-1). The OSBA claims that the set aside would have to be made available to the Commonwealth at below market prices in order to be useful as an economic development tool and would have to be counted against the total pool of merger savings, resulting in fewer merger savings to be shared by the ratepayers. According to the OSBA, this would lead to a misallocation of merger benefits across PECO’s rate classes. (OSBA St. 4 at 3-4).

The Joint Petitioners, to avoid these potential legal and regulatory obstacles, provided for PECO to contribute \$8.0 million over four years to PEDA to be used for energy-related economic development projects and initiatives of benefit to the PECO service territory. The Joint Petition provides that PEDA will submit to the Commission and the Joint Petitioners copies of the report it sends annually to the Governor and the General Assembly so that the use of these funds can be monitored. (Joint Petition at ¶52).

The City stated that the Commission should require that the Joint Petition provide substantial and direct benefits to PECO ratepayers in the form of a set aside of energy via virtual divestiture to provide economic development for the City and others within the service territory. According to the City, only such a mechanism would ensure direct net public benefit from this merger. (City M.B. at 16).

b. ALJ's Recommendation

The ALJ recommended that the Settlement does promote economic development in the PECO service territory by providing substantial rate relief and stability to all PECO customers, including the residential, commercial and industrial classes. The ALJ found that these benefits, when considered in conjunction with the economic development contributions PECO has agreed to make, are substantial, will be available sooner, will be shared by more customers and will be allocated more fairly than will the benefits from any set-aside. (I.D. at 52-53).

c. Exceptions and Replies

In its Exceptions, the City disagrees with the ALJ because it maintains that a set aside program of the scope and nature detailed by its witness would provide far more public benefit within PECO's service territory than would the related terms of the

Settlement. The City contends that a set aside would not have the effect of subsidizing others outside of PECO's service territory and could serve as a laboratory for testing whether the Commission should establish a state-wide program. The City maintains that the use of power to subsidize companies for a time that agree to locate and provide jobs within PECO's service territory, or to remain there, would not violate public policy any more than PECO's current tariff policies which provide the same thing, except that it would be the public and not PECO weighing the public benefits. (City Exc. at 15-17).

In reply, the Joint Applicants note that the City is the only party that favors a set-aside of virtually divested generation but opines that the City's support is apparently contingent on such generation being set aside for the City's benefit. The Joint Applicants contend that there are serious legal and other obstacles to implementing a set aside program which the City fails to meaningfully address in its Exceptions. They point to the rate relief and rate stability provided by the Settlement, coupled with the contributions PECO has agreed to make to PEDA, as support for substantial economic development benefits produced by the Settlement. (Joint Applicants R.Exc. at 23).

In its Reply Exceptions, the OCA submits that the initiatives in the Settlement, along with other provisions of the Settlement, provide substantial benefits to Pennsylvania and to PECO's service territory and are responsive to Directed Questions 1 through 4. The OCA states that the ALJ's decision is well-reasoned and well-supported and the City's Exception should be denied. (OCA R.Exc. at 9-11).

In its Reply Exceptions, the OSBA submits that the City has not adequately considered the various ramifications of a power set-aside. OSBA contends that if the set aside power were to be provided at a discount, it is reasonable to conclude that the cost of the discounted power would be counted against the total pool of merger savings to be shared by ratepayers. The result, according to the OSBA, would be fewer dollars for the rate cuts and other consumer, employee and community benefits the City claims are

already too meager. The OSBA further contends that any attempt to restrict the benefits of generation-related merger savings to a subset of PECO's customers would result in a misallocation of merger savings. (OSBA R.Exc. at 19-21).

d. Disposition

Our review of this issue leads us to conclude that the ALJ's acceptance of the Joint Petition in regard to this matter is reasonable and should be adopted. As such, we shall adopt the ALJ's recommendation. While we note the ability of neighboring states to avail themselves of opportunities to enhance their economic competitiveness through access to economical energy resources, we agree with the ALJ that the limited support for such a concept in this proceeding, as well as the significant beneficial economic development aspects of the Joint Petition, lead us to conclude this is not the appropriate proceeding to initiate a set aside to foster economic development as contemplated within the Directed Questions. As a result, the Exceptions of the City are denied.

2. Directed Question 5

The final Directed Question of the Commissioners inquired into whether the combination of the PSE&G gas division with the PECO gas division and PGW would provide critical mass for a viable, shareholder owned public utility, assuming off-system sales revenue from an LNG facility and separate resolution of the PGW debt problem.

a. Positions of the Parties

The Joint Petitioners have proposed that this issue be addressed in a separate, fact-finding investigation to commence upon consummation of the proposed merger. The Settlement stated that the Commission may assign such investigation to the Office of

Administrative Law Judge for the preparation of a report on such issues, that PECO agrees to fully cooperate in such a proceeding and that other Joint Petitioners may elect to participate in such proceeding. (Joint Petition at ¶ 55).

PGW proposed that the scope of this investigation be expanded to include a more detailed due diligence type study to include consideration of an authority structure to house the combined entity. (PGW M.B. at 52).

The City proposed that this investigation be expedited upon conclusion of this proceeding, with a final report produced by the Commission no later than December 31, 2006. (City M.B. at 22).

The Joint Applicants opposed the state authority option proposed by PGW and asserted that consideration of this option would detract from a reasoned assessment of possible solutions to PGW's problems. The Joint Applicants cited evidence that approximately \$410 million of annual diseconomies could be expected with a spin-off of EEG's post-merger gas operations. (Joint Applicants R.B. at 49).

b. ALJ's Recommendation

The ALJ recommended that the requests to modify Paragraph 55 of the Settlement be denied and this provision be accepted at this time. She stated that if and when this investigation is undertaken, the scope can be expanded to include consideration of the PGW proposals, if appropriate. The ALJ also recommended rejection of the City's proposal as it makes no sense to investigate the potential consolidation of PGW with EEG's combined gas operations before the merger has been consummated. Additionally, the ALJ recommended that the Commission should not accept the City's recommendation that the investigation be conducted so as to be concluded by December 31, 2006. She noted that any consolidation contemplated by this Directed Question

would constitute a significant and complicated corporate transaction that would entail months of due diligence, extensive negotiations and a lengthy regulatory approval process. In her opinion, more time may be necessary to address those complicated issues. (I.D. at 53-54).

c. Exceptions and Replies

In its Exceptions, the City contends that merely suggesting that an investigation regarding the feasibility of the combination of PGW into EEG may begin after the consummation of the merger does not ensure that fact-finding will occur or that this investigation will occur expediently. The City opines that if the issues and investigation are as significant and complicated as the ALJ suggests, then it is in the public interest to begin this investigation as soon as possible. It further notes that it is only recommending that the parties undertake the preliminary investigation stage, with any consolidation occurring only after adequate due diligence. According to the City, if the preliminary stage of this proceeding does not begin until after consummation of the merger, any potential benefits will be substantially delayed. Also, the City notes that it adopts and incorporates the following Exception filed by PGW. (City Exc. at 17-18).

PGW excepts to the ALJ's recommendation because it does not support Paragraph 55 of the Settlement as the answer to Directed Question 5 and it does not support the idea of a separate fact-finding investigation following consummation of the merger. PGW opines that existing publicly available data warrant a full due diligence type study of the combination concept and contends that the Commission should order such a study as the response to this Directed Question. (PGW Exc. at 36-37).

In reply, the Joint Applicants note their agreement with the ALJ's analysis of this issue and add that Exelon has no intention of spinning off its gas operations. Therefore, they opine that pursuit of the "state authority" model would be a waste of

time. The Joint Applicants further state that only in the post-Merger environment, will it be possible to assemble all of the data needed to fully evaluate the pros and cons of consolidating PGW with EEG's combined gas operations. (Joint Applicants R. Exc. at 24).

In its Reply Exceptions, the OCA submits that the process contained in the Joint Petition provides a reasonable means for consideration of this issue, would allow an investigation to continue in a forum where the myriad of issues can be thoroughly explored, where all affected parties can participate and where a reasoned decision can be reached. The OCA reiterates its agreement with the ALJ's recommendation and opines that the Exceptions of the City and PGW be denied. (OCA R. Exc. at 11-12).

d. Disposition

On consideration of the record evidence, the Commission adopts the recommendation of the ALJ on this matter. We conclude that the better approach is to proceed as agreed upon by the Joint Petitioners once the merger described within this proceeding is consummated. We agree with the ALJ that, at the time the investigation is undertaken, the scope can be altered and/or expanded to include consideration of the opposing Parties' proposals, if appropriate. Accordingly, the Exceptions of the City and PGW are denied.

VII. CONCLUSION

Based on the foregoing, we shall adopt ALJ Chestnut's November 30, 2005 Initial Decision. The Exceptions of the various Parties are denied; **THEREFORE,**

IT IS ORDERED:

1. That the Initial Decision of Administrative Law Judge Marlane R. Chestnut, issued November 30, 2005, is adopted, consistent with this Opinion and Order.

2. That the Exceptions filed on December 20, 2005, by the City of Philadelphia, the PPL Companies, and Philadelphia Gas Works to the Initial Decision of Administrative Law Judge Marlane R. Chestnut are denied.

3. That the Joint Petition for Settlement submitted by PECO Energy Company, Public Service Electric & Gas Company, Office of Trial Staff, Office of Consumer Advocate, Office of Small Business Advocate, Department of Environmental Protection, Citizens for Pennsylvania's Future, Joy Bergey and Lisa Z. Leighton, Action Alliance of Senior Citizens of Greater Philadelphia, Association of Community Organizations for Reform Now and Tenants' Action Group, the Philadelphia Area Industrial Users Group, The Reinvestment Fund, through its Sustainable Development Fund, Pennsylvania State Senator Anthony H. Williams, and the Energy Coordinating Agency of Philadelphia, Inc., at Docket No. A-110550F0160, is approved, including all terms and conditions.

4. That the Joint Application of PECO Energy Company and Public Service Electric and Gas Company for Approval of the Merger of Public Service Enterprise Group Incorporated with and into Exelon Corporation is granted, subject to the following condition:

The Joint Applicants shall make a post-merger compliance filing at FERC detailing the generation units that they intend to divest and identifying the proposed purchasers of those units, as required by FERC's July 1, 2005 Order approving the Merger. If, and to the extent that, FERC issues a final, non-appealable order in response to that compliance filing requiring the Joint Applicants to implement any additional mitigation, the Joint Applicants shall implement

such additional mitigation within the time period required by
FERC

5. That PECO Energy Company is hereby granted, and a Certificate of Public Convenience shall be issued, upon compliance with the conditions herein set forth, the right to consummate the merger of Public Service Enterprise Group Incorporated with and into Exelon Corporation as set forth in the Merger Agreement and Joint Application.

6. That any Protest filed in this proceeding and not satisfied or withdrawn pursuant to the terms of the Joint Petition for Settlement is denied.

7. That PECO Energy Company shall file with the Commission written notice of the merger within thirty (30) days of the consummation of that transaction.

8. That the record at Docket No. A-110550F0160 be marked closed.

BY THE COMMISSION,



James J. McNulty
Secretary

(SEAL)

ORDER ADOPTED: January 27, 2005

ORDER ENTERED: **FEB 01 2006**

**PENNSYLVANIA PUBLIC UTILITY COMMISSION
HARRISBURG, PENNSYLVANIA 17105-3265**

**Joint Application of PECO Energy
Company and Public Service Electric
And Gas Company for Merger**

**Public Meeting held January 27, 2006
JAN-2006-OSA-0037
Docket No. A-110550F0160**

STATEMENT OF CHAIRMAN WENDELL F. HOLLAND

Today, the Commission considers the Joint Application of PECO Energy Company (PECO) and Public Service Electric and Gas Company for approval of the merger of Public Service Enterprise Group Inc. with and into Exelon Corporation. With the combined legal and technical efforts of the Commission's multi-faceted resources, we are presented with a high-quality assessment and recommendation of a complex merger application. I would like to extend many thanks to our Office of Administrative Law Judge as well as the Office of Special Assistants, Office of Trial Staff and all of the other parties to the proceeding for their contributions.

When I became Chairman, I said this Commission would focus on rates, reliability and choice, so we can protect the public interest, promote economic development and preserve the environment. As I considered this case, I was pleased to find that its terms and conditions balance the responsibility to protect the public interest with the need to ensure the viability of utility companies. This settlement protects the public interest, encourages economic development and safeguards the environment.

Perhaps most important to all consumers is that the settlement caps the company's rates through December 2010, shielding consumers from the spikes in energy prices that negatively impact family budgets. Families and seniors will be able to better predict and budget for their energy usage for years to come. I want to underscore this point: PECO's rates have remained virtually the same since 1996 and will stay frozen through 2010.

PECO also made significant commitments to enhance its Consumer Assistance Program by agreeing to increase the amount of usage subject to discounted rates and to add a special needs component that will make bills more affordable for consumers at the lowest levels of poverty. The company agreed to increase its efforts to reach out to our neighbors in need, spending an additional \$1.2 million during the next four years to educate low-income consumers about the programs available to help them pay their bills.

Consumers also will reap the benefits from PECO supporting an extension to its commitments regarding reliability and customer service. PECO agreed to performance thresholds in eight areas that are critical in providing safe and reliable service and reasonable customer service.

Beyond making a commitment to renewable power and energy efficiency initiatives as well as economic development, the company also made a commitment to the City of Philadelphia and its residents. PECO pledged to maintain its corporate headquarters for its distribution business in the city through at least 2010. The company also agreed that many key workforce positions that affect reliability and customer service will not be reduced prior to January 2011.

The Public Utility Code requires that this Commission must affirmatively determine that the "public benefit will result" from any merger under consideration and that the merger will promote the "service accommodation, convenience or safety of the public" in some substantial way. I believe that the merged entity we approve today result in better service, reliability and rates for Pennsylvania's consumers.

January 27, 2006
DATE

Wendell F. Holland
Wendell F. Holland, Chairman

Joint Application of PECO Energy Company and Public Service Electric and Gas Company for Approval of the Merger of Public Service Enterprise Group Incorporated with and Into Exelon Corporation
Docket Number A-110550F0160

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ACKNOWLEDGEMENT OF RECEIPT & ACCEPTANCE OF SERVICE

AND NOW, to wit, this _____ day of _____, 20__,

the undersigned, as evidenced by execution hereof, acknowledges receipt, and accepts service of an Opinion and Order an official Commission document entered, issued, or otherwise promulgated under date of February 1, 2006 at Docket No. A-110550 16 on behalf of:

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OFFICE OF TRIAL STAFF

KENNETH L MICKENS ESQUIRE
ROBERT V ECKENROD ESQUIE
PA PUC OFFICE OF TRIAL STAFF
PO BOX 3265
HARRISBURG PA 17105-3265

Cathy Rayer
Signature

Kindly sign and date this acceptance of service and acknowledgement of receipt, and, return the same for filing to:

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Harrisburg, PA 17105-3265

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AND NOW, to wit, this 15th day of February, 2006,

the undersigned, as evidenced by execution hereof, acknowledges receipt, and accepts service of an Opinion and Order an official Commission document entered, issued, or otherwise promulgated under date of February 1, 2006 at Docket No. A-110550 F0160 on behalf of:

TANYA J MCCLOSKEY ESQUIRE
JAMES MULLINS ESQUIRE
OFFICE OF CONSUMER ADVOCATE
5TH FLOOR FORUM PLACE
555 WALNUT STREET
HARRISBURG PA 17101-1923


Signature

Kindly sign and date this acceptance of service and acknowledgement of receipt, and, return the same for filing to:

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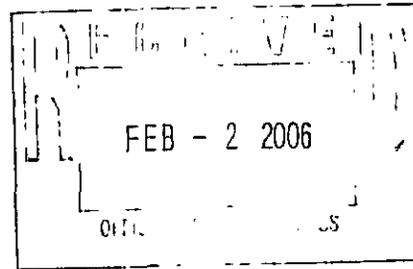
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ACKNOWLEDGEMENT OF RECEIPT & ACCEPTANCE OF SERVICE

AND NOW, to wit, this _____ day of _____, 20__,

the undersigned, as evidenced by execution hereof, acknowledges receipt, and accepts service of an Opinion and Order an official Commission document entered, issued, or otherwise promulgated under date of February 1, 2006 at Docket No. A-110550 F0160 on behalf of:

WILLIAM R LLOYD JR ESQUIRE
SHARON E WEBB ESQUIRE
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SUITE 1102 COMMERCE BUILDING
HARRISBURG PA 17101



Signature

Kindly sign and date this acceptance of service and acknowledgement of receipt, and, return the same for filing to:

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Harrisburg, PA 17105-3265

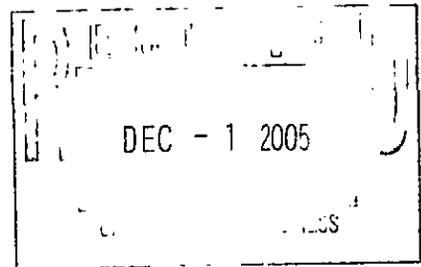
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ACKNOWLEDGEMENT OF RECEIPT & ACCEPTANCE OF SERVICE

AND NOW, to wit, this _____ day of _____, 20__,

the undersigned, as evidenced by execution hereof, acknowledges receipt, and accepts service of an Initial Decision an official Commission document entered, issued, or otherwise promulgated under date of November 30, 2005 at Docket No. A-110550 F0160 on behalf of:

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