



The Reinvestment Fund  
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October 14, 2005

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James J. McNulty, Secretary  
Pennsylvania Public Utility Commission  
Commonwealth Keystone Building  
400 North Street, 2nd Floor  
Harrisburg, PA 17120

Subject: 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 No. A-110550 F0160

Dear Secretary McNulty:

Enclosed for filing with the Commission are the original and nine copies of the  
Main Brief of The Reinvestment Fund in the above-referenced proceeding.

I have attached a Certificate of Service showing that all parties to this proceeding are  
being duly served.

Sincerely,

Roger E. Clark, Esq.

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PA PUBLIC UTILITY COMMISSION  
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Enclosures: Main Brief of The Reinvestment Fund  
Certificate of Service

Copies: See attached Certificate of Service

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BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION

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 No. A-110550 F0160

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MAIN BRIEF OF  
THE REINVESTMENT FUND

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**DOCKETED**  
OCT 18 2005

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**MAIN BRIEF OF THE REINVESTMENT FUND**

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**I. STATEMENT OF THE CASE**

On February 4, 2005, PECO Energy Company (“PECO”) and Public Service Electric & Gas Company (“PSE&G”)(collectively, “the Joint Applicants”) filed an Application with the Pennsylvania Public Utility Commission (“Commission”) seeking to obtain the approval of the Commission under Chapters 11, 22, and 28 of the Public Utility Code, for the merger of Public Service Enterprise Group (“PSEG”), the corporate parent of PSE&G, with and into Exelon Corporation (“Exelon”), the corporate parent of PECO and the ultimate corporate parent of the Joint Applicants.

The Reinvestment Fund (“TRF”) submitted a Petition to Intervene in the Exelon-PSEG merger proceeding on March 4, 2005. This Petition was unopposed by the Joint Applicants and was granted by Administrative Law Judge Marlane R. Chestnut in Prehearing Order #2 dated March 30, 2005 (see ¶5 on page 3). As TRF stated in its Prehearing Memorandum, it would focus its attention to the limited issue of how the Joint Applicants can best support the use of energy efficiency and demand management, renewable energy and advanced clean energy technologies in Pennsylvania.

TRF submitted the direct testimony of Lewis M. Milford (TRF Statement No. 1), along with two exhibits (Exhibits LMM-1 and LMM-2) on June 28, 2005. TRF also submitted the surrebuttal testimony of Lewis M. Milford (TRF Statement 1-SR) on August 24, 2005. Both pieces of testimony and the two exhibits were admitted into the record by order of the Administrative Law Judge on October 4, 2005.

Settlement discussions conducted by the parties resulted in a Joint Petition for Settlement (“Joint Petition”) that was executed by many of the parties to the proceeding and filed on September 13, 2005. The Reinvestment Fund was one of those signatories, along with the Joint

Applicants (PECO and PSE&G), the Office of Trial Staff, the Office of Consumer Advocate, the Office of Small Business Advocate, the Department of Environmental Protection, Senator Anthony Williams, Action Alliance of Senior Citizens of Greater Philadelphia, *et al.*, Citizens for Pennsylvania's Future, *et al.*, Energy Coordinating Agency, and the Philadelphia Area Industrial Energy Users Group. Although not signatories to the Joint Petition, the Labor parties (Exelon Utility Coordinated Councils, Locals 614 and 777 of the International Brotherhood of Electrical Workers and Frank Kuders) have submitted a letter indicating that they will not oppose the Joint Petition.

TRF submitted a *Statement of The Reinvestment Fund in Support of the Joint Petition for Settlement* on September 15, 2005 recommending that the Commission adopt the Joint Petition for Settlement as the basis of its Order.

## II. SUMMARY OF ARGUMENT

It is appropriate for the Pennsylvania Public Utility Commission ("Commission") to consider renewable energy, advanced clean energy technologies and energy efficiency as an element of the affirmative public benefit that must be present if the Commission is to approve the proposed merger. These technologies, which are collectively referred to as "clean energy" for the remainder of this brief, can increase the reliability of power, provide fuel diversity to protect ratepayers from escalating fuel prices, promote economic development by developing Pennsylvania resources, reduce the economic drain of electricity imports and lessen the damaging health and environmental impacts of pollution of our air, water and land. Because the Joint Petition for Settlement provides for increased support for clean energy technologies and

projects, TRF recommends that the ALJ and the Commission approve the comprehensive Joint Petition for Settlement and the proposed merger.

### III. ARGUMENT

#### A. **Expanded use of energy efficiency and demand management, renewable energy and advanced clean energy technologies offers the public considerable affirmative benefits in service, accommodation, convenience and safety of their electric utility system.**

The major theme of Mr. Milford's testimony and TRF's position in this case is that the expanded use of energy efficiency and demand management, renewable energy and advanced clean energy technologies offers the public considerable affirmative benefits in service, accommodation, convenience and safety of their electric utility system. Mr. Milford noted in his testimony several of the benefits of clean energy:

(1) Energy conservation and load management reduce peak demand and thereby increase the reliability of power by avoiding extreme peak loads that stress the utility grid. The value and cost effectiveness of these strategies are recognized by the large number of utilities and public utility commissions that are actively working to expand energy efficiency and demand response resources. (TRF Statement No. 1 at 7).

(2) Distributed generation, the deployment of smaller generation, increases the reliability of the power grid by lessening the dependence on a small number of huge generating stations that are far from the load centers. (TRF Statement No. 1 at 7).

(3) Clean energy projects protect ratepayers from escalating fuel prices by providing fuel diversity and lessening our dependence on natural gas. The March 2004 report by the Black & Veatch Corporation entitled *Economic Impact of Renewable Energy in Pennsylvania* analyzed the potential impacts to fossil fuel prices and consumption as a result of a 10% renewable

portfolio standard in Pennsylvania by consulting recent national and regional studies. According to the report, “[s]trong evidence has been presented by numerous studies that suggest that there are natural gas price impacts as a result of the adoption of renewable energy policies.” While noting that Pennsylvania uses less natural gas for electricity generation than the states in the studies, the report suggests that a 10% RPS in Pennsylvania could result in a 1% reduction in the cost of natural gas, which would result in fuel savings of almost \$140 million per year. (TRF Statement No. 1 at 7-8).

(4) Clean energy projects promote economic development by developing Pennsylvania resources and providing Pennsylvania jobs. A recent noteworthy example of this is the recent decision by Gamesa, the Spanish wind company, to locate both its North American business headquarters and a blade manufacturing facility in Pennsylvania. The Black & Veatch report cited above noted that compliance with a 10% RPS in Pennsylvania would result in \$10.1 billion additional gross state output over 20 years over the business-as-usual portfolio, would provide a \$2.8 billion advantage in earnings and would generate about 85,000 more job-years over 20 years than the business-as-usual portfolio. Other reports for other states report similar economic benefits. (TRF Statement No. 1 at 8).

(5) Clean energy projects protect public health by reducing emissions of dangerous pollutants and reduce the environmental impacts of pollution of our air, water and land. The deployment of clean energy technologies will result in reduced air and water pollution, enhancing the region’s competitive advantage. By using zero-emission technologies such as solar and wind sources and low-emission, advanced biomass technologies, clean energy projects reduce the emissions of major pollutants including carbon dioxide, nitrogen oxide, sulfur

dioxide, and mercury that stem from the current use of fossil fuel energy sources. (TRF Statement No. 1 at 9).

(6) Clean energy projects strengthen Pennsylvania's Electric Choice initiative and competitive markets for electricity. At an event celebrating the fifth anniversary of electric choice, then Chairman Glen R. Thomas stated:

As Pennsylvania celebrates five years of national leadership under electric competition, we can also celebrate national leadership when it comes to protecting the environment. Thanks to Electric Choice, Pennsylvanians can choose to light and heat their homes through green power. Nearly 120,000 Pennsylvanians have made this choice -- more than any other state. This demand has led to new technologies -- technologies that will enhance our reputation as the leader when it comes to utility competition, and technologies that will bring greater choices and services to Pennsylvania consumers. (TRF Statement No. 1 at 9).

TRF was not alone in this proceeding in acknowledging the benefits of clean energy. Both Department of Environmental Protection witness Daniel Desmond (DEP Statement No. 3) and PennFuture witness Thomas Tuffey (PennFuture Statement No. 1) provided compelling testimony about the benefits of energy conservation, load management, renewable energy, distributed generation and advanced clean energy technologies to the service, accommodation, convenience and safety of their electric utility system.

It is also worth noting that no other witness in this proceeding even attempted to undermine the argument that these clean energy options offer real and recognizable benefits in the service, accommodation, convenience and safety of the electric utility system.<sup>1</sup> These demand and supply options are now viewed as proven and accepted strategies for improving and

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<sup>1</sup> PECO witnesses O'Brien (PECO Statement No. 1-R) and Crowe (PECO Statement No. 7-R) and Office of Trial Staff witness Kalcic (OSBA Statement No. 2) challenged other aspects of the testimony of the TRF, DEP and PennFuture witnesses, but did not take issue with these points.

strengthening the electric utility system. The benefits of these strategies are now part of mainstream utility thinking.

**B. Pennsylvania public policy, as expressed by the state legislature, the Governor and his executive departments, and the Commission, is increasingly supportive of clean energy.**

It is clear that Pennsylvania public policy has moved in recent years to become increasingly supportive of energy conservation, load management, renewable energy, distributed generation and advanced clean energy technologies. Mr. Milford listed a number of events and actions that indicate a growing support for clean energy in Pennsylvania:

- (1) The creation of the regional sustainable energy funds in the 1998 settlement agreements of the restructuring proceedings for PECO Energy, Pennsylvania Power & Light, General Public Utilities and West Penn Power. (TRF Statement No. 1 at 10).
- (2) The increase in funding for the regional sustainable energy funds that was provided for in the settlement agreements of the PECO Energy/Unicom merger in 2000 and in the GPU/First Energy merger in 2002. (TRF Statement No. 1 at 10).
- (3) The expanded clean energy funding provided for by the Pennsylvania Department of Environmental Protection under the Energy Harvest Program. The third round of Energy Harvest funding, announced on May 4, 2005, will bring the total Energy Harvest support to \$15 million. (TRF Statement No. 1 at 10).
- (4) The rebirth of the Pennsylvania Energy Development Authority and the new funding it is providing for clean energy. On June 23, 2005, PEDA announced the award of \$10 million to 17 different energy projects. In making the announcement, DEP Secretary Kathleen McGinty noted:

We, in Pennsylvania, have the ingenuity and resources to develop and deploy new clean energy technology. Our commonwealth is offering significant financial incentives to make energy manufacturing a cornerstone in the state's economic future and ensure that more electricity generation comes from environmentally beneficial sources. PEDA refocuses our priorities on indigenous energy resources by investing in clean, efficient energy made in Pennsylvania. (TRF Statement No. 1 at 10-11).

(5) The enactment of the Advanced Energy Portfolio Standards Act of 2004 is the strongest statement that clean energy is official Pennsylvania public policy. This act requires electric distribution companies and electric generation suppliers to increase the percentage of the total power sold that comes for various clean and alternative energy sources. (TRF Statement No. 1 at 11).<sup>2</sup>

The trend is clear. Energy conservation, load management, renewable energy, distributed generation and advanced clean energy technologies have the support in the state legislature, in the Governor's Office, the executive departments and in the Commission. Policy makers at all levels are increasingly turning to clean energy options for strengthening and improving utility service in Pennsylvania.

**C. The Joint Petition for Settlement provides for new support for clean energy by PECO.**

The Joint Petition for Settlement provides that PECO will contribute \$12 million in new funding to the Pennsylvania Energy Development Authority for "renewable energy, energy efficiency and energy conservation (see ¶38 on pages 23-24) and \$7.2 million in funding to the Sustainable Development Fund (*ibid*). In addition, the Joint Petition provides \$8 million in new

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<sup>2</sup> PECO witnesses O'Brien (PECO Statement No. 1-R at 11) and Crowe (PECO Statement No. 7-R at 3) and Office of Trial Staff witness Kalcic (OSBA Statement No. 2 at 9-10) asserted that the AEPS preempted other utility support for clean energy, an argument that was strongly refuted by TRF witness Lewis Milford (TRF Statement 1-SR at 4-9). The inclusion of new funding for clean energy in the Joint Petition for Settlement indicates that PECO and OTS have withdrawn their objections to PECO support in this proceeding.

funding to the Pennsylvania Energy Development Authority to be used for “energy related economic development projects and initiatives” (see ¶52 on page 29). These are real dollars that will, in the coming years, be allocated to real projects. TRF looks forward to deploying its portion of these dollars for clean energy work in southeastern Pennsylvania.

The City of Philadelphia, in its *Statement in Opposition to Approval of the Merger Solely on the Terms of Joint Petition for Settlement*, called these payments a “modest short-term contribution to PEDDA” and “an even more modest one-time contribution to the Sustainable Development Fund.” (City Statement at 4). While TRF was initially seeking a higher funding level based in part on the funding levels of other state clean energy funds<sup>3</sup> and what it felt was the market need and opportunity, it accepts the amount contained in the Joint Petition and believes these amounts are a reasonable and supportable outcome of the negotiations for the settlement agreement. As for being a one-time contribution, TRF asked that its amount be paid in a single lump-sum, rather than in four annual payments. TRF also has the right to seek intervention in future PECO rate cases or other proceedings to seek additional support in the future. The funding to be provided by the Joint Petition is significant and will provide substantial affirmative benefit to the PECO ratepayers and region.

**D. The Joint Petition for Settlement provides for adequate affirmative public benefits to support of a certificate of public convenience for the merger.**

Because of the new financial support for clean energy and the other public benefits secured by the Joint Petition, TRF asserts that the proposed merger, as modified by the Joint

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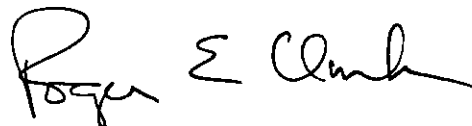
<sup>3</sup> Mr. Milford provided a table of the levels of funding for 24 clean energy funds around the country and all but one had a higher rate of funding than TRF’s Sustainable Development Fund. (TRF Statement No. 1 at 13). For example, the PSE&G funding of clean energy exceeds \$40 million per year. (TRF Statement No. 1 at 12). PECO witness Crowe pointed out that the PSE&G funding is the result of a statewide societal benefits charge, and he went on to note that “PECO would not necessarily be opposed to the development of a similar societal benefits charge in Pennsylvania...(PECO Statement No. 7-R at 7-8). But that clearly is outside the scope of this proceeding.

Petition for Settlement, will provide an adequate level of affirmative public benefit that must be present if the Commission is to award a certificate of public convenience to the Joint Applicants under 66 Pa. C.S. §1102(a)(3). TRF asserts that this merger is consistent with the “service, accommodation, convenience, or safety of the public.” 66 Pa. C.S. §1103(a).

#### IV. CONCLUSION

For the reasons set forth above, and the reasons set forth in the Joint Petition for Settlement and the TRF’s Statement in Support, TRF submits that the provisions of the Joint Petition represent a fair and reasonable balance of the many issues and interests in this proceeding. TRF also submits that the Joint Petition provides adequate affirmative public benefit to support the Commission’s approval of the proposed merger and the issuance of a certificate of public convenience.

Respectfully submitted,



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Date: October 14, 2005

**APPENDIX A.**

**PROPOSED FINDINGS OF FACT**

1. The benefits of clean, renewable energy include:
  - a) Improvements in distribution system reliability by reducing extreme peak loads that stress the utility grid. TRF Statement No. 1 at 7.
  - b) Improvement in distribution system efficiency by locating distributed generation near its use and therefore reducing system losses. DEP Statement No. 3 at 5.
  - c) Fuel diversity to protect ratepayers from escalating fuel prices and lessen our dependence on natural gas. Fuel diversity also improves electric system reliability by reducing our vulnerability to supply interruptions. DEP Statement No. 3 at 4-5. TRF Statement No. 1 at 7.
  - d) New jobs and economic development. PF Statement No. 1 at 5-6. TRF Statement No. 1 at 8.
  - e) Reduction in the dependence on foreign energy sources. PF Statement No. 1 at 5.
  - f) The reduction of air and water pollution and the protection of public health and environmental quality. PF Statement No. 1 at 5. TRF Statement No. 1 at 5 and 9.
  - g) The strengthening of Pennsylvania's Electric Choice initiative. TRF Statement No. 1 at 9.
2. The benefits of energy efficiency include:
  - a) Improvements in distribution system reliability by reducing extreme peak loads that stress the utility grid. DEP Statement No. 3 at 6-7. TRF Statement No. 1 at 7.

b) Reduction in the amount of generation needed to meet customer load, especially high-cost generation during periods of spiking demand. This provides serious financial savings for Pennsylvania households and business. DEP Statement No. 3 at 6-7. PF Statement No. 2 at 6.

3. Pennsylvania public policy has seen an increasing support for renewable energy and energy efficiency by the state legislature, the Governor and the Commission, including:

a) The creation of the regional sustainable energy funds in the 1998 settlement agreements of the restructuring proceedings for PECO Energy, Pennsylvania Power & Light, General Public Utilities and West Penn Power. TRF Statement No. 1 at 10.

b) The increase in funding for the regional sustainable energy funds that was provided for in the settlement agreements of the PECO Energy/Unicom merger in 2000 and in the GPU/First Energy merger in 2002. TRF Statement No. 1 at 10.

c) Executive Order Number 2002-8 of July 18, 2002 that declared that ensuring an affordable energy supply is critical to the welfare of Pennsylvania's citizens and to the continued economic prosperity of the Commonwealth and that maintaining a diverse and reliable energy portfolio will be critical to minimizing the effects of any single energy source on Pennsylvania's consumers and maintaining a sustainable supply of energy. DEP St. No. 3 at 2-3.

d) The expanded clean energy funding provided by the Pennsylvania Department of Environmental Protection under the Energy Harvest Program and the Pennsylvania Energy Development Authority. TRF Statement No. 1 at 10-11.

e) The enactment of the Advanced Energy Portfolio Standards Act of 2004 that requires electric distribution companies and electric generation suppliers to increase the percentage of the total power sold that comes for various clean and alternative energy sources

and that requires the adoption of new state-wide rules for interconnection and net metering of clean energy projects. PF Statement No. 3 at 10. TRF Statement No. 1 at 11.

4. The adoption of New Jersey procedures for net metering and interconnection in Pennsylvania offers significant benefits by encouraging the development of distributed renewable energy resources. PF Statement No. 3 at 3.

5. The Pennsylvania Energy Development Authority is an independent public financing authority that was created in 1982 by the Pennsylvania Energy Development Authority and Emergency Powers Act. The Authority's mission is to finance clean, advanced energy projects in Pennsylvania, including solar energy, wind, low-impact hydropower, geothermal, biomass, landfill gas, fuel cells, integrated gasification combined cycle, waste coal, coal-mine methane and demand management measures. DEP Statement in Support of Joint Petition for Settlement at 3. PF Statement No. 3 at 15-16.

6. In the Joint Petition for Settlement, PECO agrees to contribute \$12 million to the Pennsylvania Energy Development Authority to be used for the purposes of funding renewable energy, energy efficiency, and energy conservation projects with emphasis on energy conservation projects of benefit to the PECO service territory. Joint Petition at 23.

7. In the Joint Petition for Settlement, PECO agrees to contribute \$8 million to the Pennsylvania Energy Development Authority to be used for energy-related economic development projects and initiatives that benefit the PECO service territory. Joint Petition at 29.

8. The Sustainable Development Fund finances companies and projects in southeastern Pennsylvania that involve renewable energy, advanced clean energy, and energy

efficiency technologies. PF Statement No. 3 at 12-14. TRF Statement No. 1 at 14-15 and Exhibit LMM-2 at 25.

9. In the Joint Petition for Settlement, PECO agrees to provide \$7.2 million to the Sustainable Development Fund within three months after consummation of the merger. Joint Petition at 23-24.

10. In the Joint Petition for Settlement, PECO agrees to adopt net metering and interconnection rules that are materially consistent with safe utility practice and the corresponding rules currently in place in New Jersey unless the Commission, as part of its ongoing Alternative Energy Portfolio Standards ("AEPS") rulemaking proceeding at Docket No. M-00051865, adopts statewide net metering and interconnection rules that are inconsistent with the New Jersey rules.

11. Implementation of the Joint Petition for Settlement will assist the Commonwealth in carrying out Executive Order Number 2002-8 of July 18, 2002, will promote the use of efficient, clean and diverse energy technologies in Pennsylvania, will be of benefit to the PECO service territory, and will contribute to the continued economic prosperity of the Commonwealth by providing \$20 million over four years to the Pennsylvania Energy Development Authority. DEP Statement in Support of Joint Petition for Settlement at 2-3.

12. Implementation of the Joint Petition for Settlement will reduce retail electric distribution rates over a four year period for an aggregate total savings to PECO customers of \$120 million and will also cap its transmission and distribution charges for a four year period,

from January 1, 2007 through December 31, 2010. DEP Statement in Support of Joint Petition for Settlement at 4.

13. Implementation of the Joint Petition for Settlement will protect hundreds of jobs that are vital to service reliability because PECO has agreed to limitations on any reductions in its field forces prior to January 1, 2011. DEP Statement in Support of Joint Petition for Settlement at 4.

**APPENDIX B.**

**PROPOSED CONCLUSIONS OF LAW**

1. This Commission has jurisdiction over the subject-matter of the Joint Application which initiated these proceedings.
2. This Commission has jurisdiction over the parties to these proceedings.
3. Under Pennsylvania law, a public utility seeking approval of a merger must obtain a certificate of public convenience, 66 Pa.C.S. §1102(a)(3), which shall be granted only if “necessary or proper for the service, accommodation, convenience, or safety of the public.” 66 Pa.C.S. §1103(a).
4. In granting a certificate of public convenience, the Commission may impose such conditions as it may deem to be just and reasonable. 66 Pa.C.S. §1103(a).
5. A certificate of public convenience approving a merger will not be granted unless the Commission finds that the public will benefit as a result of the merger. *City of York v. Pennsylvania Public Utility Commission*, 449 Pa. 136, 141, 295, A.2d 825, 828 (1972).
6. Through the provisions of the Joint Petition for Settlement, the Joint Applicants have met their burden of demonstrating that the merger will provide affirmative public benefits to support the issuance of a Certificate of Public Convenience pursuant to 66 Pa.C.S. §1102 and §1103.

**APPENDIX C.**

**PROPOSED ORDERING PARAGRAPHS**

1. The Joint Applicants have established by a preponderance of substantial evidence that the merger, as described in the Merger Agreement and the Joint Application and as modified by the Joint Petition for Settlement, will affirmatively promote the service, accommodation, convenience, or safety of the public in a substantial way; and, therefore, satisfies the legal standard set forth in 66 Pa.C.S. §1103(a), as interpreted by the Pennsylvania Supreme Court in *York v. Pa. P.U.C.*, 449 Pa. 136, 295 A.2d 825 (1972), for the issuance of a certificate of public convenience evidencing the PUC's approval under 66 Pa.C.S. §1102(a)(3) of the merger.

2. *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*, as modified by the *Joint Petition for Settlement*, is hereby granted and approved.

3. PECO Energy Company is hereby granted a Certificate of Public Convenience evidencing approval of the merger under 66 Pa. C.S. §1103(a).

4. The Protests filed in this proceeding, and not withdrawn pursuant to the terms of the Settlement, are denied and dismissed.

5. The proceedings at Docket No. A-110550F0160 are concluded and the docket shall be marked closed.

6. PECO Energy Company shall file with the Commission and the parties written notice of the merger within 30 days of the consummation of that transaction.

**BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

JOINT APPLICATION OF PECO ENERGY :  
COMPANY AND PUBLIC SERVICE ELECTRIC :  
AND GAS COMPANY FOR APPROVAL OF THE : Docket No. A-110550 F0160  
MERGER OF PUBLIC SERVICE ENTERPRISE :  
GROUP INCORPORATED WITH AND INTO :  
EXELON CORPORATION :

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**CERTIFICATE OF SERVICE**

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I certify that on October 14, 2005, I had served a copy of the Main Brief of The Reinvestment Fund to the following persons in the manner shown below:

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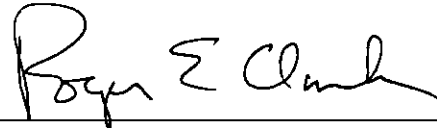
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October 14, 2005



COMMONWEALTH OF PENNSYLVANIA  
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IN REPLY PLEASE  
REFER TO OUR FILE

October 14, 2005

James J. McNulty, Secretary  
Pennsylvania Public Utility Commission  
P.O. Box 3265  
Harrisburg, PA 17105-3265

ORIGINAL

Re: 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 No. A-110550F0160

DOCUMENT  
FOLDER

Dear Secretary McNulty:

Enclosed for filing please find an original and nine (9) copies of the **Main  
Brief** of the Office of Trial Staff (OTS) in the above-captioned proceeding.

Copies are being served on all active parties of record.

Sincerely,

Kenneth L. Mickens  
Senior Prosecutor  
Office of Trial Staff

Enclosure

c: Parties of Record  
Hon. Marlane R. Chestnut

SECRETARY'S BUREAU

2005 OCT 14 AM 10:07

BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION

ORIGINAL

Joint Application of PECO Energy Company :  
and Public Service Electric and Gas :  
Company for Approval of the Merger of : Docket No. A-110550F0160  
Public Service Enterprise Group :  
Incorporated with and into Exelon :  
Corporation :

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MAIN BRIEF  
OF THE  
OFFICE OF TRIAL STAFF

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DOCUMENT  
FOLDER

Kenneth L. Mickens  
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Robert V. Eckenrod  
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P.O. Box 3265  
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Dated: October 14, 2005

**DOCKETED**  
OCT 18 2005

SECRETARY'S BUREAU  
OCT 14 2005

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## I. INTRODUCTION

### A. History of the Proceeding

On February 4, 2005, PECO Energy Company (“PECO”) and Public Service Electric and Gas Company (“PSE&G”) (collectively, “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.

Subsequently, on February 19, 2005, the Commission required that notice of the Joint Application be published in the *Pennsylvania Bulletin*, thereby allowing interested parties until March 7, 2005, to file protests and petitions to intervene. The Office of Trial Staff (“OTS”) filed a Notice of Appearance and, ultimately, twenty-three parties, including the Office of Consumer Advocate (“OCA”) and the Office of Small Business Advocate (“OSBA”), filed protests or petitions to intervene.

The case was assigned to the Office of Administrative Law Judge for disposition and a prehearing conference was convened on March 29, 2005, with Administrative Law Judge Marlane R. Chestnut (“ALJ”) presiding. Two public input hearings were held in Philadelphia on June 30, 2005. In accordance with the procedural schedule, OTS filed direct and surrebuttal testimony opposing the proposed merger on the basis that the Applicants had failed to demonstrate that the merger would result in substantial public benefits as required under the Public Utility Code.

By Secretarial Letter dated July 15, 2005, the parties were directed to respond to a series of five Directed Questions posed by Vice Chairman James H. Cawley and Commissioner Bill Shane. The parties served Supplemental Testimony in accordance with a revised procedural schedule addressing the Directed Questions.

Commencing in mid-May, the parties engaged in a collaborative process to address the issues raised by the Joint Application in an effort to resolve all outstanding issues. These discussions ultimately proved successful and resulted in a comprehensive settlement of issues in controversy among most of the parties. A Settlement in Principle was obtained on September 9, 2005.<sup>1</sup>

A Joint Petition for Settlement was submitted to the ALJ for disposition on September 12, 2005. OTS filed a Statement in Support of the Joint Petition for Settlement on September 14, 2005, submitting that the Joint Petition for Settlement was in the public interest and should be adopted by the ALJ and the Commission.

Hearings on outstanding issues (involving parties who had not agreed to the Settlement) were held in Philadelphia on September 22-26, 2005. Moreover, during that time, the testimony and exhibits of all of the parties were entered into the record.

#### **B. Overview of Settlement Terms and Conditions**

As set forth above, based upon a collaborative process, a Joint Petition for Settlement was agreed to by the Applicants, OTS and certain other parties to this proceeding. The salient provisions of the Settlement require that PECO's distribution

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<sup>1</sup> Both the City of Philadelphia and PGW opposed the Joint Petition in Settlement, while PPL and the Labor parties indicated that they neither supported nor opposed the Joint Petition.

rates be reduced by approximately \$120 million over a period of four years and continues the caps on PECO's current transmission/distribution rates through December 31, 2010. Moreover, the settlement also provides that PECO will be subject to more stringent corporate safeguards.

Specifically, the proposed settlement requires that within approximately thirty days of the consummation of the merger, PECO will reduce its retail electric distribution rates by \$40.0 million annually from the levels that otherwise would be in effect pursuant to the Commission's Order approving the 2000 Unicom Merger Settlement, and the December 19, 2002 Order approving the roll-in to base rates of the effects of the Revenue Neutral Reconciliation Gross Receipts Tax. The \$40.0 million distribution rate reduction is scheduled to remain in effect for two years, after which the annual rate decrease will become \$20.0 million. The \$20.0 million rate reductions will remain in effect for an additional two years, thereby producing aggregate rate reduction over the four year period of \$120 million.

PECO has also agreed, within the context of the settlement, to participate in a separate fact-finding investigation, instituted at the Commission's discretion, following the consummation of the merger, to examine the issues related to a potential consolidation of the operations of PGW with and into the natural gas distribution business of the merged company.

Additionally, PECO has agreed to implement a number of corporate safeguards designed to further insulate PECO's customers from the heightened risks associated with Exelon's non-jurisdictional operations. Among other things, PECO has agreed to

continue to maintain separate debt, guarantee that the cost of capital used in establishing PECO's rates shall not reflect any risk adjustment associated with its corporate parent and has agreed not to guarantee the debt or credit instruments of Exelon or any affiliate regulated by the Commission. Further, PECO has agreed to notify the Commission of: its intention to transfer more than 5 percent of PECO retained earnings to Exelon over a six-month period at least 60 days prior to any such transfer; its intention to declare a special cash dividend from PECO at least thirty days before declaring the dividend; and its most recent quarterly common stock cash dividend payment from PECO within thirty days after declaring the dividend. Moreover, PECO has agreed to provide the Commission with access to all written information provided to common stock, bond or bond rating analysts which directly or indirectly pertains to PECO or any affiliate that exercises influence or control over PECO.

Pursuant to the Settlement, PECO has also agreed to improve certain aspects of its customer service and reliability, expand its universal service efforts, and has committed to maintaining a corporate presence within the Commonwealth.

## II. DISCUSSION

### A. **The Merger, as Conditioned on the Settlement Terms, Provides Real and Substantial Benefits to PECO's Customers and is in the Public Interest.**

The benchmark for determining the propriety of a proposed merger is whether the merger would "affirmatively promote the 'service, accommodation, safety or convenience of the public' in some substantial way."<sup>2</sup> Moreover, the determining factor

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<sup>2</sup> *City of York v. Pennsylvania Public Utility Commission*, 449 Pa. 136, 141, 295 A.2d 825, 828 (Pa. 1973).

in evaluating the terms and conditions of a settlement are whether they are in the public interest.<sup>3</sup> Based upon the terms of the settlement, OTS submits that the proposed merger meets these standards, and, as such, should be approved by the ALJ and the Commission.

In the initial Joint Application, PECO did not propose to flow any merger savings directly through to PECO's ratepayers. Instead, it offered vague assertions that economies of scale may, invariably, lead to lower rates than what otherwise would have been attainable. However, as a result of the negotiated settlement, the proposed merger will yield PECO's customers a savings of \$120 million in distribution rates over the course of the next four years, thereby providing real, quantifiable benefits to PECO's ratepayers that may not have otherwise been available had this proceeding been fully litigated. Additionally, with PECO's agreement to extend the transmission and distribution rate cap until December 31, 2010, PECO's customers will enjoy a level of rate stability over the course of the next several years.

Also, as a result of the merger, both PECO and its ratepayers will benefit from the addition of corporate safeguards which are designed to insulate it from the non-jurisdictional operations of its affiliates and its parent, Exelon. These additional safeguards, negotiated as part of the settlement, are above and beyond the protections that otherwise may have been put in place had this proceeding been fully litigated.

PECO has also agreed to enhance customer service and service reliability over and above the levels it had agreed to in the 2000 Unicom Merger Settlement. Moreover, it has

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<sup>3</sup> See *Pennsylvania Public Utility Commission v. The York Water Company*, Docket No. R-00049165 (October 4, 2004); *Pennsylvania Public Utility Commission v. C. S. Water and Sewer Associates*, 74 Pa. PUC 767 (1991).

made a number of commitments that will enhance its universal service programs, as well as the operation of those programs.

In the aggregate, the commitments made by PECO in resolution of its Joint Application provide affirmative, substantial benefits to ratepayers, the community and PECO alike. As a result, approval of the Joint Petition in Settlement, and the Merger, is in the public interest.

Moreover, as evidenced by the support of the settlement and merger conditions on behalf of the many diverse parties to this proceeding, the conditional merger provides affirmative and substantial benefits on many levels. With the exception of market power issues, the only party to this proceeding that has opposed the Joint Petition in Settlement is the City of Philadelphia. Curiously enough, the proposed merger provides many significant benefits to the City, including an approximate rate reduction of \$1 million over the next four years, a commitment by PECO to retain its corporate headquarters in Philadelphia and a commitment to provide \$3 million in charitable giving and sponsorships. Considering the significant level of benefits provided to the City of Philadelphia under the Settlement, it is difficult to understand why it would oppose the Joint Petition in Settlement.

### III. CONCLUSION

**WHEREFORE**, for the reasons stated above, the Office of Trial Staff respectfully requests that the ALJ and the Commission adopt the Joint Petition in Settlement without modification because it is in the public interest.

Respectfully submitted,



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Senior Prosecutor

Robert V. Eckenrod  
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Office of Trial Staff  
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Dated: October 14, 2005

# Appendix A

## OTS PROPOSED FINDINGS OF FACT

1. That the proposed Joint Petition in Settlement is in the public interest. OTS Statement In Support of Settlement.

## OTS PROPOSED CONCLUSIONS OF LAW

1. The record in this proceeding supports a conclusion that the proposed merger, as modified by the Joint Petition for Settlement, would promote the service, accommodation, safety or convenience of the public in a substantial way. See, *City of York v. Pennsylvania Public Utility Commission*, 449 Pa. 136, 141, 295 A.2d 825, 828 (Pa. 1973).

## OTS PROPOSED ORDERING PARAGRAPH

1. The proposed merger application, as modified by the Joint Petition for Settlement is approved.

BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Joint Application of PECO Energy Company :  
and Public Service Electric and Gas :  
Company for Approval of the Merger of : Docket No. A-110550F0160  
Public Service Enterprise Group :  
Incorporated with and into Exelon :  
Corporation :

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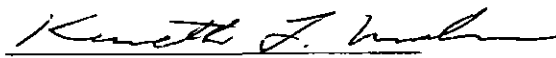
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Docket No. A-110550F0160

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Joint Application of PECO Energy and  
Public Service Electric and Gas Company

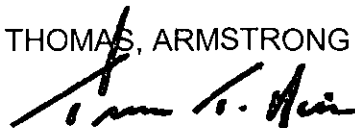
Dear Secretary McNulty:

We represent Philadelphia Gas Works in the above referenced proceeding and on October 13, 2005, filed our Main Brief with you. There were two versions to the Main Brief: a Proprietary Version and a Public Version. It has come to our attention that some of the paper copies of the Public Version of the Main Brief did not contain a Page 14. To be sure that the Public Version of the Main Brief is complete, we are enclosing for filing an original and nine (9) copies of Page 14 and ask that you insert the page into the Public Version of the Main Brief. Copies of Page 14 and this letter are being served upon the persons and in the manner set forth on the Certificate of Service.

Very truly yours,

THOMAS, THOMAS, ARMSTRONG & NIESEN

By



Thomas T. Niesen

Encl.

cc: Certificate of Service  
Steven P. Hershey, Esquire (w/encl.)  
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Table 1  
Impact of the Proposed Exelon/PSEG Merger  
on Concentration in the PJM East Delivered Gas Market

Participant	Pre-Merger			Post-Merger		
	Contracts (Mmcf/d)	Market Share	HHI	Contracts (Mmcf/d)	Market Share	HHI
Exelon/PSEG	--	--	--	2,035	40%	1,585
PSEG	1,663	33%	1,059	--	--	--
New Jersey Resources	686	13%	180	686	13%	180
Exelon	372	7%	53	--	--	--
Pepco	311	6%	37	311	6%	37
Philadelphia Gas Works	295	6%	33	295	6%	33
UGI Corp	256	5%	25	256	5%	25
NUI Corporation	250	5%	24	250	5%	24
South Jersey Industries	230	4%	20	230	4%	20
NiSource Inc	215	4%	18	215	4%	18
Williams Energy	116	2%	5	116	2%	5
Dominion	97	2%	4	97	2%	4
Sunoco	93	2%	3	93	2%	3
PPL	74	1%	2	74	1%	2
WGL Holdings	68	1%	2	68	1%	2
Keyspan	55	1%	1	55	1%	1
Southern Union Company	48	1%	1	48	1%	1
Philadelphia Authority For Industrial Development	35	1%	0	35	1%	0
Amerada Hess Corporation	34	1%	0	34	1%	0
Others	214	4%	1	214	4%	1
	5,112	100%	1,469	5,112	100%	1,942

The PJM East gas market, thus, would be highly concentrated post-merger. See *DQE, Inc., supra*. Additionally, the proposed merger increases the HHI by over 470. If the post-merger HHI exceeds 1,800 and the change (increase) in the HHI exceeds 100, "it is presumed that the merger is likely to create or enhance market power." PGW St. No. 1 at 15-17.

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Before The  
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Administrative Law Judge  
Marlane R. Chestnut, Presiding

Joint Application of PECO Energy : Docket No. A-110550F0160  
Company and Public Service Electric :  
and Gas Company for Approval of :  
the Merger of Public Service :  
Enterprise Group Incorporated with :  
and Into Exelon Corporation :

SECRETARY'S BUREAU

2005 OCT 19 PM 4:05

10/19/05

**CERTIFICATE OF SERVICE**

I hereby certify that I have this 19<sup>th</sup> day of October, 2005, served a true and correct copy of the foregoing letter and Page 14 of the Public Version of the Main Brief of Philadelphia Gas Works, upon the persons and in the manner set forth below:

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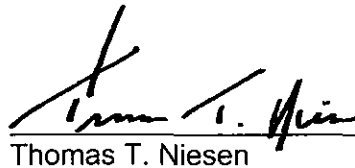
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October 20, 2005

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PA PUBLIC UTILITY COMMISSION  
SECRETARY'S BUREAU

Via UPS Overnight

James J. McNulty, Secretary  
Pennsylvania Public Utility Commission  
Commonwealth Keystone Building  
400 North Street, 2<sup>nd</sup> Floor  
Harrisburg, Pennsylvania 17120

Re: 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 No. A-110550F0160

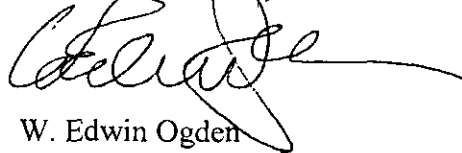
Dear Secretary McNulty:

Enclosed herewith for filing on behalf of Metropolitan Edison Company, Pennsylvania Electric Company, Pennsylvania Power Company and FirstEnergy Solutions Corp. are an original and nine (9) copies of the Reply Brief. Also enclosed is a disk in Word containing the Reply Brief.

I have served copies of this document on all parties to this proceeding as shown on the attached Certificate of Service. The Administrative Law Judge will receive a disk containing the Reply Brief in Word version, in addition to a hard copy, via UPS Overnight.

Respectfully submitted,

RYAN, RUSSELL, OGDEN & SELTZER LLP



W. Edwin Ogden

**DOCUMENT  
FOLDER**

Enclosures  
WEO:jab

c: The Honorable Marlane R. Chestnut (via UPS Overnight)  
Per Certificate of Service

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BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION

JOINT APPLICATION OF PECO ENERGY COMPANY  
AND PUBLIC SERVICE ELECTRIC AND GAS  
FOR APPROVAL OF THE MERGER OF  
PUBLIC ENTERPRISE GROUP INCORPORATED  
WITH AND INTO EXELON CORPORATION

DOCKET NO. A- 110550F0160

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REPLY BRIEF  
ON BEHALF OF  
FIRSTENERGY COMPANIES  
PA PUBLIC UTILITY COMMISSION  
SECRETARY'S BUREAU

DOCUMENT  
FOLDER

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DOCKETED  
OCT 25 2005

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**I. Scope of FirstEnergy Companies' Reply Brief**

This Reply Brief on behalf of the FirstEnergy Companies responds to arguments set forth in the Applicants' Initial Brief, with respect to market power issues, that are either unsupported or unsupportable, or both; and are contrary to the evidence in this proceeding, including the substantial evidence of record produced by the FirstEnergy Companies.

For purposes of consistency, defined terms that are used in the FirstEnergy Companies' Main Brief also are used for purposes of this Reply Brief.

The FirstEnergy Companies' Main Brief fully discusses their market power concerns with the Proposed Merger, pointing out that no substantial evidentiary basis exists in this proceeding which would permit the Commission to approve the Proposed Merger from a market power perspective. This Reply Brief refers back to portions of the FirstEnergy Companies' Main Brief, where appropriate, and incorporates those portions that address various arguments made in the Applicants Initial Brief.

## II. Argument

### A. Potential Adverse Market Power Consequences of the Proposed Merger Remain Unresolved

The sufficiency of the market power mitigation plan that the Applicants have proposed, to remedy the significant market power issues they admit are otherwise of serious concern in the context of a merger the size of the Proposed Merger, remains unresolved at this point. See FirstEnergy Companies' Main Brief at pages 8-19; PECO Statement No. 3, page 3; FERC Order, paragraphs 128, 142, 178 and ordering paragraph (G)<sup>1</sup>.

This is the proverbial "elephant in the room" that the Applicants would strongly prefer to ignore – but, the absence of substantial and conclusive evidence in this proceeding establishing the sufficiency of the Applicants' remedial plan to curb potential adverse market power consequences of the Proposed Merger cannot be ignored.

The Applicants bear the burden of proof in this proceeding. Furthermore, the Commission's decision in this case must be based on substantial evidence. See FirstEnergy Companies' Main Brief at pages 5-7.

No substantial evidentiary basis exists in this proceeding from which the Commission could conclude that the market power concerns related to the Proposed Merger, established by numerous intervenors including the FirstEnergy Companies, have been sufficiently addressed as required by the market power remediation provisions of the Electric Competition Act. 66 Pa. C. S. § 2811. Also, see the discussion of market power evidence in the FirstEnergy Companies' Main Brief, at pages 7- 19.

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<sup>1</sup> Appendix B to the Applicants' *Initial Brief* contains the FERC Order. The pagination differs from the copy used for and referenced in the FirstEnergy Companies' Main Brief. Thus, for clarity, the further references to the FERC Order are to paragraph numbers rather than to page numbers.

The Applicants' efforts to pick through, criticize and otherwise attempt to discredit various details of the several expert market power analyses conducted by other parties for purposes of this proceeding amount to nothing more than a smoke screen. When all the evidentiary dust settles, the result remains unsubstantiated and inconclusive.

Furthermore, in striving so mightily to create conclusive proof where none exists, the Applicants end up with positions that are inconsistent with the evidence in this case, and applicable legal precedents. These inconsistencies, and the end result, are discussed further below.

**B. The Applicants' Selective Acceptance of Commission Jurisdiction Over Market Power Concerns Must Be Rejected**

The FirstEnergy Companies have not taken a position on whether the Commission should exercise jurisdiction generally over the Proposed Merger. However, the Applicants have requested approval of the Joint Petition for Settlement, and the issuance of a certificate of public convenience, pursuant to the Commission's authority to approve mergers under Section 1103 of the Public Utility Code, 66 Pa. C. S. § 1103 and the Pennsylvania Supreme Court's decision in York v. Pa.P.U.C., 295 A2d. 825 (1972). See Appendix A to Applicants' Initial Brief, proposed conclusion 2 and proposed ordering paragraphs 2 and 3. In view of such requests, a similar tacit acceptance of Commission jurisdiction over the Proposed Merger should apply to the Commission's exercise of its obligations under the market power provisions of the Electric Competition Act. 66 Pa. C. S. § 2811. Yet, the Applicants continue to press arguments that the Commission has no jurisdiction to consider market power impacts of the Proposed Merger, and that the FERC proceeding and FERC Order pertaining to the Proposed

Merger have nothing to do with *retail* competition. See Applicants' Initial Brief at pages 9, 36.

As set forth below, such arguments are contrary to applicable legal precedents as well as the evidence in this proceeding, including the Applicants' evidence.

**1. The Commission has broad authority to protect retail customers from market power abuses pursuant to Section 2811 of the Electric Competition Act.**

The Applicants argue that the Commission may embark upon inquiries concerning a proposed merger's market power impacts only when the Commission otherwise has jurisdiction over the proposed merger; and, that if the Commission finds the Proposed Merger does not require approval under Chapter 11 of the Public Utility Code, then the Section 2811 provisions of the Electric Competition Act, governing remedial action for market power concerns, are not applicable. Applicants' Initial Brief at page 9.

First, such an argument should not be relevant where the relief sought includes Chapter 11 approval. As pointed out above, the Applicants do seek such relief.

Moreover, such an argument is incorrect as a matter of law. Section 2811 provides the Commission with broad and substantial authority, and an obligation, to review and remedy any market power concerns that threaten Pennsylvania's retail competitive electricity market. Although Section 2811(e) pertains directly to proposed mergers, there is no express reference back to Chapter 11 as being the exclusive authority over mergers. The Commission also has ample authority under Sections 2811(a), 2811(b), 2811(c) and 2811(d) to address market power concerns with the Proposed Merger. 66 Pa.C.S. §§ 2811(a)-(d). Indeed, another party to this proceeding has

recommended that the Commission pursue its remedies under Section 2811(d). See PPL Companies' Main Brief at pages 54-58.

**2. Ample legal precedents link the potentially adverse market power impacts in the wholesale and retail competitive electricity markets, and discourage premature approval of unknown market power consequences.**

On one hand, the Applicants are quick to cite ARIPPA v. Pa.P.U.C., 792 A.2d 636 (at 657-658), to support the proposition that the FERC's review and findings on wholesale market competition should be used to support findings by this Commission with respect to impacts of a proposed merger on retail competition.<sup>2</sup> Applicants' Initial Brief at page 18.

In Re DOE, Inc., 186 PUR4th 39 (1998), the Commission also directed that the FERC's "Appendix A" analysis should be used to assess retail market power and competitiveness issues for electric utility mergers. 186 PUR 4<sup>th</sup> at 47. The Applicants have acknowledged and purport to rely on this precedent. See Applicants' Brief at page 16; and, Appendix A thereto at page 16.

On the other hand, the Applicants are quick to ignore the DOE and ARIPPA precedents when confronted with the FERC's reservation of its final judgment in this case as to whether or not the Applicants' proposed mitigation plan is sufficient to curb market power related to the Proposed Merger; arguing, instead, that FERC's wholesale market power review has nothing to do with retail competition. The Applicants emphasize that the Commission's focus is on whether the Proposed Merger will disrupt *retail* competition, and argue that parties raising market power issues in this proceeding did not focus on Pennsylvania's *retail* market but instead focused on the

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<sup>2</sup> ARIPPA involved the 2001 merger of the FirstEnergy Companies' parent entities.

FERC's wholesale market analysis. Id., at page 18. The Applicants argue that the FERC proceeding (in which a further filing and "Appendix A" analysis from the Applicants have been ordered, following the completion of the Applicants' planned generation asset divestiture, to determine whether Applicants' proposed market power mitigation has been sufficient to overcome market power concerns) deals wholly with wholesale markets, and that nothing about that filing will relate to retail competition. Id., at page 36.

Contrary to the Applicants arguments, the ample legal precedents, above, firmly establish that the "Appendix A" analysis yet to be completed at the FERC is relevant, applicable and related to this Commission's market power determination in this proceeding.

The Commission's decision in DQE also provides clear precedent for the Commission to proceed cautiously. In that case, involving a proposed Allegheny Power System/DQE, Inc. merger, the Commission specifically acknowledged that a post-merger review of market power is disfavored because after a merger has been consummated it is far more difficult to address and correct market power abuses. 186 PUR 4<sup>th</sup> at 60-61.

As an evidentiary matter, the Applicants are quick to overlook the unrefuted evidence from the FirstEnergy Companies in this case that the robust retail competitive electricity market envisioned by the Commission in the ARIPPA case has not materialized. See FirstEnergy Companies' Main Brief at pages 13-15. Such unrefuted evidence suggests the need for additional caution in reviewing and signing off on market power impacts of a proposed merger, not a premature rush to judgment as advocated by the Applicants.

It is clear that the FERC Order views a further review of market power from the Proposed Merger, after divestiture, to be necessary. The FERC concluded that such review is needed “to be sure that, at the conclusion of the divestiture, competition has been restored to its pre-merger level, for the merger to be consistent with the public interest.” Appendix B to Applicants’ Initial Brief, FERC Order paragraph 128. In view of such caution, it is hardly appropriate for this Commission to rush to a conclusion about the market power impacts of the Proposed Merger.

**3. Substantial evidence, including Applicants' evidence, links the potentially adverse wholesale and retail competitive electricity market impacts of the Proposed Merger.**

The Applicants' effort to drive a jurisdictional wedge between the Commission's jurisdiction over market power in retail competitive markets under Section 2811, and the FERC's jurisdiction over wholesale markets, is without merit as a matter of legal precedent, as set forth above. It is also contrary to the substantial evidence in this proceeding. First, the Applicants' own market power expert witness, Dr. Hieronymus, testified that wholesale prices drive retail prices. Furthermore, Dr. Hieronymus relied on his analyses conducted in the FERC proceeding as the basis for his conclusions about retail competition in the context of this Commission proceeding. PECO Statement No. 3, pages 2, 8-9; PECO Statement 3-R, pages 1-3.

In addition, expert testimony from the FirstEnergy Companies' witnesses, William D. Byrd and Julia Frayer, established the interrelationship between wholesale market activity and Pennsylvania's retail competitive electricity market. See e.g., Met-Ed/Penelec/Penn Power Statement No. 1, pages 7-10; Met-Ed/Penelec/Penn Power Statement No. 1-S-1, pages 8-11; Met-Ed/Penelec/Penn Power Statement No. 3, pages 4-

8; Met-Ed/Penelec/Penn Power Statement No. 3-S, pages 2-6; FirstEnergy Companies' Main Brief at pages 11-19.

Other intervenors with market power concerns related to the Proposed Merger likewise established the link between the wholesale and retail competitive electricity markets. See e.g., PPL Companies' Main Brief at pages 17-18.

The Applicants gloss over this evidence by asserting that all the parties' arguments were considered and rejected by the FERC. Applicants' Initial Brief at 4, 18-19. In response, it must first be pointed out that such a bold assertion does not do justice to the FERC process, or to the reservation of judgment in the FERC Order. The FERC Order recognized that the Applicants' analysis had errors, and that other parties did raise valid issues. Appendix B to Applicants' Initial Brief, FERC Order e.g., paragraphs 121, 128.

But, moreover, such an assertion by the Applicants is itself contrary to the Applicants' "theory" that the FERC proceeding and FERC Order are not germane to this Commission proceeding and issues of retail electricity market competition, and just highlights the total invalidity of arguing that the FERC and Commission proceedings involve separate and distinct market power issues. The record evidence on market power in this Commission proceeding from all parties, including the Applicants, consists of analyses conducted for the FERC proceeding. Applicants efforts to now deny that there is an integral relationship between such FERC evidence and retail competition are wholly without merit.

Furthermore, although the Applicants challenged some of Ms. Frayer's findings, they did not challenge the fundamental wholesale-retail market link she

established.<sup>3</sup> Moreover, the Applicants did not challenge Mr. Byrd's testimony at all. And, Mr. Byrd's points were not addressed by the FERC Order. These experts for the FirstEnergy Companies established substantial evidence of record, that remains unchallenged, concerning the potential adverse impact on Pennsylvania's retail competitive electricity market from the Proposed Merger's market power, if not sufficiently mitigated. See FirstEnergy Companies' Main Brief at pages 11-19.

**4. The Applicants' conclusion concerning potentially adverse market power consequences of the Proposed Merger, and related requested relief, is unsupported and unsupportable on the basis of the current record in this proceeding.**

The Applicants conclude, as follows (Applicants' Initial Brief at page 36):

Because there is no reason to believe that FERC's review of the compliance filing will not adequately address all wholesale competition issues, there is no reason for this Commission to duplicate FERC's review of that compliance filing. Such an effort would be a meaningless exercise.

This conclusion totally misses the point of this Commission's obligations to protect the retail competitive market. The FERC Order specifically made the point that the pending filing for approval of the Proposed Merger at this Commission means that the Commission "will therefore be able to protect" its own jurisdiction. Appendix B to Applicants' Initial Brief, FERC Order paragraph 213. The Applicants are urging that this Commission dismiss its obligations simply by deferring to the FERC.

The Applicants are asking this Commission to commit to something that the FERC Order has not yet resolved. The FERC has predicated its approval of the Proposed Merger on a further filing to be made by the Applicants after their generation asset divestiture is completed, and pursuant to which the FERC will then decide whether

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<sup>3</sup> The Applicants attempt to discredit Ms. Frayer's testimony by asserting a purported lack of experience in market power issues before FERC. *Id.* at 23. The Applicants have overlooked Ms. Frayer's extensive experience with such issues. Met-Ed/Penelec/Penn Power Statement No. 3, Appendix A.

further market power mitigation is required beyond what the Applicants have proposed thus far. Yet, the Applicants are asking this Commission to step in and approve market power elements of the Proposed Merger, before such aspects have been thoroughly reviewed in the still pending FERC proceeding. The Commission should not accept any such invitation to be first-in-line in providing a *carte blanche* blessing to a proposed merger that has such significant and, as yet, unresolved market power consequences.

**C. The Joint Petition for Settlement Does Not Resolve Lingering Market Power Concerns**

The FirstEnergy Companies have not taken a position as to whether the Joint Petition for Settlement provides public benefits. However, the proposed settlement does not address the void in the record in this proceeding concerning market power concerns of several of the intervenors that have been raised and supported by substantial evidence, and remain unresolved. See FirstEnergy Companies' Main Brief at 10-11.

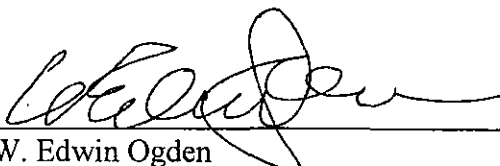
### III. Conclusion

The Applicants cannot manufacture evidence out of arguments. The present state of the record in this proceeding does not include an evidentiary basis that would permit the Commission to conclude that the admitted anticompetitive impacts of the Proposed Merger will be remedied by the current mitigation plan. The sufficiency of that plan is still subject to the FERC's review and approval.

For all of the reasons set forth on behalf of the FirstEnergy Companies in their Main Brief and in this Reply Brief, the Applicants' Proposed Merger cannot be approved at this point.

Respectfully submitted,

Dated: October 20, 2005



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OCT 20 2009

BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION

PA PUBLIC UTILITY COMMISSION  
SECRETARY'S BUREAU

Joint Application of PECO Energy :  
Company and Public Service Electric :  
and Gas Company for Approval of : Docket No. A-110550F0160  
the Merger of Public Service Enterprise :  
Group Incorporated with and into Exelon :  
Corporation :

CERTIFICATE OF SERVICE

I hereby certify that I have this day served copies of FirstEnergy Companies' Reply Brief upon the persons and in the manner indicated below in accordance with the requirements of 52 Pa. Code § 1.54.

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SECRETARY'S BUREAU

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**RE: Joint Application of PECO Energy Company and Public Service  
Electric & Gas Company for Approval of the Merger of Public  
Service Enterprise Group, Inc., with and into Exelon Corporation;  
Docket No. A-110550F0160**

Dear Secretary McNulty:

Enclosed please find the original and nine (9) copies of the Reply Brief of the City of Philadelphia in the above-referenced proceeding. We have also enclosed a copy of the brief On diskette in Word format.

As evidenced by the attached Certificate of Service, all parties to the proceeding are being served with a copy of this filing. Please date stamp the extra copy of this transmittal letter and kindly return it to our messenger for our filing purposes. Thank you.

Sincerely,

*Daniel W. Cantú-Hertzler*  
Daniel W. Cantú-Hertzler

Enclosures

Cc: Honorable Marlane Chestnut, Administrative Law Judge  
All parties (per Certificate of Service)

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Before the  
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Administrative Law Judge  
Marlane R. Chestnut, Presiding

Joint Application of PECO Energy Company : Docket No. A-110550F0160  
and Public Service Electric and Gas Company :  
for Approval of the Merger of Public Service :  
Enterprise Group Incorporated with and into :  
Exelon Corporation :

REPLY BRIEF OF  
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## I. INTRODUCTION

The City of Philadelphia (“City”) relies on its Main Brief served October 13, 2005, and files this Reply Brief in response to the Main Brief of PECO Energy Company (“PECO”) and Public Service Electric & Gas Company (“PSE&G”) (jointly, “Applicants”). In summary, the City argues herein that: 1) the emerging company will have significant market power and therefore the Public Utility Commission (“PUC” or “Commission”) should not defer to the Federal Energy Regulatory Commission (“FERC”) but should fully review this issue as required under state law, and 2) if the merger is allowed, the Commission should consider Philadelphia Gas Works (“PGW”) in devising a remedy to the undue market power.<sup>1</sup>

## II. ARGUMENT

### A. **The Public Utility Commission Should Not Defer to the FERC Here.**

Applicants repeatedly argue that the Commission must defer to the July 5, 2005 decision of the FERC concerning market power. (*E.g.*, Applicants’ Main Brief at 17-18, 38.) While the PUC certainly has the discretion to defer to a final decision of the FERC, it should not do so in this instance. Most basically, there is no outstanding final decision, because the FERC granted reconsideration on August 29, 2005. *Kokajko v. FERC*, 837 F.2d 524 (1<sup>st</sup> Cir. 1988); *City of Tacoma v. FERC*, 2000 U.S. App. LEXIS 4071 (D.C. Cir. 2000) (order of which agency has granted reconsideration is not a final order). In *ARIPPA v. Pa. PUC*, 792 A.2d 636 (Pa. Commw. 2002), FERC had *denied* rehearing before the PUC relied on its findings concerning market power in orders issued May 24 and June 20, 2001. *See* FERC Docket No. EC01-22-000 (final order issued Mar. 15, 2001; reh’g granted May 4, 2001; reh’g denied May 7, 2001).

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<sup>1</sup> The City does not respond to every argument of parties but only those requiring further discussion. By not addressing an argument put forth in an opposing main brief, the City does not acquiesce to its allegations or conclusions.

Moreover, even if the PUC had the discretion to defer to the FERC at this time, it should not do so in this instance. The FERC did not consider or refer to the testimony of Paul Carpenter or any similar testimony, about potential vertical market power over electricity prices via power in the natural gas market; nor did it hear any live testimony or cross-examination.<sup>2</sup> See *Exelon Corporation - Public Service Enterprise Corporation, Inc.*, 112 FERC ¶ 61,011 (2005). The Electricity Generation Customer Choice and Competition Act, 66 Pa. C.S. §§ 2801-2812, and the Natural Gas Choice and Competition Act, 66 Pa. C.S. §§ 2201-2212, mandate that the PUC conduct its own investigation concerning market power. As provided in 66 Pa.C.S. § 2811, the Commission “shall monitor the market . . . to prevent anticompetitive or discriminatory conduct and the unlawful exercise of market power.” § 2811(a). Further, “[u]pon complaint or upon its own motion for good cause shown, the commission shall conduct an investigation of the impact on the proper functioning of a fully competitive . . . market, including the effect of mergers, consolidations, acquisition or disposition of assets . . .” § 2811(b). The Commission has also otherwise maintained jurisdiction in order to monitor and control possible anti-competitive behavior and address market power issues, See *Re DQE, Inc.*, 1998 Pa. PUC LEXIS 148 (Pa. PUC 1998).

It would be inappropriate for the Commission to defer to the FERC under these circumstances, where the FERC did not even consider important evidence, let alone test it in an evidentiary hearing.

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<sup>2</sup> Especially absent a hearing, it is difficult to accept Applicants’ characterization of “the efficacy of the Joint Applicants’ virtual divestiture proposal” as “hotly litigated.” (Applicants’ Main Brief at 33.)

**B. The Proven Ability of the Merged Company to Utilize Future Market Power in the Wholesale Natural Gas Market Demonstrates an Ability to Affect Retail Electricity Prices.**

Applicants claim to have established that any effect on electricity rates is unlikely, because of the electricity rate freeze under the Joint Petition for Settlement. (Applicants' Main Brief at 37-38.) However, in considering an application for a certificate of public convenience, it is appropriate for the Commission to consider effects at least ten years out. *See Virginia Electric & Power Co.*, NO. E-22, SUB 418, 2005 Pa. PUC LEXIS 5, \*28 (April 19, 2005). Based on Dr. Carpenter's compelling testimony, it is reasonably likely that EEG's power in the natural gas market within the PJM-East territory will affect both wholesale and retail electricity rates,<sup>3</sup> given the PJM pricing mechanism and EEG's prospective control over many nuclear power plants able to produce electricity at a small fraction of the marginal cost of gas-produced electric power at such times.

**C. The Question Is Potential to Exercise Market Power, Not Whether Market Power Would Be "Highly Concentrated" Both Upstream and Downstream.**

Applicants argue that the PUC must reject a challenge based on vertical market power unless "both the upstream and the downstream markets are highly concentrated after the merger, *i.e.*, the HHI is above 1,800." (Applicants' Main Brief at 38-39.) That is not the law; rather, the question is whether the merger will significantly increase Applicants' potential use of market power.

While the FERC did state in *Engage Energy America, LLC*, 98 F.E.R.C. ¶ 61,207, 61,750, 2002 FERC LEXIS 351, \*17 (Feb. 27, 2002), that "both highly concentrated common

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<sup>3</sup> It makes no sense to argue, as Applicants appear to do on page 17 of their Main Brief, that the witnesses' focus on wholesale markets means they cannot have demonstrated an impact on retail prices, which will be dependent on wholesale prices after 2010.

upstream and downstream markets are necessary in order to allow effective strategies of foreclosure or raising rivals' costs," the question here is not so much power over competitors as the ability to raise electricity prices. As Dr. Carpenter has shown, EEG will be able to do that effectively because it can raise the price of natural gas supply under certain circumstances, thereby increasing the price *all* generators receive for electricity, but benefiting EEG the most because of its monopoly on cheap-to-produce electricity from nuclear power plants. Direct Testimony of Dr. Carpenter, PGW Statement No 1 ("PGW-1") at 4. In *Engage Energy America*, the merger did not increase any ability of Duke Energy to exercise vertical market power associated with control of transmission as Duke Power agreed to transfer control of its transmission facilities. *Id.* at ¶ 61,750, 2002 FERC LEXIS 351 at \*17. In the NEPOOL market, the merged company would control 20%, compared with 40% of the downstream market under the proposed Exelon/PSEG merger and the NEPOOL market concentration was borderline moderate, 1,016, compared with 1,942 per Dr. Carpenter, PGW-1 at 17, and 1,572 even per Dr. Hieronymus, PECO Exh. WHH-1 at Exh. J-16. In the Midwest, upstream markets had HHIs no higher than 1,356, and the applicants controlled no more than 5% of the firm gas transportation capacity. *Id.* at ¶ 61,750., 2002 FERC LEXIS 351 at \*13-\*14. In the West, the upstream market was unconcentrated, and the applicants controlled only a small portion of the downstream market and were acquiring pipelines not interconnected to that market. *Id.* at ¶ 61,757, 2002 FERC LEXIS 351 at \*18-19 & n.13. Indeed, no party intervened "to allege that the proposed transaction will harm competition in any respect." *Id.*

Similarly, in *El Energy Corp.*, 92 F.E.R.C. ¶ 61,076, 2000 FERC LEXIS 1468 (July 26, 2000), concentrated upstream markets did not correspond to any concentrated downstream markets, and the applicants had only "limited presence in the downstream markets . . . affected

by the combination of [their] gas, coal and generation interests.” *Id.* at ¶ 61,332, 2000 FERC LEXIS 1468 at \*20-\*21.

No case cited by Applicants stands for the proposition that the FERC cannot reject a merger unless both upstream and downstream HHI exceeds 1,800. In any event, as noted above, the question under Pennsylvania law is really whether the merger will risk a significant increase in the ability to exercise market power. Even if upstream market concentration is only high moderate, as Dr. Hieronymus contends, the large increase in HHI is highly significant and should lead the PUC to reject the merger without greater mitigation.

**D. The Commission Should Consider the Philadelphia Gas Works in Fashioning a Remedy for Undue Market Power.**

Applicants questions “whether the City’s alleged concerns about market power issues have substance or whether the City is opportunistically attempting to use this proceeding to unload PGW.” (Applicants’ Main Brief at 16.) However, the City has legitimate concerns for market power, and the Commission can fashion better mitigation for undue market power by considering PGW than by donning blinders.

The City has a load of 94 MW, among the largest in PECO’s service territory. Direct Testimony of Kent Miller, The City of Philadelphia Statement No. 1 (“City-1”) at 3. Given that, market power exercised to determine prices will have direct and substantial effects upon the operations and budget of the City, not to mention the other governmental entities, residents, and businesses within the City. The City is also concerned with the market power issue raised by PJM Interconnection (“PJM”) in its “2004 State of the Market Report” at 21, *i.e.*, that market power is endemic to the structure of the PJM capacity markets. City-1 at 4.

The Commissioners, not the City, raised the issue of combining PGW with PECO Gas and/or PSE&G in connection with this proceeding. If, as the evidence shows, EEG’s power in

the wholesale gas market would be sufficient to affect wholesale and retail electricity prices from time to time, then it would not be prudent to discuss a remedy without considering PGW. After all, PECO and PGW share essentially the same customer bases within the City, and have periodically explored the possibility of cooperation or combination.<sup>4</sup> The City is willing to consider involving PGW in an appropriate remedy. The fact that this might delay formal approval of the merger is insufficient reason for the Commission to approve a Joint Petition for Settlement that would forbid consideration of PGW until after consummation of the merger.

### **III. PROPOSED ADDITIONAL FINDINGS OF FACT**

1. The terms of the proposed Joint Petition for Settlement would not significantly constrain the ability of the Joint Applicants to exercise vertical market power after 2010.
2. In the shadow of the sweeping and long-term effects of the proposed merger, the terms reached with settling parties are not to the benefit of the public because they are short-term and modest.

### **IV. PROPOSED ADDITIONAL CONCLUSIONS OF LAW**

1. As no overall public benefit is demonstrated, the Joint Applicants have not met their burden of demonstrating that a Certificate of Public Convenience should be granted pursuant to 66 Pa.C.S. §§ 1102-1103 .

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<sup>4</sup> As recently as the spring of 2005, PGW retained Public Financial Management to explore the possibility of acquiring PECO Gas. (Tr. 9/26/2005 at 533-34.) Applicants concede that “the Commission’s directed question is worthy of discussion” and that “PECO does not rule out a possible acquisition of PGW.” Applicants’ Main Brief at 57, 58 (adding that they wish to consider this only “outside the context of the Merger at issue” and following its consummation).

**V. PROPOSED ORDERING PARAGRAPHS**


1. [If the PUC approves the merger]: Approval of the merger is conditioned on the Joint Applicants' divestiture of 6,600 MW of power, per their revised application to the Federal Energy Regulatory Commission.
2. Without separate express approval of the Commission, the Joint Applicants and their affiliates may not combine the natural gas procurement functions of any current or future Exelon or PECO company with those of any current or future PSEG or PSE&G company
3. The Commission will retain jurisdiction to assure divestiture of market power to an acceptable level and to review the effects of the merger upon competition in Pennsylvania.

**VI. CONCLUSION**

**WHEREFORE**, the City of Philadelphia respectfully requests that the Pennsylvania Public Utility Commission not defer to FERC on market power issues, and disallow the merger or permit it only subject to appropriate conditions, including those set forth herein and in the City's Main Brief.

Respectfully submitted,

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Dated: October 20, 2005

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**Docket No. A-110550F0160**

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Dated this 20<sup>th</sup> day of October, 2005 in Philadelphia, Pennsylvania.

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October 21, 2005

James J. McNulty  
Secretary  
Pennsylvania Public Utility Commission  
Commonwealth Keystone Building  
400 North Street  
P. O. Box 3265  
Harrisburg, PA 17105-3265

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In re: Docket No. A-110550F0160  
Joint Application of PECO Energy and  
Public Service Electric and Gas Company

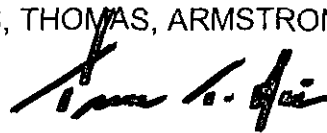
Dear Secretary McNulty:

Enclosed for filing on behalf of Philadelphia Gas Works are an original and nine (9) copies of its Reply Brief in the above matter. A disk containing an electronic copy of the Reply Brief is also enclosed. Copies of the Reply Brief are being served upon the persons and in the manner set forth on the Certificate of Service attached to it.

Very truly yours,

THOMAS, THOMAS, ARMSTRONG & NIESEN

By



Thomas T. Niesen

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cc: Certificate of Service  
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Before the  
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Administrative Law Judge  
Marlane R. Chestnut, Presiding

Joint Application of PECO Energy : Docket No. A-110550F0160  
Company and Public Service Electric :  
and Gas Company for Approval of :  
the Merger of Public Service :  
Enterprise Group Incorporated with :  
and Into Exelon Corporation :

REPLY BRIEF  
OF  
PHILADELPHIA GAS WORKS

PA PUC  
SECRETARY'S BUREAU

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DOCKETED  
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DATED: October 21, 2005

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## I. INTRODUCTION

This proceeding concerns the Joint Application of PECO Energy Company ("PECO") and Public Service Electric & Gas Company ("PSE&G") and the merger of Public Service Enterprise Group, Inc. ("PSEG"), PSE&G's parent company, into Exelon Corporation ("Exelon"), PECO's parent company. The proposed merger would be a vertical merger combining the gas and electricity assets of Exelon with the gas and electricity assets of PSEG. Philadelphia Gas Works ("PGW") intervened in the proceeding.

PGW filed a Main Brief in which it addressed issues pertinent to the proceeding including the issue of market power that the proposed vertical merger would create for the merged entity in the delivered natural gas market and the merged entity's ability and incentive to use this market power to adversely affect the public interest and competition in the electricity and natural gas markets. PGW also addressed the remedial measures the Public Utility Commission ("Commission") should consider in order to mitigate the merged entity's market power and ensure competition consistent with the public interest.

Applicants filed a Main Brief in which they contend that they have demonstrated that the proposed merger would not present market power issues to the natural gas market.<sup>1</sup> PGW addresses the Applicants' Initial Brief in this Reply Brief, demonstrating as it did in its Main Brief that the proposed merger raises significant vertical market power concerns and, as a result, presents a risk that there would be significant erosion of properly functioning gas and electric markets in Pennsylvania as a result of the

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<sup>1</sup> Main Briefs or Proposed Findings of Fact were also filed by the City of Philadelphia, the PPL Companies, the FirstEnergy Companies, the Office of Trial Staff, the Office of Consumer Advocate, the Office of Small Business Advocate, the Department of Environmental Protection, the Reinvestment Fund, the Action Alliance and PennFuture.

proposed merger. PGW also addresses the Joint Petition for Settlement and Directed Questions Nos. 1 and 5.

*PGW submits this Reply Brief in accordance with the briefing schedule set forth in Prehearing Order #7. Consistent with Ordering Paragraph 40 of Revised Prehearing Order #2, this Reply Brief is supplemental to PGW's Main Brief with reference, as appropriate, to sections and pages of PGW's Main Brief.*

## II. DISCUSSION

### A. Legal Standard

PGW addressed the legal standards applicable to this proceeding in Sections III.A and III.B. of its Main Brief. In reply to the legal standard analysis presented by Applicants (Applicants' Initial Brief at 5-9), PGW refers the Commission to Sections III.A. and III.B. Applicants suggest that approval of the proposed merger may not be required. However, Commission approval was required under nearly identical circumstances in *Re DQE, Inc.*, 186 PUR 4<sup>th</sup> 39 (1998) and is, likewise, required here. See PGW Main Brief at 5. The proposed merger would, moreover, effect a change in control of PSE&G, which holds a certificate of public convenience, thus requiring approval under 52 Pa. Code §69.901. Applicants must demonstrate that the merger will not be detrimental and will affirmatively promote the public interest and the Commission must investigate and determine whether the merger will result in the unlawful exercise of market power.

### B. The Joint Settlement Does Not Adequately Protect the Public and the Commission Should Not Approve It

The proposed merger is the largest utility merger ever proposed in the United States. The magnitude of the merger and the concentration of market power that will result from it is evident from Applicants' Initial Brief at page 22, where they discuss their mitigation proposal and explain that they propose as a mitigation measure to divest 6,600 MW of capacity, which is by far the largest amount of generation ever proposed to be divested in connection with a merger. The merged entity will stretch from Chicago to the Hudson River and serve over seven million electric customers and two million gas customers. See Applicants' Initial Brief, Appendix B at 3. Applicants own HHI screen

calculations confirm significant market power would result from the merger. See PGW Main Brief at 35-37.

Applicants and the signatory parties to the Joint Petition for Settlement support the Settlement terms and conditions. They claim that the Settlement terms, including nominal rate reductions, contributions to various organizations and reporting of wholesale prices, are affirmative public benefits that support the merger. The evidence of record demonstrates that the proposed merger would produce substantial detriments, including substantial market power for the merged entity in both the electric and gas markets, detriments that far outweigh any benefit that might result. See PGW Main Brief at 10-12 and 35-39 and Proposed Findings of Fact Nos. 32-37. However, the proposed merger, even as supplemented by the terms and conditions of the Settlement, would not promote the public interest.

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. These rate reductions are inconsequential and of no real benefit to the public, especially when weighed against the risks to the public from an exercise of market power. PGW St. No. 1-S at 6-7; *Also see* PGW Main Brief at 37-39 and Proposed Findings of Fact Nos. 32-37.

The pricing report to be provided by Applicants pursuant to the Settlement involves electricity prices, not natural gas prices. This pricing report does not give the Commission any information it does not already have access to on the PJM website. More importantly, it does not give the Commission access to any additional information that would be useful in determining whether Exelon's affiliates have been exercising market power in the PJM East electricity market. PGW St. No. 1-S at 4-5; *Also see* PGW Main Brief at 37-39 and Proposed Findings of Fact Nos. 32-37. The foregoing

criticism of the pricing report was provided by Dr. Carpenter in PGW Statement No. 1-S and not rebutted or disputed by Applicants.

The Joint Settlement does not adequately protect the public. Notably, it provides no remedy for the exercise of vertical market power that will occur as a result of the merger. The Commission, accordingly, should reject the Joint Settlement.

C. **Contrary to Applicants' Claims, There Is a Direct Relationship Between the Price of Natural Gas and the Price of Electricity in PJM East and, If the Merger Is Approved with Only the Terms of the Settlement as Remediation, the Merged Entity Will Have Both the Ability and a Strong Incentive to Increase PJM Gas Prices**

Applicants assert that they have demonstrated that the merger would not raise market power issues in the natural gas market. Going further, they propose that PGW's concerns with the merger go only to the wholesale natural gas market and that PGW made no claim that the merger would impact competition in retail markets. Applicants' Initial Brief at 37-38. Applicants' claims are not merely inaccurate, they are misleading and contradicted by the testimony of their own witness.

Harm to competition in wholesale markets adversely affects retail market competitiveness. Dr. Hieronymus testified about the relationship between wholesale and retail markets at page 14 of PECO Exhibit WHH-1. There, under the heading "that there will be no competitive harm in wholesale markets is also important from a retail perspective," Dr. Hieronymus stated that "[c]ompetitive retail markets *rely on* procurement of power from a competitive wholesale market, and, thus it is important from an ultimate customer perspective that the merger not increase market power in wholesale markets."<sup>2</sup> Given this testimony, there is simply no basis for Applicants to suggest that there is a disconnect between competitive wholesale and competitive retail

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<sup>2</sup> Similarly, Dr. Carpenter testified that the statutory obligation to consider the competitive effects of this vertical merger on retail electricity and natural gas markets means the Commission should carefully examine its effects on wholesale markets. PGW St. No. 1 at 10.

markets. A merger that harms the competitive wholesale market harms the competitive retail market.

As explained by Dr. Carpenter and addressed by PGW at page 17 of its Main Brief, and as also recognized by Applicants themselves,<sup>3</sup> there is a direct relationship *between the price of delivered natural gas and the price of electricity in PJM East*. Using data provided by the Applicants, Dr. Carpenter determined that gas is on the margin during 40% of the year in PJM East. Applicants did not dispute this. When gas is on the margin in PJM East, an increase in the PJM East gas price increases the price for PJM electricity. When one adds to this fact a scenario where an entity has market power to increase gas prices and also owns 33,727 MW of electric capacity in PJM, as the merged entity does, the result is apparent. The merged entity will have a strong ability and incentive to increase gas prices, and, thus, benefit from higher electric prices and increased profits on its baseload electric capacity. See PGW Main Brief at 15-19.

Applicants attempt to dismiss PGW's market power arguments by maintaining that PECO's existing rate cap would protect PGW and the public from any increase in electric prices that might occur as a result of higher natural gas prices brought about by the merged entity's market power. Applicants' Initial Brief at 37-38. Such a claim is mistaken for two reasons. First, a rate cap of short duration is no answer to the long term market power concerns raised by the proposed merger. PECO's rate cap expires in 2010, a short five years from now, while the proposed merged entity will be with us long after the cap's expiration.

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<sup>3</sup> Applicants acknowledge the direct relationship between the natural gas market and the price of electricity at page 38 of their Initial Brief when they state that "FERC's Merger Regulations set out a methodology for evaluating whether the merger applicants' control over natural gas transportation assets could be used to raise electric prices, which FERC calls 'vertical market power.'" Dr. Hieronymus also discusses the relationship at pages 29 and 30 of PECO Exhibit WHH-1.

Second, as recognized by this Commission, a rate cap is a conduct restriction remedy and the offer of a rate cap as a mitigation proposal is “clearly inadequate” to deal with substantial market power:

“ ... the Applicants’ offer of a rate cap is an example of a conduct restriction remedy designed to prevent the merged firm from extracting monopoly prices after the merger. As found in the Recommended Decision, rate caps do not remove the market power problem nor do they ensure competitive rates. See, e.g., R.D. at 176. Rate caps are almost always inevitably set above the competitive market price, so that a merged entity can still extract above-market prices for its product by charging customers the rate cap prices and not be in violation of this regulatory condition. See, e.g., OTS Statement No. 4, at 19-20; OCA Statement No. 1, at 29-30; APSEUG Main Brief at 30. This mitigation proposal, therefore, is clearly inadequate to deal with the substantial market power found to exist in this case. We adopt the recommendation of the ALJs which rejected the use of the rate cap as a mitigation strategy.

*Re DQE, Inc.*, 186 PUR 4<sup>th</sup> 39, 61 (1998). A rate cap is no more an appropriate market power remedy here than it was in *DQE*. Indeed, Applicants’ witnesses have never opined that the Commission should rely on PECO’s electric rate cap to mitigate the market power that would result from the proposed merger. There is no evidence of record concerning the relationship, if any, between PECO’s rate cap and the competitive market price of electricity in PJM East.

**D. Although Applicants Would Have the Commission Believe Otherwise, the Evidence of Record Shows That PGW Has a Substantial, Direct and Immediate Interest in the Proposed Merger and the Resulting Market Power**

Concluding its introductory market power discussion, Applicants contend, in a footnote,<sup>4</sup> that PGW has no standing to raise the issue of horizontal market power in the market for delivered natural gas. Applicants’ Initial Brief, footnote 19. As a PECO customer with an electric bill of more than \$2 million a year, PGW has a substantial, direct and immediate interest in the vertical market power that will be created as a result

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<sup>4</sup> See Applicants’ Initial Brief, footnote 19.

of the proposed merger, and the ability and incentive of the merged entity to exercise that market power and impact the price of electricity. A utility customer has clear standing to address rate related matters in utility proceedings. See *Appalachian Gas Sales v. Philadelphia Electric Company*, 67 PaPUC 246 (1988).

It is, moreover, accurate to say that most PGW heating customers are also PECO electric customers. An exercise of market power by the merged entity in the market for delivered natural gas that increases the price of electricity to PGW customers will make it more difficult for those of PGW's customers who are on limited budgets to pay their PGW gas bills. PGW has a substantial, direct and immediate interest in ensuring that the ability of PGW customers to pay their natural gas bill is not detrimentally impacted by a merged entity with market power and the incentive to use that power to increase the price of electric service.

Finally, PGW has a substantial, direct and immediate interest in the issue of horizontal market power in the market for delivered gas. As discussed above, retail gas market competition is adversely affected by market power in the wholesale gas market. Even though PGW's customers have had the option to choose an alternative supplier since September 2003, no competitive suppliers are currently in operation in Philadelphia – perhaps in part due to the demographics of the customer base. Anything that increases the price and/or the volatility of the price of natural gas in the wholesale market will make it even more difficult for competitive suppliers to gain a foothold. See PGW Statement No. 1, page 7. PGW has an interest in the vibrancy of the retail gas market in its service territory.

**E. Although Applicants Prefer That This Commission Approve the Merger Based on FERC's Decision, Approval on Such a Basis Is Inappropriate**

Applicants maintain that FERC has already rejected claims that they would be able to use market power in the natural gas market to increase wholesale electric prices (Applicants' Initial Brief at 38). In direct conflict with this assertion, there is no indication in the FERC's rush to judgment that the testimony of PGW witness Carpenter was considered. See PGW St. No. 1-SR at 5. Applicants themselves allow as much, stating: "Dr. Carpenter's testimony for PGW was not filed until a few days before FERC's decision and was not specifically addressed in FERC's order." Applicants' Initial Brief at 19. Furthermore, on August 29, 2005, FERC issued an Order Granting Rehearing for Further Consideration and, thus, a final FERC order on this proposed merger is pending rehearing. FERC Docket No. EC05-43-001.

Applicants essentially assert that merely obtaining a decision by FERC abolished the Commission's interest in this proceeding. Such an assertion is irrelevant and not supported by law. Regardless of what occurred at FERC, Applicants still must meet the requirements of Pennsylvania law, including the Public Utility Code. See PGW Main Brief at 4-12. An exercise of vertical market power would deny Pennsylvania customers the benefits of retail competition in both gas and electricity markets and is impermissible under the Electricity and Natural Gas Competition Acts.

**F. Dr. Carpenter Has Correctly Defined the Relevant Geographic Market and His Analysis and Conclusions Are Entitled to Dispositive Weight**

Dr. Carpenter presented an HHI analysis showing a highly concentrated, post-merger market for delivered natural gas in PJM East with an HHI of 1,942. See PGW Main Brief at 13-15. Applicants challenge Dr. Carpenter's analysis and claim, wrongly, that the natural gas market is not highly concentrated and that they, therefore, possess no market power. Applicants' Initial Brief at 39-40.

Applicants produced three HHI analyses, each with results different from the one before – a different, moving target at each stage of the proceeding as the flaws in their earlier analyses were revealed. Dr. Hieronymus' first analysis produced an HHI of 1,572, which, at a minimum, confirms the existence of a moderately concentrated market and is just 228 points less than the 1,800 threshold level for a highly concentrated market. Subsequently, Dr. Hieronymus admitted to making errors in his initial analysis (See PECO St. No. 3-R at 57-58) and produced a new HHI calculation of 1,292, which again confirms the existence of a moderately concentrated market. Finally, Dr. Morris produced a third analysis with a dramatically different HHI result of 897.

In effect, Applicants defined and re-defined the gas market during the course of the proceeding dramatically changing their HHI results in an attempt to demonstrate that they do not have market power.

- Dr. Hieronymus initially proposed a geographic market of PJM East, made up of New Jersey, Delaware, and counties in the eastern portions of Pennsylvania and Maryland. PGW St. No. 1 at 16.
- Dr. Hieronymus dramatically changed the size of his market (from 5,934 Mmcf/d to 6,831 Mmcf/d) and his measures of suppliers' capacity in his revised analysis after acknowledging errors that he made. PECO Exhibit WHH-1, Exhibit J-16 and PECO St. No. 3-R at 59.
- Dr. Morris produced an analysis that was very different from that presented by Dr. Hieronymus and included capacity on three pipelines, Maritimes & Northeast, Portland Natural Gas Transmission, and Iroquois Gas Transmission, which do not physically serve PJM East. PGW St. No. 1-SR at 19.
- At hearing, Dr. Morris presented a still different and new market definition that changed the boundary of Dr. Hieronymus' PJM East market, redrawing the boundary to exclude northern New Jersey north of Linden, where the Applicants hold capacity and make gas sales. Tr. 508.

In sum, only Dr. Carpenter presented a reliable analysis of vertical market power for Commission consideration.<sup>5</sup> See PGW Main Brief, Section C.

In further support of their market power conclusions, Applicants argue that the standard for determining whether New York and New England transportation capacity will serve the PJM East geographic market is to look at prices in the three regions. Applicants also cite Dr. Morris' "five percent" test. Applicants' Initial Brief at 40-41. Applicants acknowledge that natural gas prices between PJM East, New England and New York separate at times during peak periods. They claim, however, that the separation is sporadic, non-sustainable, short-lived and, thus, not important. Applicants claim, further, that the price data they present is uncontested. See Applicants' Initial Brief at 41-42.<sup>6</sup> However, the price differences are neither sporadic, nor non-sustainable, nor short-lived, nor trivial. The price data cited by Applicants has been, moreover, vigorously contested.

If one goes below the superficial data, as Dr. Carpenter did in response to the pricing analysis proposed by Dr. Morris, it is clear that there is a large separation in prices and that Applicants' claims to the contrary attempt to disguise a serious problem requiring remedy. During 2003 to 2005, the New York price exceeded 105% of the PJM East price on 23% of winter days, and the New England price exceeded the PJM East price on 24% of winter days. These price differences were significant on absolute terms. During the 23% of winter days when the New York price exceeded 105% of the PJM East price, the New York price exceeded the PJM East price by \$3.00/MMBtu on

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<sup>5</sup> Applicants claim that the sole difference between Dr. Carpenter's calculations and the calculations of Drs. Hieronymus and Morris is the definition of the geographic market. Applicants' Initial Brief at 40. However, both Dr. Carpenter and Dr. Hieronymus used PJM East as the relevant geographic market in their HHI calculations. PJM East is the geographic market where there is the most overlap in Exelon and PSEG's electricity and natural gas assets. PGW St. No. 1 at 15-16.

<sup>6</sup> Similar to the characterization presented by Applicants in their Initial Brief, Dr. Hieronymus described the price separations as "trivial" in his testimony. PECO St. No. 3-R at 52.

average. During the 24% of winter days when the New England price exceeded 105% of the PJM East price, the New England price exceeded the PJM East price by \$2.20/MMBtu on average. PGW St. No. 1-SR at 15; *Also see PGW Main Brief at 27-30.* In addition, prior to the 2003 – 2005 period considered by Dr. Morris, his 5% test also fails for the New York and PJM East markets during some summer periods, particularly in the summer of 2002. PGW St. No. 1-SR at 15; *Also see PGW Main Brief at 28-29.*

These separations reveal a serious problem. Indeed, the days that Dr. Morris *offhandedly attempts to dismiss, in fact, represent a significant portion of the winter, a time period when prices are typically their highest.* PECO St. No. 11-R, Figure 2, at 19. Therefore, even if Dr. Morris' test is accepted and the Commission concludes that Exelon/PSEG can exercise market power only when prices in PJM East are separated from prices in New York and New England, then it reveals that Exelon/PSEG can exercise market power during a significant portion of the season when gas prices in PJM East are highest.

Applicants declare that the price data shows that there is no reason to believe that price separations would permit sustainable price increases in PJM without drawing a supply response from New York and New England. PGW has shown that the price data demonstrates just the opposite. During the winter period, prices separate on a significant and sustainable basis. Even according to Dr. Morris the price differences occur "about 30 percent" of the time in the winter. Tr. 502. So Applicants' own testimony suggests that Exelon/PSEG *could exercise market power and cause price increases during 30% of the winter, when prices are already at their highest.* Again, the price separations are significant and sustainable and Applicants' claims to the contrary attempt to disguise a serious problem requiring remedy.

**G. In Order to Properly Analyze This Merger, PSEG's Transco Capacity with New York Deliverability Should Be Included in the Market Power Analysis**

Applicants propose that 794 MMcf/d of PSEG's Transco capacity with delivery points in the New York market should be excluded from the PJM East market calculation. Citing Dr. Carpenter's testimony that "pipeline capacity capable of serving New York and New England should be considered to be in a separate geographic market," Applicants erroneously argue that Dr. Carpenter inconsistently included it in his analysis. Applicants' Initial Brief at 42. Applicants are wrong to say Dr. Carpenter was inconsistent in his treatment of PSEG's Transco capacity. Dr. Carpenter appropriately treated it as part of the PJM East market (which includes all of New Jersey).

PSEG's Transco capacity is appropriately included in Dr. Carpenter's PJM East market power analysis for two reasons. First, PSEG's Transco capacity represents almost half (794 MMcf/d out of 1,663 MMcf/d) of PSEG's total interstate capacity into PJM East. The PSEG Transco capacity is used, in significant part, to meet PSE&G's basic gas service requirements ("BGSS") in PJM East during winter months. Capacity required for BGSS requirements is not available to sell gas into New York and is appropriately included by Dr. Carpenter in his PJM East market analysis. PGW St. No. 1 at 17 (Proprietary and Public Versions); *Also see* PGW Main Brief at 31-32(Proprietary and Public Versions).

Second, the evidence of record does not support the assumption that the PSEG uses anything close to its entire Transco capacity to sell gas in New York during peak demand conditions. Dr. Carpenter conducted a rigorous review of sales data and demonstrated that PSEG's sales into New York on peak days are never even close to 794 MMcf/d. He also showed that PSEG uses its Transco capacity to sell in PJM East, in New Jersey. Thus, it is unreasonable for Applicants to argue that the 794 Mmcf/d of PSEG Transco capacity should be excluded from PJM East, and entirely appropriate

for Dr. Carpenter to include the capacity in his market analysis. See PGW St. No. 1-SR at 17-19 (Proprietary and Public Versions); *Also see PGW Main Brief at 31-32 (Proprietary and Public Versions).*

**H. The Evidence of Record Demonstrates Clear and Substantial Market Power**

Applicants claim that the record in this proceeding shows that there is no market power problem regardless of the results of the HHI calculations. They present four assertions: (1) Applicants cannot exercise market power during peak periods because they need all of their transportation capacity to serve their own loads, *i.e.* Applicants have no spare capacity during peak periods (Applicants' Initial Brief at 43-44); (2) there is a mismatch between peak gas demand and peak electric demand (Applicants' Initial Brief at 44-45); (3) FERC Open-Access Regulations prevents Applicants from withholding capacity (Applicants' Initial Brief at 45-46); and (4) natural gas markets are subject to oversight by FERC's OMOI (Applicants' Initial Brief at 46). None of these assertions is supported by the evidence of record.

**Available Capacity During Peak Periods**

Applicants do not need or use all of their capacity to serve their own loads on peak days. Evidence presented by Dr. Carpenter shows quite clearly that PSEG has capacity to make spot sales during peak periods. PGW St. No. 1-SR at 17-18 (Proprietary Version). If Applicants have capacity to make spot sales then they do not need and are not using all of their capacity to meet their own load as argued by Applicants. Applicants did not rebut the spot sales data presented by Dr. Carpenter. Indeed, Dr. Morris relied on it in arguing that Dr. Hieronymus' geographic market should be redefined. Tr. 509. The citation to page 21 of Dr. Morris' testimony that appears at page 44 of Applicants' Initial Brief does not support Applicants' argument. Dr. Morris' testimony there is simply that supplies during peak periods tend to be at their maximum

levels. The cited testimony does not support a conclusion that Applicants cannot withhold unneeded capacity.

### **Mismatch Between Peak Gas Demand and Peak Electric Demand**

Applicants' argument concerning a mismatch of peak gas and peak electric demand is a classic red herring. Coincident peaking of gas and electric demands is not necessary for the merged entity to have or act upon market power. The analysis of Dr. Hieronymus that shows power generation gas consumption highest in PJM East in summer while New York and New England LDC gas consumption highest in winter has absolutely no bearing on whether the Applicants can exercise vertical market power. Dr. Carpenter showed and Applicants did not dispute that gas is on the margin 40% of the time and 60% of peak hours in PJM East. During these times, increases in the price of natural gas will cause the price of electricity to increase. The ability to affect the price of electricity during these times is unrelated to whether power generation consumption of natural gas is at a peak.

### **FERC Open-Access Regulations**

Applicants argue that the availability of interruptible transportation capacity would prevent them from withholding pipeline capacity and exercising market power. However, Applicants ignore evidence (that their own witnesses did not dispute) presented by Dr. Carpenter concerning the El Paso situation. Contrary to Applicants' assumption that interruptible capacity will be available to thwart Applicants' market power, the availability of interruptible capacity on the El Paso Natural Gas Pipeline did not prevent a large capacity holder from withholding capacity in market conditions not different from those in PJM East. PGW St. No. 1-SR at 25.

Applicants claim that Dr. Carpenter should have presented statements by electric generators, or data on the use of interruptible transportation in PJM East. Applicants,

however, have the burden of proof. If the availability of interruptible transportation was to be considered as a preventive measure to the exercise of market power, then it was up to Applicants, not PGW, to support the argument with adequate evidence. Applicants, however, presented no evidence showing that interruptible transportation is used in PJM East. They presented no statements by electric generators that say that generators view interruptible transportation as a good substitute for firm transportation.

Having presented no evidence about the actual use of interruptible capacity, Applicants offer a flawed argument that “logically” generators who have not contracted for firm capacity should be able to rely on interruptible capacity. In fact, if Applicants withheld capacity, then these generators would be more likely to buy high-priced gas in PJM East than to rely upon interruptible transportation, which is inherently unreliable. See PGW St. No. 1-SR at 23. The Applicants’ flawed “logical” argument should not be enough to give the Commission comfort that interruptible capacity can deter capacity withholding, especially in light of undisputed evidence that interruptible capacity did not prevent capacity withholding in market conditions not different from those in PJM East.

### **Market Oversight**

Applicants argue that FERC’s OMOI will watch for evidence of market abuse by the merged entity. Market manipulation, including the withholding of capacity, is, however, very difficult for regulators - either FERC or PJM or this Commission - to detect after the fact, unless the regulators are collecting the right data, are carefully monitoring the actions of the company, and are able to distinguish between price movements caused by actions of the company and price movements that are the result of the complexities of market forces. PGW St. No. 1 at 23. Creating market power and then relying on a regulatory entity to watch for abuse of that power is not realistic. The proper mitigation measure for the market power that would result from the merger is the

divestiture of PECO Gas and PSE&G's gas distribution company (including the gas assets held and managed by PSEG ER&T).

I. **Although Applicants Attempt to Divert Commission Consideration of Divestiture as a Remedy by Arguing That It Is "Overbroad," Divestiture Is the Cleanest, Easiest and Most Effective Remedy for the Vertical Market Power That Would Be Created by the Proposed Merger**

The cleanest, easiest and most effective remedy for the market power problem created by the proposed merger would be to require, as a condition for approval of the merger, the divestiture of PECO Gas and PSE&G's gas distribution company (including the gas assets held and managed by PSEG ER&T). PGW St. No. 1 at 30-31. Divestiture of assets is the preferred way of dealing with a market power problem. Divestiture of assets has been long accepted by the courts and enforcement agencies as an effective means to address market power concerns in merger cases and is a remedy available to the Commission whenever it deems appropriate pursuant to its authority under the Competition Acts. See PGW Main Brief at 7-10 for a discussion of divestiture and the Commission's authority to direct divestiture as a mitigation measure in merger proceedings.

Applicants claim that divestiture as a remedy is too broad and argue that it is Applicants' contract rights, not their natural gas distribution assets, which cause the market problem identified by Dr. Carpenter. Applicants' Initial Brief at 46-47. Dr. Carpenter was asked a series of questions on cross examination regarding this matter and he explained why divestiture is not too broad a remedy. "You can't have a distribution pipe without the gas that goes in it." Tr. 491. When the pipes are divested, the contracts go with them, thus isolating the gas contracts from the electric market incentives. Tr. 492.

In an attempt to remedy vertical market power, Applicants propose, for the first time in their Main Brief, to “commit” that they will not combine their natural gas procurement functions after the merger is closed without obtaining the Commission’s approval. Applicants’ Initial Brief at 48. This alleged commitment, which would leave control of the natural gas assets in the hands of the merger partners, does nothing to address market power concerns.<sup>7</sup> First, it is not even a concession on the part of the Applicants. Dr. Morris testified during the hearing that the Applicants would have to seek approval of this Commission if they were to combine their gas operations. Tr. 512. Second, it does nothing to remedy the Applicants’ vertical market power. Dr. Carpenter showed that the merged entity would have vertical market power, and his testimony was not based on an assumption that Applicants combined their gas procurement functions; he assumed that Applicants’ gas operations would be kept separate. Even if Applicants’ gas procurement operations are kept separate, they would still each have an incentive to exercise market power in a way that benefits Exelon/PSEG. Furthermore, by trying to separate in a non-binding manner the key issue related to the merger from the approval of the merger itself, Applicants not only seek to have their cake and eat it too, but they ask the Commission and all the parties to dedicate substantial resources to re-litigate these same issues at a later time.

An alternate remedy to divestiture, but one that would require greater regulatory supervision going forward, while also proving less effective, would require that the gas

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<sup>7</sup> Citing pages 3 and 4 of PGW Statement No. 1-S, Applicants wrongly contend that Dr. Carpenter conceded that the maintenance of separate gas procurement functions will address the problems he alleges. Dr. Carpenter is asked at pages 3 and 4 whether certain paragraphs of the Joint Petition for Settlement will prevent the merged entity from exercising market power in the PJM East gas market. He answers with a very clear “no.” While the answer goes on to discuss the maintenance of separate gas procurement functions, there is no concession by Dr. Carpenter that maintenance of separate functions would solve the market power problem that would be caused by the merger. Market power problems would be mitigated by either divestiture or the placement of gas assets in the hands of independent third parties with divestiture the preferred approach.

assets (upstream transportation contracts and storage rights) held by PECO and PSEG 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. The combination of the assets in the hands of *third parties* and the oversight of regulators would ensure that the ability to exercise market power is mitigated and separated from the incentive to exercise that power. PGW St. No. 1 at 31.

**J. Directed Question No. 1**

Applicants state in response to Directed Questions Nos. 1 through 5 (Economic Development) that to avoid certain potential legal and regulatory obstacles, the Joint Settlement provides for PECO to contribute monies to PEDDA. These contributions do not address the market power concerns identified by PGW in its response to Directed Question No. 1. As explained at pages 39 and 40 of PGW's Main Brief, the merger and resulting concentration of market power, if left unremedied, is likely to substantially **weaken** Pennsylvania's ability to enhance its competitiveness with respect to access to economical energy resources while increasing the level and volatility of natural gas and power prices. The creation of a merged entity with a dominant position in Pennsylvania's gas and power markets will make it even more difficult for the state to successfully create and sustain a competitive retail market in electricity. PGW St. No. 1-SR at 32.

**K. Directed Question No. 5**

Applicants state that Directed Question No. 5 cannot be answered without (i) extensive further investigation; (ii) an understanding of the transaction terms upon which Exelon and PGW would agree; and (iii) the regulatory treatment that would be accorded a host of difficult issues. They state that Directed Question No. 5 contemplates a

significant and complicated transaction that would entail months of due diligence. See Applicants' Initial Brief at 49-51.

In response to Directed Question No. 5, PGW stated in a somewhat similar fashion that a combination of PGW with the PECO Gas Division could result in a viable, profitable gas utility and there is sufficient data supporting the concept to warrant a more detailed due diligence type study. PGW stated further, however, that it does not support the idea of a separate fact-finding investigation following consummation of the merger. In contrast to a fact-finding investigation that the Commission "may" initiate, PGW believes that existing publicly available data warrant a full due diligence type study of the combination concept. See PGW Main Brief at 41-43 and Proposed Finding of Fact No. 39.

Having expressed some willingness to participate in a fact finding investigation which they believe could serve a valuable function in identifying issues and gathering information (See Applicants' Initial Brief at 49-50), the lengthy discussion that follows at pages 53 through 58 of Applicants' Initial Brief is nothing more than a trashing of PGW and Mr. White personally, which is irrelevant to this proceeding and serves little to no purpose. Mr. White has 25 years experience with PGW and his testimony, summarized, is simply that a preliminary analysis supports a further informed study of the possible combination of PGW and PECO Gas.<sup>8</sup>

Mr. White acknowledged many times that the analysis discussed in his testimony was preliminary only and also based on the scenario of a PGW purchase of PECO Gas. In fact, the Introduction to the preliminary analysis used by Mr. White specifically states: "Public Financial Management (PFM) has been requested by PGW to examine the

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<sup>8</sup> As phrased by Mr. White, "the sum and substance of what I'm saying [is] ... there's enough information that it warrants further study." Tr. 549.

financial viability of the potential purchase of the PECO gas service territory." PECO Cross Examination Exhibit No. 4. Mr. White further explained for whom and how the analysis was performed and that it was prepared under the supervision of senior PGW management of which he is one. He testified that he is familiar with the study and the determinations made in it. Tr. 533-534.

Although Applicants claim that the preliminary analysis is replete with unsupported and unrealistic assumptions ( See Applicants' Initial Brief at 54), the preliminary analysis is straightforwardly based on publicly available PECO information. PGW St. No. 2 at 1-2. Applicants claim in this regard that the "most glaringly" unrealistic assumption is the presumption that PECO would sell its gas assets for \$1.1 billion to \$1.2 billion, a figure above, but only barely above net book value. See Applicants' Initial Brief at 54. Yet, Applicants have presented no evidence of record suggesting that there is a fair market value which differs from book value. In the context of a preliminary analysis that concludes that further study is warranted, it is entirely appropriate to assume a transaction price slightly above book value.

Contrary to Applicants' assault on Mr. White as equivocal and evasive concerning the LNG facility (Applicants' Main Brief at 55), Mr. White provided substantial information about the facility for the record. He explained that PGW has been working on the project for two and a half years (Tr. 557); that, while it may be premature to assume a certain level of benefit, it is not premature to assume that the project will have some benefit (Tr. 557); that many approvals are required for the project (Tr. 558-560); and that it is presently engaged in confidential contract negotiations with a developer in respect to the project (Tr. 561). The only information Mr. White declined to provide were details of the financial benefit from the Terminal project based on contract terms currently at issue in confidential contract negotiations. He was not at liberty to provide

that information because of an existing confidentiality agreement between PGW and the developer and the fact that the issue is a matter of current negotiations. Tr. 565.<sup>9</sup>

Finally, Applicants argue that, on its face, any affiliation with PGW may be contrary to PECO's duty to its customers. They claim that on financial and operational bases any affiliation must be seriously questioned.<sup>10</sup> Applicants' Initial Brief at 56-58. This disparaging commentary about PGW is, again, not necessary or relevant in order to respond to the Commission's request for information. Applicants themselves acknowledge as much when, after offering the condemnation of PGW, they "return to the point." Applicants' Initial Brief at 57.<sup>11</sup> Applicants state that PECO does not rule out a possible acquisition of PGW at some future point and that they have expressed their willingness to begin to address questions. Based on a preliminary analysis of publicly available information concerning PECO revenue, cash flow and debt, there is sufficient data supporting the concept of a combination of PGW and PECO Gas to warrant a more detailed due diligence type study. PGW St. No. 2 at 3-5.

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<sup>9</sup> Applicants assert that Mr. White had little to add concerning the billion dollar debt problem. Mr. White did not address the matter of the billion dollar debt in his testimony (See PGW St. No. 2 at 6) because Directed Question No. 5 expressly assumes a "separate resolution of the problem of a billion dollar debt." It, accordingly, was not necessary to address the debt problem to respond to the Question.

<sup>10</sup> In respect to operational matters, Applicants question the condition of PGW's facilities. An independently prepared Black and Veatch assessment found PGW's facilities to be in good operating condition and sufficiently maintained. Tr. 594-595; Also see Tr. 576. Mr. White declined to agree to counsel's characterization of PGW facilities as being in poor condition. Tr. 572-573. Some district offices are in need of repair but the basic infrastructure, the management of cast iron mains, the underground system, and the LNG plants are in good operational order. Tr. 575-576.

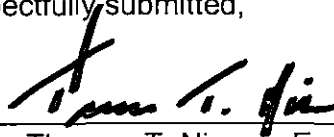
<sup>11</sup> There is, moreover, no relationship between the concept of a potential combination of PECO Gas and PGW and PGW's market power concerns. The Joint Application raises the issue of whether the proposed merger is likely to result in anticompetitive or discriminatory conduct, including the unlawful exercise of market power. See PGW Main Brief at 6-10. The discussion of a potential combination of PECO Gas and PGW arises from the Commission's July 15, 2005, request for information.

### III. CONCLUSION

The proposed merger, even as supplemented by the terms and conditions of the *Joint Petition for Settlement*, would not promote the public interest. Instead, the proposed merger would produce substantial detriments, including substantial market power for the merged entity in both the electric and gas markets, that far outweigh any benefit that might result. The Joint Application of PECO Energy Company and Public Service Electric and Gas Company at Docket No. A-110550F0160 and the *Joint Petition for Settlement* at that same docket should be denied unless the merger is modified to provide for the divestiture of PECO Gas and PSE&G's gas distribution company (including the gas assets held and managed by PSEG ER&T).

Respectfully submitted,

By



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Before The  
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Administrative Law Judge  
Marlane R. Chestnut, Presiding

Joint Application of PECO Energy : Docket No. A-110550F0160  
Company and Public Service Electric :  
and Gas Company for Approval of :  
the Merger of Public Service :  
Enterprise Group Incorporated with :  
and Into Exelon Corporation :

CERTIFICATE OF SERVICE

I hereby certify that I have this 21st day of October, 2005, served a true and correct copy of the Reply Brief of Philadelphia Gas Works, upon the persons and in the manner set forth below:

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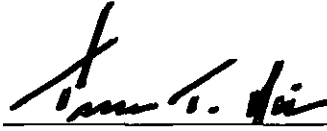
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October 21, 2005

**VIA FEDERAL EXPRESS**

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**ORIGINAL**

**Re: 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 No. A-110550F0160**

**Reply Brief of the PPL Companies**

Dear Secretary McNulty:

Enclosed for filing please find an original and nine (9) copies of the Reply Brief of the PPL Companies in the above-captioned proceeding.

Copies of this brief are being served upon all of the parties to this proceeding in accordance with the attached certificate of service.

If you have any questions regarding this matter, please do not hesitate to contact the undersigned.

Sincerely,



Donald A. Kaplan  
Counsel for the PPL Companies

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cc: Hon. Marlane R. Chestnut (by Hand Delivery)  
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BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION

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JOINT APPLICATION OF PECO :  
ENERGY COMPANY AND PUBLIC :  
SERVICE ELECTRIC AND GAS :  
COMPANY FOR APPROVAL OF THE : DOCKET NO. A-110550F0160  
MERGER OF PUBLIC SERVICE :  
ENTERPRISE GROUP :  
INCORPORATED WITH AND INTO :  
EXELON CORPORATION :

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Reply Findings Of Fact.

Reply Conclusions Of Law.

### APPENDIX 3

Consolidated Recommended Findings Of Fact and Conclusions Of Law

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**BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

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<b>JOINT APPLICATION OF PECO</b>	:	
<b>ENERGY COMPANY AND PUBLIC</b>	:	
<b>SERVICE ELECTRIC AND GAS</b>	:	
<b>COMPANY FOR APPROVAL OF THE</b>	:	<b>DOCKET NO. A-110550F0160</b>
<b>MERGER OF PUBLIC SERVICE</b>	:	
<b>ENTERPRISE GROUP</b>	:	
<b>INCORPORATED WITH AND INTO</b>	:	
<b>EXELON CORPORATION</b>	:	

**REPLY BRIEF OF THE PPL COMPANIES**

Pursuant to Prehearing Order No. 7 issued by Administrative Law Judge (“ALJ”) Marlane R. Chestnut on September 12, 2005, PPL Electric Utilities Corporation; PPL EnergyPlus, LLC; PPL Brunner Island, LLC; PPL Holtwood, LLC; PPL Martins Creek, LLC; PPL Montour, LLC; PPL University Park, LLC; Lower Mount Bethel Energy, LLC and PPL Susquehanna, LLC (collectively, the “PPL Companies”) submit this post-hearing Reply Brief on the Joint Application of PECO Energy Company (“PECO”) and Public Service Electric and Gas Company (“PSE&G”) (collectively, the “Joint Applicants” or the “Merging Parties”) for Approval of the Merger of Public Service Enterprise Group Incorporated (“PSEG”) With and Into Exelon Corporation (“Exelon”).<sup>1</sup>

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<sup>1</sup> The PPL Companies’ proposed Reply Findings of Fact and Conclusions of Law are attached hereto in Appendix 2. The PPL Companies initial proposed Findings of Fact and Conclusions of Law were in Appendix 1 to their Main Brief. Appendix 3, also attached hereto, integrates the two sets of Findings of Fact and Conclusions of Law

## I. INTRODUCTION AND OVERVIEW.

The Joint Applicants' Initial Brief in support of their proposed merger improperly attempts to shift the burden of proof to parties opposing the merger. It also asks the Commission to abdicate its responsibility to evaluate the merger and instead rely on the flawed determination by the Federal Energy Regulatory Commission ("FERC").<sup>2</sup> However, the law is clear. It is the Joint Applicants who have the burden of proof. They must convince the Commission that the merger is in the public interest, and bear the burden of demonstrating that the proposed merger will not result in competitive harm.<sup>3</sup> They have failed to do so.

The Joint Applicants' market analysis and mitigation plan suffer from three fundamentally flaws:

1. The Joint Applicants' market analysis fails to analyze the PJM Classic market, and thus ignores the market screen failures that result when that market is separately analyzed.<sup>4</sup>
2. The Joint Applicants' market analysis fails to account for the impact that financial transmission rights ("FTRs") have upon a post-merger PJM East market and the merged entity's incentive and ability to exercise market power in that market.<sup>5</sup>
3. The Joint Applicants' divestiture plan relies upon a "virtual" divestiture mitigation scheme that will fail to prevent the merged entity from exercising market power, will require constant federal and state oversight, and flies in the face of established Commission precedent, which emphasizes a strong preference for true structural relief.<sup>6</sup>

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<sup>2</sup> *Exelon Corp., et al.*, 112 FERC ¶ 61,011 (2005) ("FERC Merger Order").

<sup>3</sup> *See infra*, Section II.

<sup>4</sup> *See infra*, Section III.B.

<sup>5</sup> *See infra*, Section III.C.

<sup>6</sup> *See infra*, Section III.D.

The record amassed in this proceeding supports only one conclusion: the proposed merger will likely increase market concentration levels, decrease competition in both the wholesale and the retail markets, and thus increase the price of electricity for Pennsylvania consumers. The Joint Applicants' market power mitigation proposals will be ineffective in preventing this harm.

Nor should the FERC Merger Order be given any weight. FERC gave the proposed merger only a cursory review and made no effort to examine carefully the important competitive issues it raised. Indeed, FERC refused to hold hearings and subject the Joint Applicants' untested assertions to discovery and cross-examination.<sup>7</sup> In contrast, the Commission exercised its responsibility under the laws of the Commonwealth to conduct a thorough examination into the anti-competitive impact of the proposed merger, including hearings in which the parties had an opportunity to test the Joint Applicants' assertions through critical questioning – an opportunity that, with respect to Dr. Kalt, the Joint Applicants chose to forego.<sup>8</sup>

The Commission should find that the proposed mitigation is insufficient to address the competitive harms caused by the merger. It should order the Joint Applicants to identify the specific assets that they would *sell* – not “virtually” divest – to mitigate the competitive harms, including the additional competitive harm identified by the PPL Companies. The Commission should further direct the Joint Applicants to refrain from closing their merger until they have received a subsequent determination from the Commission that their revised mitigation plan is acceptable.

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<sup>7</sup> FERC Merger Order at P 1.

<sup>8</sup> Hr'g Tr. 367:24-369:18, Sept. 22, 2005 (“Tr.”).

If the Commission concludes that it does not have the power to prevent the proposed merger or to condition its approval on additional, pre-merger relief,<sup>9</sup> pursuant to its authority under Section 2811 of the Electricity Generation Customer Choice and Competition Act (“Competition Act”),<sup>10</sup> the Commission should still find that the proposed merger (even as proposed to be mitigated) will likely lessen competition in Pennsylvania electricity markets. The Commission should then direct that the record of this proceeding, along with the Commission’s findings, be certified to the appropriate state and federal authorities.

This proceeding is not about whether the Exelon and PSE&G are “strong advocates of competition in resale and wholesale markets for both electricity and natural gas.”<sup>11</sup> Whatever the Joint Applicants have advocated in the past is irrelevant. This proceeding is about whether they are attempting a consolidation that will cause competitive harms. The PPL Companies have established that they are.

If, however, prior positions are relevant (as the Joint Applicants claim), the Commission should recognize the PPL Companies’ early and critical support for retail restructuring in Pennsylvania. Indeed, the PPL Companies will take second seat to no

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<sup>9</sup> The PPL Companies take no position on the Joint Applicants’ claim that the Commission lacks jurisdiction to approve the proposed merger. *See* 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 No. A-110550F0160, Main Brief of the PPL Companies at p. 4 (filed Oct. 14, 2005) (“PPL Companies’ Main Brief”).

<sup>10</sup> 66 Pa.C.S. § 2811.

<sup>11</sup> 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 No. A-110550F0160, Initial Brief of Joint Applicants, PECO Energy Company and Public Service Electric and Gas Company, at p. 11 (filed Oct. 14, 2005) (“JAs’ Initial Brief”).

one in their support for reliance on competitive market forces to provide products and services to consumers on an efficient and cost-effective basis. That is why the PPL Companies asked Dr. Kalt to testify in response to the Commission's Directed Questions that, while the proposals suggested were well-intentioned, they would not likely foster economic development or a healthy state economy.<sup>12</sup> Rather, the PPL Companies recommended that the Commission defend its existing pro-competition policies.

In fact, the very reforms that the Commission has adopted in the electric power sector have been designed to foster a system in which market forces set electric prices so that market forces can determine choices of users of electric power.<sup>13</sup>

The PPL Companies have been strong advocates for competitive wholesale markets as well. Robust competitive markets at *both* the wholesale and retail levels are necessary for Pennsylvania electricity consumers to realize the benefits of competition.

The PPL Companies participated in this proceeding because they are very concerned that the merged entity's ability to exercise market power in wholesale and retail electricity markets in Pennsylvania is a serious threat to competition in those markets. Unless that threat is eliminated through effective mitigation, the progress toward retail competition in the Commonwealth could suffer a huge set-back. Accordingly, the PPL Companies urge the Commission to act to preserve competition in wholesale and retail electric power markets for the benefit of the citizens of the

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<sup>12</sup> 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 No. A-110550F0160, PPL Statement No. 1-SR, Surrebuttal Testimony of Joseph P. Kalt, Ph.D. on behalf of the PPL Companies at pp. 20-21 (filed Aug. 26, 2005) ("Kalt Surrebuttal Testimony").

<sup>13</sup> *Id.* at p. 20.

Commonwealth by finding that the proposed merger is anticompetitive and ordering effective structural relief.

**II. THE JOINT APPLICANTS HAVE MISSTATED THE BURDEN OF PROOF AND LEGAL STANDARD WHICH APPLY TO THE COMMISSION'S DETERMINATION OF WHETHER THE MERGER RAISES COMPETITIVE CONCERNS.**

The Joint Applicants argue an erroneous standard for analyzing the anticompetitive effects of their merger, and improperly attempt to shift the burden of proof regarding competitive harm to the entities opposing the merger. There is no basis for the Joint Applicants' assertion that the PPL Companies (and other parties expressing market power concerns) are required to demonstrate that the merger "is likely" to result in competitive harm.<sup>14</sup> The Joint Applicants have the burden of demonstrating that the proposed merger *will not* result in competitive harm,<sup>15</sup> and otherwise "will affirmatively promote the 'service, accommodation, convenience, or safety of the public' in some substantial way."<sup>16</sup> Entities seeking approval of a merger have the initial "burden to show that the merger will be in the public interest and that it will not otherwise result in the unlawful exercise of market power."<sup>17</sup> The Joint Applicants' attempt to shift that burden to the parties contesting the merger should be rejected.

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<sup>14</sup> JAs' Initial Brief at p.17.

<sup>15</sup> See 66 Pa.C.S. § 2811(e).

<sup>16</sup> *City of York v. Pa. Pub. Util. Comm'n*, 295 A.2d 825, 828 (1972); see also, *ARIPPA v. Pennsylvania Pub. Util. Comm'n*, 792 A.2d 636, 655 (Pa. Cmwlth 2002) ("We specified that those seeking the merger were required to demonstrate more than the mere absence of any adverse effect upon the public, i.e., that the merger would promote the service, accommodation, convenience or safety of the public in some substantial way.")

<sup>17</sup> *Re DQE, Inc.*, 186 P.U.R. 4th 39, 42-43 (1998) ("*Re DQE, Inc.*"). Ironically, at times, the Joint Applicants appear to concede this fact. See JAs' Initial Brief at pp. 7-8 (citing *City of York v. Pa. Pub. Util. Comm'n*, 295 A.2d 825, 828).

Equally erroneous is the Joint Applicants' attempt to establish a new legal standard, whereby the parties contesting a proposed merger must now *prove* that the transaction will result in definitive harm to Pennsylvania's competitive electricity markets. Such certainty is not legally required, nor logical in an antitrust setting. Section 2811(e) (1) directs the Commission to "consider whether the proposed merger . . . is likely to result in anticompetitive or discriminatory conduct..."<sup>18</sup> and Section 7 of the Clayton Act – the antitrust standard the Commission should incorporate into its Section 2811 consideration of the proposed merger's impact on competition<sup>19</sup> – simply asks for a predictive judgment about the likelihood and magnitude of a merger's competitive effects. As the United States Supreme Court continues to emphasize, "a plaintiff need only prove that [the merger's] effect *may be* substantially to lessen competition."<sup>20</sup>

As discussed *infra* at Sections III.A – III.D, the Joint Applicants have failed to rebut the record evidence that the proposed merger is likely substantially to lessen competition in Pennsylvania's retail and wholesale electricity markets. Therefore, the Commission must conclude that the merger of Exelon and PSEG is not in the public interest.<sup>21</sup>

The Joint Petition for Settlement in no way alters this conclusion.<sup>22</sup> The factors the Joint Applicants cite in support of the Settlement are not recognized by the

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<sup>18</sup> 66 Pa.C.S. § 2811(e)(1) (emphasis added).

<sup>19</sup> See PPL Companies' Main Brief at pp. 18-22.

<sup>20</sup> *California v. American Stores Co.*, 495 U.S. 271, 284 (1990) (emphasis in original).

<sup>21</sup> There is little significance to the Joint Applicants' boast that they have agreed to divest the "largest amount of generation ever proposed," JAs' Initial Brief at p. 22, when the proposed merger is one that promises to create the largest utility company in the county.

<sup>22</sup> JAs' Initial Brief at pp. 11-14.

Department of Justice's Horizontal Merger Guidelines, and thus fail to remedy the unacceptable levels of market concentration produced by the proposed merger. Short-term rate reductions or rate caps, for example, may forestall market power induced price increases, but the effects will only last until the rate reductions and cost caps expire, and only then after imposing the significant costs typically associated with inefficient price regulation. The prophylactic purpose of Section 7 of the Clayton Act is not served by short-term solutions that fail to address the permanent anticompetitive effects the proposed merger will have on Pennsylvania's competitive electricity markets.

Although the Joint Applicants have not yet attempted to overcome the anticompetitive effects of their merger by claiming that the merger will also produce efficiencies, their burden would be even more onerous if they attempted to do so. Courts considering efficiency claims in the context of a merger have required strong evidence of efficiencies to overcome anticompetitive concerns,<sup>23</sup> and no decision has relied on efficiencies in rejecting a challenge to an otherwise illegal merger.<sup>24</sup> There is little, if

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<sup>23</sup> See, e.g., *FTC v. Libbey*, 211 F. Supp. 2d 34, 52-53 (D.D.C. 2002) (showing that \$18 million in efficiencies failed to rebut a prima facie showing that defendant would be able to increase prices after the merger); *FTC v. H.J. Heinz Co.*, 246 F. 3d 708, 720-22 (D.C. Cir. 2001) (rejecting efficiencies defense due to high concentration levels and insufficient showing that merger was only way to realize efficiencies); *FTC v. Univ. Health, Inc.*, 938 F.2d 1206, 1223 (11th Cir. 1991) ("Economies employed in defense of a merger must be shown in what economists label 'real terms.' To hold otherwise would permit a defendant to overcome a presumption of illegality based solely on speculative, self-serving assertions.").

<sup>24</sup> Antitrust Law Developments, A.B.A. Sec. Antitrust L. 347 (5th ed. 2002). See, e.g., *FTC v. Arch Coal, Inc.*, 329 F. Supp. 2d 109, 151-153 (D.D.C. 2004) (reducing defendants' claimed efficiencies from \$130 – 140 million over a five-year period to \$35 – 40 million, noting that defendants had not quantified the savings with precision and discounting for efficiencies that were not merger-specific. Even the efficiencies the Court accepted did "not . . . provide a complete defense to plaintiffs' prima facie case."); *United States v. Oracle Corp.*, 331 F. Supp. 2d 1098, 1175 (N.D. Cal. 2004) (rejecting the defendant's efficiency claims as "flawed and unverifiable" and finding as a matter of law that defendant had failed to meet its burden on efficiencies).

any, evidence in the record on merger-specific efficiencies – certainly nothing even remotely approaching the threshold needed to substantiate such a claim.<sup>25</sup> The Joint Applicants have not shown that merger-specific substantiated savings are enough to overcome the harm to the competitive marketplace from proceeding with the proposed merger. Simply put, there is no efficiency argument that can save this proposed merger. Further relief of the type proposed by the PPL Companies is necessary.

The U.S. Supreme Court has stated that, when a merger is *likely* to produce an entity that controls “an undue percentage share of the relevant market and results in a significant increase in the concentration of firms in that market,” it is so “inherently likely to lessen competition substantially” that it should be enjoined absent credible evidence showing that the merger is not likely to have such anticompetitive effects.<sup>26</sup> The Joint Applicants have failed to put forth the necessary credible evidence, and the likely anticompetitive effects of the proposed merger have been demonstrated. The

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<sup>25</sup> The 1997 revisions to the Horizontal Merger Guidelines made clear that the enforcement agencies would only credit merger-specific efficiencies in the analysis. U.S. Department of Justice and Federal Trade Commission, *Horizontal Merger Guidelines*, 57 Fed. Reg. 41,552 (Sept. 10, 1992), *revised*, 4 Trade Reg. Rep (CCH) ¶ 13,104 (Apr. 8, 1997) (“Horizontal Merger Guidelines”). In other words, the cost savings that occur in any merger as a result of reducing overhead and personnel have no relevance to the competitive effects analysis. To the extent that merger-specific efficiencies result, they must be reasonably verifiable and assessed net of costs produced by the merger or incurred in achieving those efficiencies. Vague or speculative efficiency claims are not sufficient. *Id.* Moreover, “[w]hen the potential adverse competitive effect of a merger is likely to be particularly large, extraordinarily great cognizable efficiencies would be necessary to prevent the merger from being anticompetitive.” *Id.* The Commission has also adopted this framework in analyzing an efficiencies defense. *See Re DQE, Inc.*, 186 P.U.R. 4th at 65 n.8 (adopting the FERC Merger Guidelines and stating that they require “that any claimed efficiencies or synergies must be *merger-specific and verifiable* before they can be considered as an offset to any increase in market power created by the merger”) (emphasis added).

<sup>26</sup> *United States v. Philadelphia Nat'l Bank*, 374 U.S. 321, 363 (1963).

Commission should find conclusively that, as proposed, the merger is likely to injure competition in the Commonwealth.

**III. THE JOINT APPLICANTS HAVE FAILED TO DEMONSTRATE THAT THEIR MERGER WILL NOT LESSEN COMPETITION.**

The only way that the Joint Applicants' proposed merger could pass muster is if the record before the Commission is ignored. The Joint Applicants repeatedly seek to do just that by relying on the FERC Merger Order and attempting to use FERC's illogical and often cryptic decision to support a favorable decision by the Commission.<sup>27</sup> Reliance on FERC's decision, however, would be misplaced. As explained more fully below, FERC: (1) reached its conclusion without the aid of discovery or an evidentiary hearing on the many issues raised by the parties opposing the transactions;<sup>28</sup> (2) blatantly ignored many of the issues raised by the intervening parties;<sup>29</sup> (3) relied upon precedent and data that do not support the conclusions reached;<sup>30</sup> and (4) adopted an untested, and highly suspect, virtual mitigation scheme that is contrary to this Commission's established precedent.<sup>31</sup> Several aspects of the FERC Merger Order also rely upon future filings or continued regulation to ensure ultimate compliance. This flies in the face of the well-established analytical and relief principles relied upon by the federal antitrust agencies and this Commission.<sup>32</sup>

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<sup>27</sup> JAs' Initial Brief at pp. 18-19, 27, 30, 33-35.

<sup>28</sup> *See infra*, section III.B.

<sup>29</sup> *See infra*, sections III.B, III.C.

<sup>30</sup> *See infra*, sections III.B, III.C.

<sup>31</sup> *See infra*, section III.D.

<sup>32</sup> *See infra*, Section IV.F. Moreover, the FERC Merger Order also ignored FERC's own, well-established obligation to hold a hearing when presented with disputed issues of fact. *See, e.g., Pub. Serv. Co. of N.H. v. FERC*, 600 F.2d 944, 955 (D.C. Cir.), *cert. denied*, 444 U.S. 990

In their Initial Brief, the Joint Applicants incorrectly claim that Dr. Kalt ignored the FERC Merger Order and failed to address the purported errors therein.<sup>33</sup> Dr. Kalt not only responded, he highlighted the importance of the instant proceeding – one in which the Joint Applicants’ dubious claims have been fully explored – as the means by which a complete evidentiary record can be developed:

From the perspective of sound public policy, the FERC’s approval - made without the benefit of full discovery and an evidentiary hearing - is inadequate due to factual issues that remain unresolved. Fortunately, these can now be examined with care in the [Commission’s] proceeding.<sup>34</sup>

As Dr. Kalt pointed out, the record upon which the FERC decision was based was not enough for the United States Department of Justice, which only three weeks after the

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(1979); *Sea-Land Serv., Inc. v. United States*, 683 F.2d 491, 496 (D.C. Cir. 1982); *City of Los Angeles v. FMC*, 388 F.2d 582, 583 (D.C. Cir. 1967). Particularly when confronting antitrust issues, the Courts have emphasized the need for a full investigation of the facts in an adversarial hearing. *Gulf States Utils. Co. v. FPC*, 411 U.S. 747 (1973); *Maryland People’s Counsel v. FERC*, 761 F.2d 780, 786 (D.C. Cir. 1985); *Northern Natural Gas Co. v. FPC*, 399 F.2d 953, 958 (D.C. Cir. 1968). FERC also ignored antitrust court precedent, which makes clear that market definition determinations are intensely factual, and typically are not resolved by antitrust courts without extensive discovery and trial-type proceedings. *See, e.g., Forsyth v. Humana, Inc.*, 114 F.3d 1467, 1477 (9th Cir. 1997), *aff’d on other grounds*, 525 U.S. 299 (1999); *Thompson v. Metro. Multi-List, Inc.*, 934 F.2d 1566, 1573-74 (11th Cir. 1991), *cert. denied*, 506 U.S. 903 (1992); *Yeager’s Fuel Inc. v. Pa. Power & Light Co.*, 953 F. Supp. 617, 645 (E.D. Pa. 1997).

<sup>33</sup> JAs’ Initial Brief at p. 18.

<sup>34</sup> Kalt Surrebuttal Testimony at p. 2. The Commission should reject the Joint Applicants’ gratuitous and preposterous attack on the credentials of the PPL Companies’ witness Dr. Joseph P. Kalt. *See* JAs’ Initial Brief at p 23 n.14. Dr. Kalt’s Curriculum Vitae speaks for itself in establishing his credentials as a renowned economic scholar in the field of competitive analysis, including electricity markets. He holds the Ford Foundation Professorship in International Political Economy at the John F. Kennedy School of Government at Harvard University, a position he has held since 1992. He has testified on competition issues in electricity and other markets before the federal courts, FERC and other forums, including this Commission. The fact that Dr. Hieronymus frequently submits testimony under FERC’s Appendix A Guidelines in support of utility mergers does not give automatic credibility to his testimony. Indeed, in this case, Dr. Hieronymus did not know the import shares into the PJM East market assigned by the model upon which he based his testimony. Nor could Dr. Hieronymus state how that information could be extracted from the model. Tr. at 414:4-10. In addition, the Joint Applicants’ criticism of Dr. Kalt’s “lack of expertise” is rather strange given that Joint Applicants’ “counsel for market power issues,” Skadden, Arps, Slate, Meagher and Flom, LLP, has asked Dr. Kalt to proffer testimony before FERC and elsewhere on several occasions.

FERC Merger Order was released, issued an extensive subpoena to PJM Interconnection, L.L.C. (“PJM”) asking for detailed information regarding the PJM Energy Market.<sup>35</sup> The incomplete FERC record was also not enough for the NJBPU. It not only asked FERC for a rehearing, but also is developing a full record on the potentially anticompetitive effects of the proposed merger.<sup>36</sup> For these reasons, this Commission should accord the FERC Merger Order no weight in its deliberations.

**A. The Joint Applicants’ Claims Regarding The Proposed Merger’s Impact On Retail Electricity Markets In Pennsylvania Are In Error.**

The PPL Companies do not dispute that the focus of Section 2811 is on the potentially anticompetitive effects of a merger on retail electricity markets in the Commonwealth.<sup>37</sup> However, the Joint Applicants are wrong to assert that “no party submitted any evidence, much less demonstrated, . . . that it ‘is likely’ that the Merger will somehow increase the Joint Applicants’ market power in any competitive retail market in Pennsylvania or that the Merger otherwise will prevent competitive retail markets from functioning properly.”<sup>38</sup> Putting aside the erroneous legal standard assumed by the Joint Applicants,<sup>39</sup> the PPL Companies not only submitted evidence, but demonstrated conclusively, that by creating market power in wholesale electricity

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<sup>35</sup> Kalt Surrebuttal Testimony at p. 2, Exhibit JPK-12.

<sup>36</sup> Kalt Surrebuttal Testimony at p. 2.

<sup>37</sup> See 66 Pa.C.S. § 2811(e) (1); JAs’ Initial Brief at p. 17.

<sup>38</sup> JAs’ Initial Brief at p. 17.

<sup>39</sup> See *infra*, section II. Again, it is not the intervenors’ burden to demonstrate that the proposed merger is likely to result in competitive harm. It is the Joint Applicants’ burden to show that it will not harm retail electricity markets in Pennsylvania.

markets, the proposed merger poses a serious threat to competition in retail electricity markets in Pennsylvania.<sup>40</sup>

Prices in wholesale and retail markets are inextricably linked, as demonstrated by the fact that: (1) whenever wholesale electricity prices have been below the negotiated price caps, retail competitors (Electric Generator Suppliers or “EGSs”) have been able to capture electric utility customers; and (2) in states where price caps have expired or are not used, retail electricity prices increase and decrease in step with wholesale electricity prices.<sup>41</sup> This evidence, introduced by the PPL Companies, remains unrefuted. Thus, to the extent the proposed merger reduces competition (and hence increases prices) in wholesale power markets, Pennsylvania competitive retail customers will be harmed as suppliers pass through their increased wholesale power costs.<sup>42</sup> The Joint Applicants’ ignore this record evidence.

Also in error is the Joint Applicants’ assertion that the PPL Companies did not dispute Dr. Hieronymus’ claim that the competitive retail market cannot be injured because: (1) PECO’s retail electric and gas operations do not overlap with PSE&G’s; and (2) Exelon’s retail marketing affiliate is not active in PJM East, while PSE&G does not engage in competitive retail marketing.<sup>43</sup> To the contrary, the PPL Companies demonstrated that, even if the Joint Applicants are not active in retail electricity markets in Pennsylvania, the threat to retail competition remains given that, under a price cap

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<sup>40</sup> See Kalt Direct Testimony at pp. 4-6.

<sup>41</sup> *Id.* at pp. 5-6.

<sup>42</sup> *Id.* at p. 4.

<sup>43</sup> JAs’ Initial Brief at pp. 17-18.

regime, the merged entity can use its market power to increase wholesale electricity prices, and thus squeeze out retail competitors.<sup>44</sup> As Dr. Kalt explained:

First, the Merging Parties can foreclose EGSs' ability to offer products that can compete against the price-capped service offered by existing electric utilities by taking actions that increase wholesale prices, and in particular prevent the ability of Exelon's retail customers in Pennsylvania from receiving competitive offers. And second, to the extent that the Merging Parties cause wholesale prices to increase through an exercise of market power, retail prices would similarly be increased, leading to higher costs for electricity customers.<sup>45</sup>

There is thus no merit to the Joint Applicants' assertion that the PPL Companies failed to "focus on how their allegations affect the Pennsylvania retail markets or raise any issues that are unique to the Pennsylvania markets."<sup>46</sup>

Equally in error is the Joint Applicants' argument that the parties raising market power issues "ignore or barely acknowledge that the very same issues that they raise here were also raised before and rejected by FERC."<sup>47</sup> While some of the issues raised here may also have been raised at FERC, they certainly were not given reasonable consideration. Since none of the Joint Applicants' witnesses' assertions were tested through discovery or cross-examination, FERC's conclusions should be of little import here, where a fully-developed record demonstrates conclusively that both wholesale and retail competition will suffer if the merger is approved as proposed.<sup>48</sup>

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<sup>44</sup> See Kalt Direct Testimony at p. 6.

<sup>45</sup> *Id.*

<sup>46</sup> JAs' Initial Brief at p. 18.

<sup>47</sup> *Id.*

<sup>48</sup> See, e.g., Kalt Direct Testimony at pp. 4-6.

Accordingly, the Joint Applicants' reliance on *ARIPPA* is entirely misplaced,<sup>49</sup> as the factual underpinnings of that case are inapposite. First, unlike *ARIPPA*, the fact that the Joint Applicants are not active in the Pennsylvania retail electricity markets is of little (or no) significance. As explained above, given that the Joint Applicants will be able to exercise market power under their untested mitigation plan, they will be able to increase prices in the Pennsylvania wholesale markets, and thus squeeze out potential retail competitors operating under the Commonwealth's current price cap regime.<sup>50</sup> Second, the Court's deference to FERC in *ARIPPA* is not warranted here where FERC ignored record evidence, failed to acknowledge the significant concerns raised by the protesting parties, and gave no serious consideration to the significant difficulties associated with virtual divestiture or the limitations on its ability to detect and remedy the merged entity's ability to exercise market power in the future. Its decision should be accorded no weight by the Commission.

**B. The Joint Applicants Cannot Justify Their Failure To Analyze The PJM Classic Market.**

In defining relevant markets within PJM for his Appendix A analysis, Dr. Hieronymus recognized that, given the price differentials between the western systems recently added to PJM and the constraints on the PJM Eastern Interface, he needed to analyze PJM East and PJM Pre-2004 as separate markets in order "to be conservative."<sup>51</sup> However, Dr. Kalt demonstrated that significant price differentials and congestion also exist to isolate PJM Classic as a distinct market, which should be separately analyzed as

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<sup>49</sup> JAs' Initial Brief at p. 18.

<sup>50</sup> See Kalt Direct Testimony at pp. 4-6.

<sup>51</sup> JAs' Initial Brief at pp. 25-26.

well. Even when the proposed mitigation is taken into account, the proposed merger produces numerous screen failures when PJM Classic is properly analyzed as a separate market.<sup>52</sup>

The PJM Classic price differentials are readily traceable to specific congestion identified in the PJM 2004 State of the Market Report.<sup>53</sup> Despite the evidence presented by Dr. Kalt, which demonstrated that these price differences reach averages of \$15 per MWh,<sup>54</sup> Dr. Hieronymus' "conservative" approach stopped at the PJM Classic border. The reason is obvious – by including Allegheny Power's ("APS") generation (which would otherwise be excluded if the PJM Classic market were analyzed separately), Dr. Hieronymus can substantially reduce the merged entity's market share, and thus make it appear as if the proposed merger does not raise significant market power concerns. This attempt by the Joint Applicants to limit the markets to be tested must be rejected. The only way the Commission can be sure that the proposed merger does not raise market power concerns is if all relevant markets are analyzed and the Joint Applicants' divestiture proposal operates to remedy the market screen failures in all of them. This, the Joint Applicants have failed to do, for when the diluting effect of APS' generation

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<sup>52</sup> The Commission can safely ignore the Joint Applicants' claim that the only thing to be learned from significant screen failures resulting from the separate consideration of the PJM Classic market is that the Joint Applicants should not divest to PPL or other larger market participants. JAs' Initial Brief at pp. 26-27. As the Joint Applicants are well aware, the FERC Merger Order was predicated on the Joint Applicants' commitment to remove the restrictions on who may purchase the divested assets. FERC Merger Order at P 120 (accepting the Joint Applicants' "revised proposal, which increases the total mitigation from 5,500 to 6,600 MW and removes almost all of the restrictions on who can buy the assets"). As a result, the Joint Applicants are precluded by the terms of their own supplemental application, and FERC's acceptance thereof, from seeking to reinstitute restrictions on the potential purchasers of the divested assets. Moreover, such restrictions are anticompetitive and discriminatory. Kalt Direct Testimony at pp. 37-38.

<sup>53</sup> *Id.* at p. 17.

<sup>54</sup> *Id.*, Exhibit JPK-3.

supply is removed from the analysis, the merged entity's potential market power in PJM Classic is observed and numerous screen failures occur.<sup>55</sup>

Ignoring the significant price differentials identified by Dr. Kalt, the Joint Applicants contend that congestion along the Western Interface is not significant. This is simply not true. In Exhibit JPK-2, Dr. Kalt demonstrated that, on average, the yearly difference between the APS zone and the Pepco zone, which is located in PJM Classic, is \$3.27 per MWh<sup>56</sup> – a fact the Joint Applicants do not dispute. The price differentials depicted in JPK-2, however, are *annual average* price differentials,<sup>57</sup> which include both periods of high congestion when the price differentials are significant and the incentive to exercise market power is at its peak, and periods of low or no congestion when the incentive is not significant. There is even more striking evidence, which the Joint Applicants overlook in JPK-3 of moving weekly average price differentials. The contrast between the APS zone and the Pepco zone depicted in that exhibit shows average price differentials reaching as high as \$15 per MWh during the winter and summer months when congestion is at its peak.<sup>58</sup> As such, Exhibit JPK-3 directly refutes the Joint Applicants' unsubstantiated contention that congestion along the Western Interface is not significant.

Moreover, the Joint Applicants continue to misunderstand the effect of redispatch on market definition. Nowhere is this more evident than their claim that, since the

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<sup>55</sup> *Id.*, Exhibits JPK-4 and JPK-11 (demonstrating the impact of the proposed merger on the PJM Classic market).

<sup>56</sup> *Id.*, Exhibit JPK-2.

<sup>57</sup> Kalt Direct Testimony at p. 15.

<sup>58</sup> *Id.*, Exhibit JPK-3.

congestion on the Western Interface can be solved by PJM through redispatch, PJM Classic is not a separate market.<sup>59</sup> Although redispatch may allow PJM to alleviate constraint, the fact that redispatch occurs is actually evidence of a separate market, since it means that PJM is calling on more expensive units on the high-price side of the constraint to alleviate the congestion and prevent constraint.

Thus, the Joint Applicants' claim that congestion on the Western Interface was limited to 78 hours in 2004 is completely erroneous.<sup>60</sup> This number refers to actual constraints, or instances in which the ability to move power across the interface was limited.<sup>61</sup> In Exhibit JPK-3 Dr. Kalt analyzes congestion – the proper benchmark for examining market definition – and identifies at least *twenty-two* price spikes, representing price differentials over \$5 per MWh that were caused by congestion over a twenty-two month period.<sup>62</sup> These numerous, significant price spikes demonstrate that PJM Classic is isolated as a relevant market particularly during the summer and winter peak periods.<sup>63</sup>

The Joint Applicants next argue that the congestion on the Bedington-Black Oak line does not define PJM Classic as a relevant market. However, as both Dr. Kalt and Dr. Hieronymus agree, the Bedington-Black Oak line, which is a pathway between APS and the PJM Classic market, was identified by PJM as the “single most constrained facility in

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<sup>59</sup> JAs' Initial Brief at p. 28.

<sup>60</sup> *See id.*

<sup>61</sup> It would be highly improbable for average price differentials across the Western Interface to be as much as \$3.31 or \$1.77 (as shown in JPK-2) if there were congestion, i.e., price differentials in only 78 of the 8,760 hours during the year.

<sup>62</sup> Kalt Direct Testimony, Exhibit JPK-3.

<sup>63</sup> Kalt Direct Testimony at p. 18.

PJM during 2004.”<sup>64</sup> The congestion associated with the Bedington-Black Oak line, combined with the APS south interface, restricts west-to-east flows of power and limits the ability of facilities upstream of PJM Classic to participate in the PJM Classic market.<sup>65</sup> Moreover, the Joint Applicants’ argument is premised on the pre-expansion definition of the Western Interface and does not reflect the practical reality of today’s PJM market.<sup>66</sup>

Equally in error is the Joint Applicants’ attempt to justify their failure to analyze PJM Classic by relying on the fact that FERC did not consider a separate analysis of the PJM Classic market.<sup>67</sup> The PJM Classic analysis demonstrating numerous market screen failures was obtained through discovery from the Joint Applicants<sup>68</sup> – an evidentiary tool that was not available in the FERC proceeding. As such, FERC’s failure to mandate a separate analysis of the PJM Classic market was based on incomplete facts and should be of little consequence to the Commission.<sup>69</sup>

Moreover, FERC concluded that the PJM Classic market need not be analyzed as a separate market based on the PJM Market Monitoring Unit’s (“PJM MMU’s”)

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<sup>64</sup> *Id.* at p. 17; Kalt Surrebuttal Testimony, Exhibit JPK-13 at p. 3 (agreeing with Dr. Kalt that the Bedington-Black Oak line is the most constrained interface in PJM); Tr. at 419:4-7 (recognizing same).

<sup>65</sup> Kalt Direct Testimony at p. 18 (citing PJM Interconnection, L.L.C., Market Monitoring Unit, 2004 State of the Market Report at 218 (Mar. 8, 2005), *available at* <http://www.pjm.com/markets/marketmonitor/som.html>).

<sup>66</sup> PPL Companies’ Main Brief at pp. 27-28.

<sup>67</sup> *Id.* at p. 27.

<sup>68</sup> Kalt Direct Testimony, Exhibit JPK-11.

<sup>69</sup> It is worth noting that, given the significant delays in receiving the PJM Classic analysis from the Joint Applicants in this proceeding, the PPL Companies were not able to present the PJM Classic market analysis to FERC until they submitted their request for rehearing. The PPL Companies’ request for rehearing is still pending before FERC, along with the rehearing requests of several other parties to this proceeding.

supposed failure to analyze a separate PJM Classic market and the claimed lack of identified binding transmission constraints isolating the PJM Classic market from the PJM Pre-2004 market.<sup>70</sup> However, FERC's conclusions make no sense. First, the PJM MMU Report did not reject a PJM Classic market definition. In fact, the PJM MMU Report never mentioned the PJM Classic market or the Pre-2004 PJM market. Instead, the PJM MMU Report focused its analysis entirely on interfaces and constraints. Thus, it cannot be read to endorse Dr. Hieronymus' market definitions. Second, FERC did not address the significant price differentials between the PJM Classic market and the rest of PJM – evidence that clearly establishes the existence of a separate PJM Classic market.

**C. FTRs Must Be Considered In Assessing The Impact Of The Merger On The PJM East Market.**

Dr. Hieronymus' reliance upon the "pro rata" or "squeeze down" method to allocate import capacity to market participants in PJM East is inappropriate and significantly understates the merged entity's market share.<sup>71</sup> While the pro rata method assigns a very modest share of imports to Joint Applicants' market share, Dr. Kalt's method more accurately assigns a much larger share. The Joint Applicants' attempt to justify their choice of import allocation methodology by turning to FERC's Order No. 642 should be rejected.<sup>72</sup> Order No. 642 and FERC's Merger Guidelines do not address

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<sup>70</sup> FERC Merger Order at P 123.

<sup>71</sup> 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 No. A-110550F0160, PECO Statement No. 1, Exhibit WHH-1, Exhibit No. J-1 at pp. 38-40 (filed Feb. 4, 2005) (containing the Direct Testimony of William H. Hieronymus filed with FERC in Docket No. EC05-43-000) ("Hieronymus FERC Direct Testimony"); JAs' Initial Brief at p. 29.

<sup>72</sup> See JAs' Initial Brief at p. 30 (citing *Revised Filing Requirements Under Part 33 of the Commission's Regulations*, Order No. 642, 65 Fed. Reg. 70,983 (Nov. 28, 2000), FERC Stats. & Regs., Regulations Preambles (Jul. 1996 – Dec. 2000) ¶ 31,111, at p. 31,894 (2000) ("Order No.

the manner in which FTRs should be factored into an Appendix A merger analysis. The Order and Guidelines were adopted before FTRs came into widespread use as a means by which congestion costs could be hedged.<sup>73</sup>

Nor does Order No. 642 suggest that direct evidence of an analytically superior methodology should be ignored. Neither Dr. Hieronymus nor FERC made any effort to investigate or analyze the effect of allocating imports based upon FTR ownership. They relied upon the pro rata method not because it was based on sound economic principles, but rather because that was the way they have treated imports in the past.<sup>74</sup> Dr. Kalt, however, recognized the importance of analyzing FTRs. Amazingly, FERC made no attempt to address Dr. Kalt's conclusion that significantly different outcomes result when imports are properly allocated based on FTR ownership.<sup>75</sup>

This Commission cannot afford to accept the Joint Applicants' invitation to make the same mistake as FERC. Rather it should recognize that because an FTR gives its holder the economic value of the price difference resulting from congestion, it provides the Joint Applicants with the incentive to withhold generation in PJM East. Such a strategy will not only drive up the price of electricity or generation, but will increase the value of the FTRs themselves. In both instances, the merged entity will benefit.<sup>76</sup>

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642"), *order on reh'g*, Order No. 642-A, 66 Fed. Reg. 16,121 (Mar. 23, 2001), 94 FERC ¶ 61,289 (2001)).

<sup>73</sup> See, e.g., *PECO Energy Co.*, 81 FERC ¶ 61,257, at p. 62,260 (1997) (approving PJM's initial allocation of FTRs). FTRs were initially used in the PJM spot market in 1998.

<sup>74</sup> See Hieronymus FERC Direct Testimony at p. 39.

<sup>75</sup> See Kalt Direct Testimony at p. 29, Exhibit JPK-7 (demonstrating screen failures in all but one of the season/load conditions, with five of the post-merger markets being "highly concentrated" and presumed as likely to permit the exercise of market power).

<sup>76</sup> *Id.* at p.18. The incentive to withhold is not disputed. Dr. Hieronymus acknowledges that, if the value of the generation in PJM East increases relative to the generation outside of PJM

The Joint Applicants' claim that Dr. Kalt's testimony should be discredited because he purportedly changed his position on FTRs should also be summarily rejected.<sup>77</sup> Dr. Kalt's testimony did not change. Dr. Kalt has never taken the position that FTRs provide physical import rights. Rather, Dr. Kalt's unchallenged position has always been that FTRs effectively allow the Joint Applicants to "sink" their lower cost generation into PJM East,<sup>78</sup> and thus FTRs allow parties, such as the Joint Applicants, to treat the lower cost generation located outside of PJM East as if that generation were located in the PJM East market because FTRs give the holders the value of any price differences across the interface.<sup>79</sup>

The Joint Applicants also err in claiming that Dr. Kalt "ignores important facts" in failing to consider the impact of the Joint Applicants' load in his FTR analysis.<sup>80</sup> Contrary to the Joint Applicants' claims, load will not "cancel out" the incentive to withhold created by the FTRs.<sup>81</sup> First, this argument ignores the fact that Dr. Kalt's FTR

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East, the value of the FTRs across the interface will increase and an incentive to withhold will exist. This will be true even if the FTR holder is not an importer. *See* Tr. 414:21-23; Kalt Surrebuttal Testimony, Exhibit JPK-13 at pp. 8-9.

<sup>77</sup> JAs' Initial Brief at p. 30. The statement upon which the Joint Applicants' erroneous claim is based was Dr. Kalt's response to a gross mischaracterization made by Dr. Hieronymus on rebuttal. *See* 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 No. A-110550F0160, PECO Statement No. 3-R, Rebuttal Testimony of William H. Hieronymus at p. 20 (filed July 29, 2005) ("Hieronymus Rebuttal Testimony") (claiming that Dr. Kalt "misunderstand[s] the distinction between the physical right to import energy and the financial consequences of owning FTRs into PJM East").

<sup>78</sup> Kalt Direct Testimony at 28.

<sup>79</sup> Kalt Surrebuttal Testimony at p. 14.

<sup>80</sup> JAs' Initial Brief at pp. 31-32.

<sup>81</sup> *Id.* at p. 32.

analysis is an economic capacity analysis.<sup>82</sup> As the Joint Applicants are well aware, load is not factored into an economic capacity analysis.<sup>83</sup> Second, even if the Joint Applicants' load is accounted for in the economic capacity analysis, the incentive to withhold generation still exists. Exelon and PSEG through their various generation affiliates have sufficient generation resources to serve their native load obligations without needing to import generation capacity.<sup>84</sup> Therefore, FTRs are not necessary to supply their load and the gains obtained by increasing the value of FTRs will not be "washed out."

Moreover, the Joint Applicants' argument that FTR ownership is "washed out" under the available economic capacity analysis ignores the fact that the Joint Applicants have proposed the minimum mitigation necessary to pass the Merger Guideline screens when using the pro rata import allocation method in PJM East. It is a simple matter of logic to conclude that a merger that barely passes the merger analysis screens when FTRs are ignored will fail such screens when FTRs are used to allocate more imports to the merged entity, and hence leave it with a higher market share. Accordingly, the

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<sup>82</sup> Kalt Direct Testimony, Exhibit JPK-8.

<sup>83</sup> Hieronymus Rebuttal Testimony at pp. 21-22. Any claim by the Joint Applicants that PPL's counsel is to blame for excluding their load/FTR analysis is unfounded. As PPL's counsel correctly pointed out during the hearing, the Joint Applicants have the burden of proof in this case and had several opportunities to properly present this analysis in Dr. Hieronymus' Supplemental or Rebuttal Testimony when addressing Dr. Kalt's FTR claims. To claim that a new study should be accepted on rejoinder without allowing the PPL Companies or any of the intervenors' expert witnesses an opportunity to study and respond is contrary to the procedural schedule established by the ALJ. See Tr. 391:14-24, 394:1-4, 10-17 (noting ALJ Chestnut's disapproval of the Joint Applicants' attempt to introduce the new study so late in the proceeding).

<sup>84</sup> See 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 No. A-110550F0160, Exhibit WHH-1a, Supplemental Testimony and Exhibits of William H. Hieronymus on behalf of Exelon Corporation, Exhibit J-19 (filed May 27, 2005) ("Hieronymus Supplemental Testimony").

Commission can comfortably reject all of the Joint Applicants' rationalizations for ignoring this important economic factor in assessing the lessening of competition caused by the proposed merger.

**D. Contrary To The Joint Applicants' Claims, Their Virtual Divestiture Proposal Will Not Prevent The Exercise Of Market Power.**

The Commission has recognized that conduct remedies such as virtual divestiture are no substitute for the physical divestiture of generation assets:

[S]tructural remedies, such as joining an ISO or divestiture of plants or other assets, are preferred by the federal antitrust enforcement agencies (and accepted by FERC) because they are the cleanest and most effective way to deal with a market power problem. With structural remedies, there is no need for continuing oversight of the merged entity to ensure that it does not abuse its market power – the unlawful market power has been effectively removed by the structural remedy.<sup>85</sup>

Nevertheless, the Joint Applicants claim that their virtual divestiture proposal will mitigate the anticompetitive effects of the merger. The record evidence does not support this claim. Far from effective, the Joint Applicants' virtual divestiture proposal will do nothing to eliminate – and actually may enhance – the merged entity's ability to exercise market power. While the merged entity theoretically is required to make the virtually divested energy available on a "firm basis twenty-four hours a day, seven days a week,"<sup>86</sup> it remains the case that scheduled maintenance, increases or decreases in output, and other planned outages may affect the prices of, and hence the profits to be realized from, the annual three-year auctions.<sup>87</sup> Thus, despite the Joint Applicants' reliance on FERC's

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<sup>85</sup> *Re DQE, Inc.*, 186 P.U.R. 4th at 61 (citations omitted). Indeed, even the Joint Applicants admit that the divestiture of physical units is "[t]he most common form of mitigation." JAs' Initial Brief at p. 21.

<sup>86</sup> *See id.* at p. 33.

<sup>87</sup> *See* Kalt Direct Testimony at pp. 22-23.

statement about the difficulty of withholding output from nuclear plants, “it remains the case that the capacity at issue is *nuclear*, and strong reasons can exist for not pushing for the return of a unit to service in the face of any party’s – including, here, the owner’s – reservations about re-starting.”<sup>88</sup>

Nor will the purchaser of the virtually divested energy contracts be able to affect the merged entity’s ability to withhold. Even Dr. Hieronymus concedes that the purchasers of the virtually divested capacity will not control whether or when outages will occur.<sup>89</sup> Thus, far from conceding that “withholding the nuclear units is not a realistic danger,”<sup>90</sup> Dr. Kalt established that not only is there an incentive for the merged entity unilaterally to exercise market power to increase its earnings, but that any such profit-maximizing strategy would be very difficult to detect and control.<sup>91</sup>

Similarly, the Joint Applicants’ fail to cast doubt on the merged entity’s ability to withhold fossil generation to exercise market power, and thus increase its earnings from the virtual divestiture auctions. Even accepting the Joint Applicants’ faulty premise that the withholding of nuclear output is unlikely, the merged entity will continue to control significant amounts of fossil generation. Therefore, the incentive and ability to withhold power from other more flexible units, and thus artificially inflate prices in the forward markets in which nuclear energy will be repeatedly auctioned, cannot be ignored.<sup>92</sup> Indeed, the Joint Applicants’ own witness concedes that the incentive exists to withhold

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<sup>88</sup> *Id.* at p. 22 (emphasis in original).

<sup>89</sup> Kalt Surrebuttal Testimony, Exhibit JPK-13 at pp. 12-13; Tr. at 425:13-24.

<sup>90</sup> JAs’ Initial Brief at p. 34.

<sup>91</sup> *See, e.g.*, Kalt Surrebuttal Testimony at pp. 5-7.

<sup>92</sup> *Id.* at pp. 7-8.

the output from *other facilities*, as the resulting benefits of higher prices will be realized by *all the plants* (both nuclear and fossil) owned by the merged entity.<sup>93</sup>

The Joint Applicants next try to fall back on FERC's reliance on the virtually divested capacity to control market power in the virtually divested sales.<sup>94</sup> This, of course, is circular reasoning. The Joint Applicants cannot rely on the virtual divestiture to prove the effectiveness of virtual divestiture as a remedy.<sup>95</sup>

Equally in error is the Joint Applicants' claim that Dr. Kalt failed to explain "how raising prices in the *near-term* markets, would cause prices to increase in the *long-term three year markets* in which the virtual divestiture auctions will take place."<sup>96</sup> To the contrary, Dr. Kalt discussed how fossil fuel facilities could be withheld, and benefits could be obtained, by simply elevating the forward prices for the next month or two at the time of the auction.<sup>97</sup> The Joint Applicants asserted (without foundation) that such a withholding strategy is not feasible. Dr. Kalt demonstrated, however, that the annual auctions for three-year contracts are *not* sufficiently long-term such that the near-term forward prices of fossil fuels will have no bearing on the offers received by the merged

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<sup>93</sup> *Id.*, Exhibit JPK-13 at pp. 10-11 (deposition excerpts of Dr. William H. Hieronymus) and Exhibit JPK-14 (Dr. Hieronymus' response to OCA-V-6) at p. 2.

<sup>94</sup> JAs' Initial Brief at p. 34.

<sup>95</sup> *See* Kalt Direct Testimony, Exhibit JPK-5 (showing PJM East HHI increases ranging from 340 to 1,033 points, screen failures in all relevant markets, and merged firm market shares as high as 47.6 percent).

<sup>96</sup> JAs' Initial Brief at p. 34 (emphasis in original).

<sup>97</sup> Kalt Surrebuttal Testimony at pp. 8-9; *see also* Kalt Direct Testimony at pp. 22-23 ("[F]or example, withholding mid-merit supplies in conjunction with, or as opposed to, nuclear plants as the next round of nuclear power contracting comes due might credibly be used to signal prospects of higher going-forward prices, thereby increasing the demand for and prices of power sold under "virtual divestiture" nuclear contracts."); PPL Companies' Main Brief at pp. 42-44.

entity.<sup>98</sup> The Joint Applicants did not dispute that the entities participating in the virtual divestiture auctions will be expected to incorporate currently-reported wholesale electricity forward prices and supply projections into their offers.<sup>99</sup> Thus, to the extent the merged entity can strategically increase near-term forward prices, the price for the virtually divested capacity (which could be as much as 900 MW each year) would be artificially elevated as well.<sup>100</sup>

In a last-ditch effort to save their fatally-flawed virtual divestiture proposal, the Joint Applicants assert that their mitigation plan will be monitored and, to the extent problems arise, presumably remedied, by the PJM Market Monitor or FERC.<sup>101</sup> While the Joint Applicants may assert that this “close monitoring” is an “affirmative benefit” of the merger,<sup>102</sup> in reality, it is not. As explained below and in PPL’s Post-Hearing Brief,<sup>103</sup> such continued (and potentially indefinite) regulatory oversight – regardless of the severity of the penalties that may be imposed – is antithetical to fundamental competitive market assumptions and contrary to Commission precedent.

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<sup>98</sup> Kalt Surrebuttal Testimony at p. 9.

<sup>99</sup> *Id.*

<sup>100</sup> *Id.* The Joint Applicants’ argument – that both FERC and Dr. Hieronymus “deemed” long term markets to be competitive, JAs’ Initial Brief at p. 35, demonstrates that neither FERC nor Dr. Hieronymus bothered to actually analyze whether the merged entity would be able to exercise market power in the pricing of the three-year forward contracts.

<sup>101</sup> JAs’ Initial Brief at pp. 35-36.

<sup>102</sup> *Id.* at pp. 10, 14.

<sup>103</sup> See PPL Companies’ Main Brief at pp. 44-46.

**E. The Joint Applicants' Structural Divestiture Plan Lacks The Specifics Necessary For It To Be Considered Effective, Verifiable Mitigation.**

The Joint Applicants would have the Commission believe that they have “committed” to a “robust mitigation plan,”<sup>104</sup> an essential piece of which involves actually “divesting certain generating assets.”<sup>105</sup> Their so-called “commitment” is entirely illusory. Far from “robust,” the Joint Applicants’ structural divestiture scheme relies upon a non-specific pool of generating assets that the Joint Applicants may (or may not) decide to sell. In fact, the only thing definite about the Joint Applicants’ mitigation plan is that the merged entity will be entirely in control of its implementation, rather than the appropriate regulatory authorities or a market monitor.

The Commission has observed that mitigation plans, like the Joint Applicants’ proposal, which are devoid of specifics and place the merged entity in control of the timing and specifics of the plan’s implementation, do not eliminate – and may actually enhance – the merged entity’s incentive and ability to exercise market power:

Equally disturbing is the fact that the Applicants would retain authority over which option could be chosen to satisfy this requirement. They could, for example, choose the option most favorable to them and least favorable to promoting competition.<sup>106</sup>

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<sup>104</sup> JAs’ Initial Brief at p. 9.

<sup>105</sup> *Id.* at p. 11.

<sup>106</sup> *Re DQE, Inc.*, 186 P.U.R. 4th at 62 (internal citations omitted). In its discussion of structural remedies, the Commission equated joining an ISO, which expands market capacity and reduces (or eliminates) market concentration, with divestiture. *See Id.* at 61 (“structural remedies, such as joining an ISO or divestiture of plants or other assets, are preferred by the federal antitrust enforcement agencies (and accepted by FERC) . . .”). We note that, on rehearing, the Commission allowed the merged entity in *Re DQE, Inc.* to engage in energy and capacity sales as a form of *interim* relief only. This temporary form of mitigation was permitted to afford the merged entity sufficient time to join a fully-functioning ISO. *Re DQE, Inc.*, 186 P.U.R 4th 449, 453 (1998).

The Joint Applicants' refusal to provide any specifics regarding the manner in which their divestiture plan will be implemented, and its effectiveness in restoring competitive electricity markets in Pennsylvania essentially leaves the fox guarding the hen-house. In addition, since the Joint Applicants place so much reliance on the FERC Merger Order and FERC's consideration and approval of the specific divestiture that will ultimately be proposed,<sup>107</sup> it is entirely appropriate for the Commission to withhold its final authorization until the Joint Applicants' actual divestiture plan has been approved by FERC. This will allow the Commission to participate in the FERC proceeding to ensure that the Commission's concerns regarding competitive Pennsylvania markets are addressed. Moreover, given FERC's less than thorough consideration of the Joint Applicants' Federal Power Act ("FPA") Section 203 application, withholding the final Commission order until the FERC divestiture plan proceedings are complete may be necessary. In this way, the Commission can convene its own investigation of the Joint Applicants' divestiture plan if FERC fails to conduct a proper and complete inquiry.

**F. The PJM Market Monitor, FERC Enforcement Authority, And Rate Caps Cannot Remove The Merged Entity's Incentive And Ability To Exercise Market Power.**

Having failed to analyze a critical market entirely (PJM Classic), having failed to properly measure market shares in another (PJM East), and having proposed a mitigation plan that is incapable of preventing the unlawful exercise of market power the proposed merger portends, the Joint Applicants fall back on the PJM Market Monitor, FERC's enforcement authority, and rate caps as their last defenses against a finding that the proposed merger will produce unacceptable market concentration levels even with the

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<sup>107</sup> JAs' Initial Brief at pp. 21, 33.

proposed divestiture. Continued regulatory oversight of this type runs contrary to the fundamental principles of competitive markets. It would be poor public policy for the Commission to rely on a conduct remedy to correct a structural distortion in the competitive electricity market. Accordingly, should the Commission determine that the merger can go forward if properly mitigated, it must insist on structural relief.

The Joint Applicants rely heavily in their Initial Brief on the PJM Market Monitor, described by their witness Mr. Crowley, as an effective back-stop to any failures in their proposed mitigation scheme.<sup>108</sup> The Joint Applicants falsely claim that no one rebutted Mr. Crowley's testimony or Dr. Hieronymus' testimony regarding the powers of FERC's Office of Market Oversight and Investigations ("OMOI"). The sum and substance of Mr. Crowley's testimony relates to after-the-fact monitoring by an entity that can only investigate and make recommendations; it does not directly control the prices at which Exelon bids energy into the market. As Mr. Crowley admitted in cross-examination:

Q. Mr. Crowley, when the Exelon Power team decides to bid a unit into the PJM market, under normal operating conditions does it consult with the Market Monitor?

A. No.

Q. Does it consult with the Market Monitor regarding the price it's going to bid the unit at?

A. No.

Q. And it doesn't consult with the Market Monitor with respect to whether or not it is going to operate a unit, does it?

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<sup>108</sup> See JAs' Initial Brief at pp. 35-36.

A. No. We are required as a designated capacity resource to bid that unit in.

Q. To bid the unit into the market?

A. Yes.

Q. But that can be anything up to \$1000; is that correct?

A. That's the cap in PJM, that's correct, the price cap.<sup>109</sup>

While the Joint Applicants attempt to imply otherwise, the PJM Market Monitor's ability to prevent the merged entity from exercising market power through increasing prices is extremely limited. It may be able to make recommendations for new rules that might make the market more efficient or less likely to experience short-term distortions, but it cannot remove the merged entity's incentive to exercise market power, nor control its pricing behavior.<sup>110</sup> Moreover, the Joint Applicants fail to note that the PJM Market Monitor has jurisdiction over only the organized PJM spot market. They ignore entirely the fact that many, if not most, of PJM transactions take place in the very active bilateral market outside of this organized spot market. Particularly with respect to longer term contracts – such as the ones many EGSs might rely upon to serve their retail customers – the bilateral longer-term market is of critical importance. However, transactions in these markets are all beyond the reach of the PJM Market Monitor.<sup>111</sup> In sum, reliance on the PJM Market Monitor is a poor substitute for the actual, physical divestiture of specific assets.

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<sup>109</sup> Tr. at 442:22 - 443:14.

<sup>110</sup> See PJM Interconnection, L.L.C., FERC Electric Tariff, Sixth Revised Volume No. 1, Attachment M, Section IV, First Revised Sheet No. 448 to Third Revised Sheet No. 450.

<sup>111</sup> See *id.*, Sections III-IV, First Revised Sheet No. 448 to Third Revised Sheet No. 450.

The Joint Applicants' reliance upon FERC's OMOI is equally misplaced. While they claim that Dr. Hieronymus' testimony on this subject was un rebutted,<sup>112</sup> once again, the Joint Applicants are wrong. Dr. Kalt testified on surrebuttal that "the only means by which the PA PUC can be sure that these strategies will not be profitable for the post-merger entity is if much, if not all of the virtual divestiture is replaced by real sales."<sup>113</sup> Moreover, the OMOI's principle weapon in controlling the exercise of market power is the regulation of prices under the FPA. The remedies available to FERC under the FPA to control the exercise of market power are limited, and do not include the authority to order divestiture of assets except as a condition to its approval of a merger.<sup>114</sup>

Even if FERC's OMOI is successful in identifying and punishing unlawful exercise of market power by levying fines, the fines levied (even as increased under the Energy Policy Act of 2005) may be of little help.<sup>115</sup> While it is true that those penalties may be as much as \$1 million per day, the merged entity will be so huge that even if it were ordered to pay fines of that magnitude, the additional revenue from a market power driven price increase could easily exceed the fines.<sup>116</sup> Moreover, FERC's price regulation

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<sup>112</sup> JAs' Initial Brief at p. 35.

<sup>113</sup> Kalt Surrebuttal Testimony at p. 10.

<sup>114</sup> See Joseph T. Kelliher, *Market Manipulation, Market Power, and the Authority of the Federal Energy Regulatory Commission*, 26 Energy L.J. 1 (2005) (describing FERC's remedial powers for violation of market-based rate tariffs).

<sup>115</sup> Energy Policy Act of 2005, Pub. L. No. 109-58, §§ 1283-1284, 119 Stat. 594 (2005).

<sup>116</sup> For example, based upon Dr. Hieronymus' analysis of the PJM Classic market, which was included as Exhibit JPK-11, even after mitigation, Exelon will continue to control 10,619 MW of energy during the winter peak period and 9,636 MW during the winter off-peak period (assuming conditions do not increase the market to the winter super peak market size). A \$5 increase in the PJM Classic market during a 24-hour period would result in profits of approximately \$1.23 million (\$5 X 10,619 MW X 16 hrs. plus \$5 X 9,636 MW X 8 hrs). Obviously, during periods when the market is larger, the merged entity's gains would be even greater.

or penalties cannot replicate a competitive market in efficiently allocating society's resources or providing incentives for new investments.<sup>117</sup>

Reliance upon regulatory oversight is also inconsistent with the Commission's and the federal antitrust agencies' long-accepted preference for structural relief to address market power concerns.<sup>118</sup> As the Commission has acknowledged, continued regulatory oversight of the merged entity for years after the merger is consummated is contrary to competitive principles:

The creation of new competition through structural remedies is likely to be better for electric customers than the creation of additional oversight requirements. Regulatory conditions that require continuing oversight by a regulatory body to ensure compliance generally are less effective in preventing the exercise of market power and more costly to enforce.<sup>119</sup>

And, as one former head of the Department of Justice's Antitrust Division stated:

An ideal decree was described as a one-shot affair – *e.g.*, divesting assets or ending a pricing system – and enforcement of the antitrust laws was not to give birth to a system of continuing regulation with the Division functioning as a regulatory agency. If under a decree the Division is

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<sup>117</sup> *Edison Mission Energy, Inc. v. FERC*, 394 F.3d 964 (D.C. Cir. 2005) (“If prices are suppressed in a competitive market, a natural inference is that suppliers who could otherwise profitably enter would be deterred from entry.”).

<sup>118</sup> *See supra*, Section III.E.

<sup>119</sup> *Re DQE, Inc.*, 186 P.U.R. 4th at 61. *See* U.S. Department of Justice, *Antitrust Division Policy Guide to Merger Remedies* at 8 (Oct. 2004) (“*DOJ Merger Remedies Guide*”), available at <http://www.usdoj.gov/atr/public/guidelines/205108.pdf> (“Structural remedies are preferred to conduct remedies in merger cases because they are relatively clean and certain, and generally avoid costly government entanglement in the market.” In contrast, a conduct remedy “typically is more difficult to craft, more cumbersome and costly to administer, and easier than a structural remedy to circumvent.”); *see also id.* at 18 (“Conduct remedies generally are not favored in merger cases because they tend to entangle the Division and the courts in the operation of a market on an ongoing basis and impose direct, frequently substantial, costs upon the government and public that structural remedies can avoid.”).

required to adjudge the propriety of a variety of conduct of a defendant for years to come, the Division is likely to suppress competition.<sup>120</sup>

Nor can the Commission rely on other agencies to protect Pennsylvania consumers. The Commission cannot guarantee that the priorities of those other agencies will remain unchanged, or that these agencies will continue to have the resources available to them to maintain effective regulatory oversight.

Finally, reliance on existing rate caps to protect Pennsylvania's retail customers through the end of the rate cap period in 2009 will be ineffective in ensuring, let alone preserving, competition in retail energy markets.<sup>121</sup> The anticompetitive effects of the merger will be permanent and long-lasting. Once the rate caps expire in 2010, all Pennsylvania utility customers could be at the mercy of the merged entity's market power given that the Competition Act mandates that post-price cap prices should be based upon market prices.<sup>122</sup>

Accordingly, the Commission should not place its faith in regulatory oversight, but rather in creating the proper incentives for market participants to engage in competitive conduct. That can only be achieved by requiring real divestiture of sufficient amounts of specifically identified generation units to remove the merger entity's ability and incentive to exercise market power. Doing so will protect Pennsylvania consumers for years to come, regardless of the ebb and flow of changes in enforcement policy or available resources.

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<sup>120</sup> Edwin M. Zimmerman, *New Directions in Department of Justice Enforcement Policy: The Antitrust Division's Decree Review and Private Litigation Programs*, 51 *Antitrust L.J.* 105, 109-110 (1982).

<sup>121</sup> See PPL Companies' Main Brief at p. 18 (market preventing Pennsylvanians who chose to shop from receiving the benefits of competitive retail electricity market).

<sup>122</sup> 66 Pa.C.S. § 2801(e).

#### IV. CONCLUSION.

For the foregoing reasons, the PPL Companies urge the ALJ to recommend that the Commission find that the proposed merger will likely lessen competition in the PJM Classic and PJM East wholesale electricity markets and, as a result, the Pennsylvania retail electricity market. The PPL Companies also request that the Commission hold that the mitigation proposed by the Joint Applicants is insufficient to prevent such lessening of competition. Further, the PPL Companies urge the ALJ to recommend that the Commission: (1) condition its approval of the proposed merger on the Joint Applicants' agreement to effective relief, as set forth herein and in the PPL Companies' Main Brief; and (2) certify its findings, along with the record of these proceedings, to the Attorney General of the Commonwealth, Antitrust Division of the United States Department of Justice, FERC, and the NJBPU.

Respectfully submitted,

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By 

October 21, 2005

**APPENDIX 2**

## APPENDIX 2

### REPLY FINDINGS OF FACT

#### PROCEDURAL BACKGROUND.

1. The Federal Energy Regulatory Commission's ("FERC's") conditional acceptance of the proposed merger was based on an incomplete record, developed without the benefits of discovery or an evidentiary hearing. Kalt Surrebuttal at p. 2.
2. Three weeks after the FERC Merger Order was released, the United States Department of Justice, issued an extensive subpoena to PJM Interconnection, L.L.C. ("PJM") asking for detailed information regarding the PJM energy market. Kalt Surrebuttal Testimony at p. 2, Exhibit JPK-12.
3. The New Jersey Board of Public Utilities ("NJBP"), in an ongoing proceeding, is developing a full record on the potentially anticompetitive effects of the proposed merger. Kalt Surrebuttal Testimony at p. 2.

#### ALLEGED EFFICIENCIES.

4. The U.S. Department of Justice / Federal Trade Commission Horizontal Merger Guidelines make clear that antitrust enforcement agencies should only credit efficiencies that are merger-specific, reasonably verifiable, and net of merger-related costs or costs incurred to achieve the efficiencies. *See generally*, Horizontal Merger Guidelines.
5. The Horizontal Merger Guidelines also mandate that, "[w]hen the potential adverse competitive effect of a merger is likely to be particularly large, extraordinarily great cognizable efficiencies would be necessary to prevent the merger from being anticompetitive." *See generally*, Horizontal Merger Guidelines.
6. The Joint Applicants put forth no evidence, and made no arguments, regarding efficiencies as a defense to the demonstrated anticompetitive impact of the proposed merger.

#### MARKET DEFINITION.

7. FERC did not address the significant price differentials between the PJM Classic market and the rest of PJM, despite having been presented with such information by the PPL Companies.
8. FERC was not presented with evidence of the significant screen failures that result when PJM Classic is analyzed as a separate market – and thus could not have addressed (and/or rejected) such market failures – because such information

was not produced by the Joint Applicants until June 17, 2005, in response to a discovery request in this proceeding. *See* Kalt Direct Testimony, Exhibit JPK-11.

9. FERC's reliance on the PJM Market Monitoring Unit's ("PJM MMU's") failure to analyze PJM Classic as a separate market as a reason for not considering such an analysis was in error. The PJM MMU focused entirely on interfaces and constraints, failing to even mention PJM Classic, and thus could not have explicitly rejected PJM Classic as a separate market definition.

#### **OWNERSHIP OF FINANCIAL TRANSMISSION RIGHTS.**

10. FERC did not address the effect of FTRs on market concentration levels.
11. FERC's Order No. 642 and the FERC Merger Guidelines predated the widespread use of FTRs and therefore FTRs are not addressed in the Appendix A merger analysis. *See, e.g., PECO Energy Co.*, 81 FERC ¶ 61,257, at p. 62,260 (1997) (approving PJM's initial allocation of FTRs). FTRs were initially used in the PJM spot market in 1998.
12. In analyzing the effects of allocating imports based on FTR ownership, Dr. Kalt conducted an economic capacity analysis, which intentionally does not account for load. *See* Kalt Direct Testimony, Exhibit JPK-8. As such, load cannot "cancel out" the incentive to withhold created by FTRs in such an analysis.

#### **THE JOINT APPLICANTS' MITIGATION PROPOSAL.**

13. The PJM Market Monitor cannot directly control the price at which the merged entity will bid energy into the market, Tr. at 442:22 - 443:14, and thus is powerless to prevent the merged entity from exercising market power through increasing prices.
14. The PJM Market Monitor only has jurisdiction over the organized PJM spot market, and thus cannot control the merged entity's pricing behavior in the bilateral markets outside the organized PJM spot market.

## REPLY CONCLUSIONS OF LAW

1. The Joint Applicants have the initial burden of demonstrating that the proposed merger will not result in competitive harm, 66 Pa.C.S. § 2811(e), and otherwise “will affirmatively promote the ‘service, accommodation, convenience, or safety of the public’ in some substantial way.” *City of York v. Pa. P.U.C.*, 295 A.2d at 828.
2. Given the unacceptable levels of market concentration that will result from the merger, even as mitigated, and the corresponding adverse effects on wholesale and retail competition in the Commonwealth, the Joint Applicants have failed to meet their burden of establishing lack of competitive harm and affirmative benefits to the public interest.
3. Lacking the evidentiary record that results from a complete discovery process and adversarial hearing, and relying on principles that are antithetical to the pro-competition ideology embraced by the Commission and the federal antitrust agencies, the FERC Merger Order should be accorded no weight in the instant proceeding.
4. Commission policy prefers structural remedies (e.g., physical divestiture) over conduct remedies (e.g., virtual divestiture), when attempting to mitigate the anticompetitive effects of a proposed merger. *Re DQE, Inc.*, 186 P.U.R. 4th at 61.
5. Commission policy prefers mitigation plans that: (a) are in place when the merger is consummated, (b) specifically identify the units to be divested, and (c) do not allow the merged entity to control the timing of the proposed mitigation, and the manner in which it will be implemented. *Re DQE, Inc.* 186 P.U.R. 4th at 53, 62.
6. The Commission disfavors mitigation plans that require continued monitoring or other forms of Commission involvement after the transaction is closed. *Re DQE, Inc.*, 186 P.U.R. 4th at 60-61.
7. Courts considering efficiency claims in the context of a proposed merger have required strong evidence that the proposed efficiencies are merger-specific, reasonably verifiable and assessed net of merger-related costs or costs incurred to achieve the efficiencies, *see, e.g., FTC v. H.J. Heinz Co.*, 246 F. 3d at 720-22; *FTC v. Univ. Health, Inc.*, 938 F.2d at 1223; *FTC v. Libbey*, 211 F. Supp. 2d at 52-53, and no decision has relied on efficiencies in rejecting a challenge to an otherwise illegal merger. Antitrust Law Developments, A.B.A. Sec. Antitrust L., p. 347 (5th ed. 2002); *see also FTC v. Arch Coal, Inc.*, 329 F. Supp. 2d at 151-153; *United States v. Oracle Corp.*, 331 F. Supp. 2d at 1175.
8. The Joint Applicants put forth no evidence establishing the requisite “large, extraordinarily great cognizable efficiencies” to offset the undisputed

anticompetitive effects of the proposed merger, and therefore their efficiency defense is rejected.

**APPENDIX 3**

## APPENDIX 3

### CONSOLIDATED FINDINGS OF FACT<sup>123</sup>

#### THE PROPOSED MERGER.

1. The proposed merger between Exelon and PSEG involves two of the largest generators of electricity in PJM. Hieronymus FERC Direct Testimony, Exhibit J-9.
2. Post-merger, the merged entity will be the single largest producer of electric energy in the Commonwealth. Kalt Direct Testimony at p. 36; Kalt Surrebuttal Testimony at p. 7.
3. Even after the Joint Applicants' proposed mitigation and divestiture, the merged entity will continue to own 37,100 MW of generation in PJM, including 14,400 MW (or approximately 40 percent) of the capacity in PJM East, the most constrained market in PJM. See Kalt Direct Testimony at Exhibit JPK-6a; Kalt Surrebuttal Testimony at p. 17; Hieronymus Direct Testimony at p. 4.

#### PROCEDURAL BACKGROUND.

4. \* The Federal Energy Regulatory Commission's ("FERC's") conditional acceptance of the proposed merger was based on an incomplete record, developed without the benefits of discovery or an evidentiary hearing. Kalt Surrebuttal at p. 2.
5. \* Three weeks after the FERC Merger Order was released, the United States Department of Justice, issued an extensive subpoena to PJM Interconnection, L.L.C. ("PJM") asking for detailed information regarding the PJM energy market. Kalt Surrebuttal Testimony at p. 2, Exhibit JPK-12.
6. \* The New Jersey Board of Public Utilities ("NJBPU"), in an ongoing proceeding, is developing a full record on the potentially anticompetitive effects of the proposed merger. Kalt Surrebuttal Testimony at p. 2.

#### THE IMPACT OF THE PROPOSED MERGER ON WHOLESALE ENERGY MARKETS.

7. The Department of Justice ("DOJ") and Federal Trade Commission ("FTC") have published guidelines and statements, including the Horizontal Merger Guidelines published in 1992 and revised in 1997, which set forth their merger enforcement policies.

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<sup>123</sup> Those Findings of Fact and Conclusions of Law marked by an asterisk were proposed with the PPL Companies' Reply Brief.

8. The Federal Energy Regulatory Commission (“FERC”) adopted the analytical framework of the Horizontal Merger Guidelines in its 1996 Merger Policy Statement, and in Appendix A to that statement, developed a prescribed methodology for calculating changes in market concentration caused by the merger in the relevant destination markets. *Inquiry Concerning the Commission’s Merger Policy Under the Federal Power Act: Policy Statement*, Order No. 592, 61 Fed. Reg. 68,595, 68,596, 68607 (Dec. 30, 1996), FERC Stats. & Regs., Regulations Preambles (July 1996 – Dec. 2000) ¶ 31,044 (1996), *order on reh’g*, Order No. 592-A, 62 Fed. Reg. 33,341 (June 19, 1997), 79 FERC ¶ 61,321 (1997) (“Merger Policy Statement”).
9. The Horizontal Merger Guidelines’ analysis requires identifying the relevant geographic markets serviced by the Joint Applicants, and the relevant product markets affected by the merger in each geographic market, as well as identifying all other suppliers competing in those product and geographic markets.
10. The relevant product market is electricity generated during different time periods throughout the day, for each seasonal period throughout the year.
11. PJM Classic is a separate geographic market in accordance with Horizontal Merger Guidelines analysis. Kalt Direct Testimony at pp. 14-19.
12. PJM East is a separate geographic market in accordance with Horizontal Merger Guidelines analysis. Hieronymus FERC Direct Testimony at pp. 32-33.
13. Pre- and post-merger market concentrations, as well as the changes in market concentrations, are determined by the Herfindahl-Hirschman Index (“HHI”) index. *See* Horizontal Merger Guidelines, § 1.0.
14. The Horizontal Merger Guidelines address three ranges of market concentration: (1) an unconcentrated post-merger market – if the post-merger HHI is below 1,000, regardless of the change in HHI the merger is unlikely to have adverse competitive effects; (2) a moderately concentrated post-merger market – if the post merger HHI ranges from 1,000 to 1,800 and the change in HHI is greater than 100, the merger potentially raises significant competitive concerns; and (3) a highly concentrated post-merger market – if the post-merger HHI exceeds 1,800 and the change in HHI exceeds 50, the merger potentially raises significant competitive concerns; if the change in HHI exceeds 100, it is presumed that the merger is likely to create or enhance market power.  
  
Order No. 642, 65 Fed. Reg. at 70,999 n.62.
15. The proposed merger’s effect on competition in the relevant markets has been evaluated over ten separate time and seasonal periods: Super Peak, Peak and Off-Peak periods for Summer, Winter and Shoulder seasons, along with an extreme Summer Super Peak. Hieronymus FERC Direct Testimony at p. 36.

16. The Joint Applicants' market concentration analyses show that, without mitigation, the proposed merger between Exelon and PSEG will significantly increase market concentration, and thus produce Appendix A market screen failures in all season/load conditions in PJM East, PJM Pre-2004 and PJM Expanded, with the screen failures being most severe in PJM East. *See, e.g., Kalt Direct Testimony at pp. 10, 23 and Exhibit JPK-5; Hieronymus Prepared Direct Testimony at pp. 4, 47-49.*

#### **THE IMPACT OF THE PROPOSED MERGER ON RETAIL ENERGY MARKETS.**

17. Although currently in Pennsylvania most regulated electric utilities provide generation service under negotiated price caps that are lower than wholesale electricity prices, whenever wholesale prices have been below these price caps, retail competitors (Electric Generator Suppliers or "EGSs") have been able to capture electric utility customers. Kalt Direct Testimony at pp. 5-6.
18. Moreover, when existing price caps expire, retail electricity prices increase and decrease in step with wholesale power prices, demonstrating the link between wholesale and retail electricity prices. Kalt Direct Testimony at pp. 5-6.
19. As long as most electric distribution companies in the Commonwealth remain under price caps, EGSs will be viable competitors while wholesale prices remain below the retail shopping credit. Kalt Direct Testimony at pp. 5-6.
20. To the extent the merged entity is able to use its increased market power to increase wholesale electricity prices, retail prices are likely to increase as well. Another serious consequence of the Joint Applicants' ability to exercise market power would be that it could drive existing EGSs from the Pennsylvania retail electricity market and discourage new EGSs from entering. Kalt Direct Testimony at p. 6.
21. This increase in retail prices will likely reduce (or eliminate) the profits of EGSs and prevent them from offering (and hence customers from receiving) competitive products and services. Kalt Direct Testimony at p. 6.

#### **ALLEGED EFFICIENCIES.**

22. \* The U.S. Department of Justice / Federal Trade Commission Horizontal Merger Guidelines make clear that antitrust enforcement agencies should only credit efficiencies that are merger-specific, reasonably verifiable, and net of merger-related costs or costs incurred to achieve the efficiencies. *See generally, Horizontal Merger Guidelines.*
23. \* The Horizontal Merger Guidelines also mandate that, "[w]hen the potential adverse competitive effect of a merger is likely to be particularly large, extraordinarily great cognizable efficiencies would be necessary to prevent the merger from being anticompetitive." *See generally, Horizontal Merger Guidelines.*

24. \* The Joint Applicants put forth no evidence, and made no arguments, regarding efficiencies as a defense to the demonstrated anticompetitive impact of the proposed merger.

**PROBLEMS IDENTIFIED WITH THE JOINT APPLICANTS' MARKET CONCENTRATION ANALYSES: FAILURE TO SEPARATELY ANALYZE THE PJM CLASSIC MARKET.**

25. Joint Applicants' market concentration analyses did not separately consider the PJM Classic market. Kalt Direct Testimony at pp. 14-15; Tr. at 419:12-18.
26. The record evidence demonstrates that: (a) significant average price differentials exist for sustained periods across the Western Interface and between the APS Zone and the other end of its path into PJM Classic at the PEPSCO Zone (Kalt Direct Testimony at pp. 14-15, 18 and Exhibits JPK-2, JPK-3); and (b) the Bedington-Black Oak line, which is a pathway between APS and the PJM Classic market, was the single most constrained facility in PJM during 2004. *See* PJM 2004 State of the Market Report at 214; Kalt Direct Testimony at p. 17; Kalt Surrebuttal Testimony, Exhibit JPK-13 at p. 3; Tr. at 419:4-7.
27. When the summer and winter periods are isolated from the yearly average price, the price differentials between the APS Zone from the PJM Classic market are more severe, with differences as high as \$15/MWh and sustained price differentials of \$5-10/MWh. Kalt Direct Testimony at p. 18 and Exhibit JPK-3.
28. When congestion occurs along the Bedington-Black Oak transmission line, more expensive generation units within PJM Classic are redispatched to account for the shortfall of electricity across the Western interface, thereby demonstrating that PJM Classic is a separate market. Kalt Direct Testimony at p. 16; Kalt Surrebuttal Testimony at p. 12 n.15, JPK-13 at p. 2.
29. When asked by the PPL Companies in discovery to analyze the competitive impact of the proposed merger on the PJM Classic market, the Joint Applicants' analysis revealed market screen failures in six of the ten season/load conditions. *See* Kalt Direct Testimony at Exhibit JPK-4; *see also* Kalt Surrebuttal Testimony at pp. 11-12.
30. The Joint Applicants' proposed mitigation does not correct for the Appendix A market screen failures that occur for the PJM Classic market. Kalt Surrebuttal Testimony at pp. 10-11.
31. \* FERC did not address the significant price differentials between the PJM Classic market and the rest of PJM, despite having been presented with such information by the PPL Companies.
32. \* FERC was not presented with evidence of the significant screen failures that result when PJM Classic is analyzed as a separate market – and thus could not have addressed (and/or rejected) such market failures – because such information

was not produced by the Joint Applicants until June 17, 2005, in response to a discovery request in this proceeding. *See* Kalt Direct Testimony, Exhibit JPK-11.

33. \* FERC's reliance on the PJM Market Monitoring Unit's ("PJM MMU's") failure to analyze PJM Classic as a separate market as a reason for not considering such an analysis was in error. The PJM MMU focused entirely on interfaces and constraints, failing to even mention PJM Classic, and thus could not have explicitly rejected PJM Classic as a separate market definition.

**PROBLEMS IDENTIFIED WITH THE JOINT APPLICANTS' MARKET CONCENTRATION ANALYSES: FAILURE TO ALLOCATE IMPORTS BASED ON FTRs.**

34. The Joint Applicants' market concentration analyses failed to consider the ownership of Financial Transmission Rights ("FTRs") when allocating imports and market shares in the PJM East market. Kalt Direct Testimony at p. 24; *see also* Tr. at 413:10-14; Tr. at 414:24 - 425:2.
35. FTRs are import rights that allow an owner to take generation at a particular source outside of a particular market and "sink," or deliver, it at a different point or zone on the system. Kalt Direct Testimony at p. 24; Kalt Surrebuttal Testimony at p. 13.
36. FTRs thus allow a holder to financially hedge congestion costs across a given interface. Kalt Surrebuttal Testimony at p. 14; Tr. at 383:11-17.
37. The Joint Applicants have preferential access to FTRs through grandfathered rights, as well as through the auction and sale of non-grandfathered FTRs. Kalt Direct Testimony at p. 24.
38. The Joint Applicants own a combined total of 5,500 MW of capacity on the western side of the Eastern Interface and over 40 percent of on-peak and off-peak FTRs (more than 3,000 MW in each case), which allow the Joint Applicants to "sink" their lower-cost generation into PJM East. Kalt Direct Testimony at pp. 26-27 and Exhibits JPK-6a, JPK-6b.
39. There is every reason to believe that the Joint Applicants will continue to receive the same or similar allotments of FTRs in the future. *See* Kalt Direct Testimony at pp. 27-28; Kalt Surrebuttal Testimony at pp. 14-17.
40. The Joint Applicants' annual allotments of FTRs will provide the merged entity with the incentive and ability to withhold generation in PJM, and thus increase not only the value of such generation relative to the generation outside PJM East, but also the value of their FTRs across the interface into PJM East. Kalt Surrebuttal Testimony at p. 18; *see also* Tr. at 414:21-23.
41. When imports into PJM East are properly assigned based on FTR ownership, market concentration levels increase and market screen failures are evident in all

but one of the post-merger markets, with five of them being “highly concentrated.” See Kalt Direct Testimony at pp. 28-29 and Exhibit JPK-7.

42. The Joint Applicants’ proposed mitigation does not account for these market screen failures which result when FTR ownership is properly considered. See Kalt Direct Testimony at pp. 29-30 and Exhibit JPK-8.
43. \* FERC did not address the effect of FTRs on market concentration levels.
44. \* FERC’s Order No. 642 and the FERC Merger Guidelines predated the widespread use of FTRs and therefore FTRs are not addressed in the Appendix A merger analysis. See, e.g., *PECO Energy Co.*, 81 FERC ¶ 61,257, at p. 62,260 (1997) (approving PJM’s initial allocation of FTRs). FTRs were initially used in the PJM spot market in 1998.
45. \* In analyzing the effects of allocating imports based on FTR ownership, Dr. Kalt conducted an economic capacity analysis, which intentionally does not account for load. See Kalt Direct Testimony, Exhibit JPK-8. As such, load cannot “cancel out” the incentive to withhold created by FTRs in such an analysis.

#### THE JOINT APPLICANTS’ PROPOSED MITIGATION: ACTUAL DIVESTITURE.

46. FERC’s guidelines clearly indicate that if the HHI statistics exceed the thresholds, the applicants must either propose mitigation measures that would remedy the merger’s potential adverse effects on competition or address the other DOJ/FTC merger analysis factors. Order No. 642, 65 Fed. Reg. at 70,999.
47. The Antitrust Division of the United States Department of Justice published a Policy Guide to Merger Remedies in 2004, which sets forth a framework for and factors to consider in fashioning and implementing appropriate relief in merger cases.
48. In response to the market screen failures, the Joint Applicants propose to divest control of 5,600-6,600 MW of generating capacity in the various PJM markets. See Kalt Direct Testimony at p. 4; Hieronymus FERC Direct Testimony at pp. 67-68.
49. Of this total, the Joint Applicants propose to actually divest 2,900 MW of generation capacity in PJM East to address the peak and super-peak screen failures. Hieronymus FERC Direct Testimony at pp. 10, 13. 60.
50. FERC’s Merger Policy Statement requires the merging parties to identify the specific units that will be divested. FERC Merger Order at P 141; see also *id.* at P 57 n.44 (citing Merger Policy Statement, FERC Stats. & Regs. at p. 30,136).
51. In addition, the PJM Market Monitoring Unit indicates in its analysis of the proposed merger that, without the identification of the exact units to be divested,

the PJM MMU cannot make a meaningful assessment of the proposed merger. FERC Merger Order at P 106 (citing PJM MMU Merger Analysis at p. 2). \

52. \* The PJM Market Monitor cannot directly control the price at which the merged entity will bid energy into the market, Tr. at 442:22 - 443:14, and thus is powerless to prevent the merged entity from exercising market power through increasing prices.
53. \* The PJM Market Monitor only has jurisdiction over the organized PJM spot market, and thus cannot control the merged entity's pricing behavior in the bilateral markets outside the organized PJM spot market.
54. The Antitrust Division of the United States Department of Justice has acknowledged that it is a disservice to consumers to accept proposed remedies without analyzing whether they are sufficient to redress the violation. *DOJ Merger Remedies Guide* at 4.
55. Although the Joint Applicants have created a non-specific "pool" of generators eligible for divestiture, they have not identified the specific generating units they intend to divest. See Tr. at 422:18-23; Tr. at 426:5-9.
56. The Joint Applicants intend to make the final determination as to which specific units will be divested. Tr. at 423:20-23.
57. Absent the identification of the actual units to be divested, it is impossible to tell whether the divested units will in fact mitigate the post-merger concentration in the PJM market. Kalt Direct Testimony at p. 35.
58. The Joint Applicants propose to make a compliance filing showing the merger's effect on market concentration once the actual acquirers of the actual divested assets are known. FERC Merger Order at PP 128, 135, 144.
59. The Joint Applicants also agreed to file annual reports with the Commission, beginning in 2007 and continuing through 2012, which address wholesale market prices and price trends in PJM. Joint Petition at para. 53.a.
60. The Joint Applicants promise to include information regarding price differentials between PJM East and other PJM regions in the annual report, and to make the reports available to the public. Joint Petition at para. 53.a.
61. The effectiveness of the Joint Applicants' divestiture plan thus will depend upon the continued oversight of the Commission, FERC, or other interested parties. FERC Merger Order at P 134-35 and Ordering para H.
62. If the Joint Applicants are ordered to sell, rather than virtually divest, assets, the Commission can rely on market forces to keep prices just and reasonable and need not continue to monitor closely both pricing and the operational decisions of the merged entity. See Edwin M. Zimmerman, *New Directions in Department of*

*Justice Enforcement Policy: The Antitrust Division's Decree Review and Private Litigation Programs*, 51 Antitrust L.J. 105, 109-110 (1982).

**THE JOINT APPLICANTS' PROPOSED MITIGATION: VIRTUAL DIVESTITURE.**

63. The Joint Applicants propose to "virtually" divest 2,600 MW of nuclear baseload capacity to address the market screen failures in the off-peak periods. Hieronymus Prepared FERC Direct Testimony at p. 6; *see also* Kalt Direct Testimony at pp. 20-21. 2,400 MW will be divested in PJM East, while 200 MW will be divested in the larger PJM Pre-2004 region. *See* Tr. at 421:15-18.
64. The Joint Applicants' proposed virtual divestiture will take one of two forms: (1) a firm sales contract expiring no earlier than 15 years after the date the merger is consummated; or (2) an annual auction of 3-year entitlements to baseload energy, in 25 MW blocks. Hieronymus Direct Testimony at pp. 3-4.
65. Under the Joint Applicants' virtual divestiture proposal, the merged entity will retain ownership of the divested energy and control over the scheduling and duration of outages. Tr. at 425:13-24; *see also* Kalt Direct Testimony at pp. 20, 22; Kalt Surrebuttal Testimony, Exhibit JPK-13 at pp. 12-13.
66. The Joint Applicants' continued ownership and control over the operation of the nuclear facilities creates both the ability and incentive to unilaterally exercise market power by withholding generating capacity to signal higher going-forward prices, thereby increasing demand for, and the price of, the power being sold at the annual three-year virtual divestiture auctions. *See* Kalt Direct Testimony at pp. 20, 22-23; Kalt Surrebuttal Testimony at pp. 5-6.
67. Absent the relinquishment of ownership and the ability to control the operation of the divested units, the proposed remedy cannot effectively mitigate the merged entity's incentive and ability to unlawfully exercise market power. Tr. at 425:13-24; *see also* Kalt Direct Testimony at pp. 20-23; Kalt Surrebuttal Testimony, Exhibit JPK-13 at pp. 12-13.
68. Even if the Joint Applicants' ability to control the output of their nuclear facilities were limited, the merged entity would still have the incentive and ability to profit from withholding output from other, non-nuclear plants. Kalt Surrebuttal Testimony at pp. 7-9 and Exhibit JPK-14; *see also id.*, Exhibit JPK-13 at pp. 10-11.
69. The Joint Applicants also propose to reduce, megawatt-for-megawatt, their virtual divestiture obligation in response to the retirement of capacity. Hieronymus FERC Direct Testimony at pp. 7-8.
70. Dr. Hieronymus admits that reducing the merged entity's virtual divestiture obligation in response to retirements is the equivalent of withholding, and will allow the merged entity to artificially inflate prices in a given market to its own advantage. Tr. at 426:17 - 427:1.

71. The record evidence demonstrates that, when virtual divestiture fails as effective mitigation, the proposed merger produces significant increases in market concentration, and hence significant merger screen failures in the PJM Classic, PJM East, and the PJM Pre-2004 markets. Kalt Direct Testimony at p. 23 and Exhibit JPK-5.

**THE PROPOSED SETTLEMENT.**

72. On September 12, 2005, the Joint Applicants along with the Office of Trial Staff, Office of Consumer Advocate, the Office of Small Business Advocate, Department of Environmental Protection, Citizens for Pennsylvania's Future, the Action Alliance of Senior Citizens of Greater Philadelphia, the Energy Coordinating Agency of Philadelphia, Inc., the Philadelphia Area Industrial Energy Users Group, The Reinvestment Fund/Sustainable Development Fund and State Senator Anthony Williams (collectively, the "Settling Parties") filed a Joint Petition for Settlement, which purports to resolve all issues raised by those parties regarding the merger application. Joint Petition for Settlement at p. 2.
73. The proposed settlement did not address the market power concerns raised by the PPL Companies, and preserved those issues for consideration by the Administrative Law Judge and the Commission. Stipulation Regarding Market Power Issues at paras. 1, 5.

## CONSOLIDATED CONCLUSIONS OF LAW

1. The Electricity Generation Customer Choice And Competition Act requires the Commission to “consider whether the proposed merger . . . is likely to result in anticompetitive or discriminatory conduct including the unlawful exercise of market power, which will prevent retail electricity customers in this Commonwealth from obtaining the benefits of a properly functioning and workable competitive retail electricity market.” 66 Pa.C.S. § 2811(e).
2. The Commission is required to make specific findings regarding the competitive impact of the proposed merger and refer those findings to federal and state authorities. 66 Pa.C.S. § 2811(d).
3. The Commission may not approve a merger which could result in the unlawful exercise of market power except upon “such terms and conditions as it finds necessary to preserve the benefits of a properly functioning and competitive retail electricity market.” 66 Pa.C.S. § 2811(e)(2).
4. In evaluating the impact of the proposed merger on competition in the Commonwealth, the Commission shall employ the incipency standard of the Section 7 of the Clayton Act (15 U.S.C. § 18 (2000)) and the analytical framework of the Horizontal Merger Guidelines. Horizontal Merger Guidelines at 1.
5. In the instant case, the relevant product is electric energy, analyzed for different time periods throughout the day and for each seasonal period throughout the year. Accordingly, for each relevant geographic area, ten relevant product markets must be analyzed.
6. The relevant geographic markets are PJM East, PJM Classic, and PJM Pre-2004.
7. \* The Joint Applicants have the initial burden of demonstrating that the proposed merger will not result in competitive harm, 66 Pa.C.S. § 2811(e), and otherwise “will affirmatively promote the ‘service, accommodation, convenience, or safety of the public’ in some substantial way.” *City of York v. Pa. P.U.C.*, 295 A.2d at 828.
8. \* Given the unacceptable levels of market concentration that will result from the merger, even as mitigated, and the corresponding adverse effects on wholesale and retail competition in the Commonwealth, the Joint Applicants have failed to meet their burden of establishing lack of competitive harm and affirmative benefits to the public interest.
9. The need to redispatch more expensive generation units in PJM Classic due to congestion along the PJM Western Interface and Bedington-Black Oak transmission constraint demonstrates that PJM Classic is a distinct geographic

market, and must be analyzed under the Appendix A analysis separate and apart from the PJM Expanded market.

10. Using the HHI index to calculate pre- and post-merger market concentrations, as well as the changes in market concentrations, absent mitigation, the proposed merger would result in an unacceptable increase in concentration, and hence a reduction in competition, in the PJM Classic and PJM East markets, in violation of Section 7 of the Clayton Act and the Horizontal Merger Guidelines.
11. This increase in market concentration and the resulting market screen failures become even more pronounced when the PJM Classic market is properly considered as a separate market, and imports are allocated based on FTRs in the PJM East market.
12. This lessening of competition in wholesale electricity markets will result in a similar lessening of competition in retail electricity markets, and hence higher prices for retail electricity customers in the Commonwealth – a result that is contrary to Section 2811.
13. Structural remedies are more effective for mitigating market power concerns than conduct remedies, which are difficult to design, cumbersome, costly to administer, and easier to circumvent than structural remedies. *DOJ Merger Remedies Guide* at 8; *see also* Kalt Direct Testimony at p. 20.
14. The Joint Applicants' virtual divestiture proposal will require expanded regulatory intervention into the Commonwealth's electricity markets (*see* FERC Merger Order at PP 134-135, and Ordering Paragraph H), which is antithetical to principles of market-based competition.
15. \* Commission policy prefers structural remedies (e.g., physical divestiture) over conduct remedies (e.g., virtual divestiture), when attempting to mitigate the anticompetitive effects of a proposed merger. *Re DQE, Inc.*, 186 P.U.R. 4th at 61.
16. \* Commission policy prefers mitigation plans that: (a) are in place when the merger is consummated, (b) specifically identify the units to be divested, and (c) do not allow the merged entity to control the timing of the proposed mitigation, and the manner in which it will be implemented. *Re DQE, Inc.* at 53, 62.
17. \* The Commission disfavors mitigation plans that require continued monitoring or other forms of Commission involvement after the transaction is closed. *Re DQE, Inc.*, 186 P.U.R. 4th at 60-61.
18. The Commission should only accept actual, physical divestiture as effective mitigation. *See DOJ Merger Remedies Guide* at 8.
19. \* Lacking the evidentiary record that results from a complete discovery process and adversarial hearing, and relying on principles that are antithetical to the pro-competition ideology embraced by the Commission and the federal antitrust

agencies, the FERC Merger Order should be accorded no weight in the instant proceeding.

20. \* Courts considering efficiency claims in the context of a proposed merger have required strong evidence that the proposed efficiencies are merger-specific, reasonably verifiable and assessed net of merger-related costs or costs incurred to achieve the efficiencies, *see, e.g., FTC v. H.J. Heinz Co.*, 246 F.3d at 720-22; *FTC v. Univ. Health, Inc.*, 938 F.2d 1223; *FTC v. Libbey*, 211 F. Supp. 2d at 52-53, and no decision has relied on efficiencies in rejecting a challenge to an otherwise illegal merger. *Antitrust Law Developments*, A.B.A. Sec. Antitrust L., p. 347 (5th ed. 2002); *see also FTC v. Arch Coal, Inc.*, 329 F. Supp. 2d at 151-153; *United States v. Oracle Corp.*, 331 F. Supp. 2d at 1175.
21. \* The Joint Applicants put forth no evidence establishing the requisite “large, extraordinarily great cognizable efficiencies” to offset the undisputed anticompetitive effects of the proposed merger, and therefore their efficiency defense is rejected.
22. The Proposed Settlement does nothing to mitigate the post-merger market concentration or restrain the merged entity’s incentive and ability to exercise market power, and thus does not provide the type of robust and thorough relief needed to ensure the long-term restoration of competition envisioned by the antitrust principles and incorporated into Section 2811. 66 Pa.C.S. § 2811.
23. Should the Commission assert jurisdiction over the proposed merger, any approval thereof must be conditioned on the Joint Applicants’ acceptance of significant, critical modifications to their proposed mitigation plan to address the anticompetitive concerns created by the concentration of market power in the merged entity. These conditions include, but are not necessarily limited to: (1) conversion of the Joint Applicants’ virtual divestiture proposal to a definitive plan for the actual transfer of ownership of the baseload generation; (2) additional, actual divestiture to cure the market screen failures identified in the PJM Classic market when this market is considered separately, and to remedy the screen failures in the PJM East market when FTR ownership is considered in measuring market shares; (3) identification of the specific units to be divested; and (4) additional Commission proceedings to fully consider the effectiveness of the Joint Applicants’ revised mitigation plan.
24. The Commission must refer to the Attorney General of Pennsylvania, DOJ, and FERC the investigation of the proposed merger, and certify the evidentiary record so accumulated, including its findings that the proposed transaction presents a serious threat to competition in wholesale and retail electricity markets in the Commonwealth, notwithstanding the mitigation proposed by the Joint Applicants.

BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION

ORIGINAL

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

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DOCKET NO. A-110550F0160

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Donald A. Kaplan  
Attorney for the PPL Companies

Date: October 21, 2005



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

IN REPLY PLEASE  
REFER TO OUR FILE

October 21, 2005

James J. McNulty, Secretary  
Pennsylvania Public Utility Commission  
P.O. Box 3265  
Harrisburg, PA 17105-3265

ORIGINAL

Re: 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 No. A-110550F0160

Dear Secretary McNulty:

Enclosed for filing please find an original and nine (9) copies of the **Reply  
Brief** of the Office of Trial Staff (OTS) in the above-captioned proceeding.

Copies are being served on all active parties of record.

Sincerely,

DOCUMENT  
FOLDER

Kenneth L. Mickens  
Senior Prosecutor  
Office of Trial Staff

Enclosure

c: Parties of Record  
Hon. Marlane R. Chestnut

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BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Joint Application of PECO Energy Company :  
and Public Service Electric and Gas :  
Company for Approval of the Merger of : Docket No. A-110550F0160  
Public Service Enterprise Group :  
Incorporated with and into Exelon :  
Corporation :

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REPLY BRIEF  
OF THE  
OFFICE OF TRIAL STAFF

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DOCUMENT  
FOLDER

**DOCKETED**  
OCT 25 2005

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Senior Prosecutor

Robert V. Eckenrod  
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Office of Trial Staff  
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Commission

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Dated: October 21, 2005

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## I. INTRODUCTION

### A. History of the Proceeding

On February 4, 2005, PECO Energy Company (“PECO”) and Public Service Electric and Gas Company (“PSE&G”) (collectively, “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.

Subsequently, on February 19, 2005, the Commission required that notice of the Joint Application be published in the *Pennsylvania Bulletin*, thereby allowing interested parties until March 7, 2005, to file protests and petitions to intervene. The Office of Trial Staff (“OTS”) filed a Notice of Appearance and, ultimately, twenty-three parties, including the Office of Consumer Advocate (“OCA”) and the Office of Small Business Advocate (“OSBA”), filed protests or petitions to intervene.

The case was assigned to the Office of Administrative Law Judge for disposition and a prehearing conference was convened on March 29, 2005, with Administrative Law Judge Marlane R. Chestnut (“ALJ”) presiding. Two public input hearings were held in Philadelphia on June 30, 2005. In accordance with the procedural schedule, OTS filed direct and surrebuttal testimony opposing the proposed merger on the basis that the Applicants had failed to demonstrate that the merger would result in substantial public benefits as required under the Public Utility Code.

By Secretarial Letter dated July 15, 2005, the parties were directed to respond to a series of five Directed Questions posed by Vice Chairman James H. Cawley and Commissioner Bill Shane. The parties served Supplemental Testimony in accordance with a revised procedural schedule addressing the Directed Questions.

Commencing in mid-May, the parties engaged in a collaborative process to address the issues raised by the Joint Application in an effort to resolve all outstanding issues. These discussions ultimately proved successful and resulted in a comprehensive settlement of issues in controversy among most of the parties. A Settlement in Principle was obtained on September 9, 2005.<sup>1</sup>

A Joint Petition for Settlement was submitted to the ALJ for disposition on September 12, 2005. OTS filed a Statement in Support of the Joint Petition for Settlement on September 14, 2005, submitting that the Joint Petition for Settlement was in the public interest and should be adopted by the ALJ and the Commission.

Hearings on outstanding issues (involving parties who had not agreed to the Settlement) were held in Philadelphia on September 22-26, 2005. Moreover, during that time, the testimony and exhibits of all of the parties were entered into the record. In accordance with the procedural schedule, OTS filed a Main Brief on October 14, 2005.

This Reply Brief is supplemental to the Main Brief filed on behalf of OTS and is limited to those matters raised by the various parties in their Main Briefs. Additionally,

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<sup>1</sup> Both the City of Philadelphia and PGW opposed the Joint Petition in Settlement, while PPL and the Labor parties indicated that they neither supported nor opposed the Joint Petition.

the Reply Brief will discuss matters previously addressed by OTS that require additional discussion and comment as a result of arguments presented by the parties in Main Briefs.

## II. DISCUSSION

### A. The Proposed Merger Requires Commission Approval Pursuant to the Public Utility Code.

The Public Utility Code clearly requires that a proposed merger such as that proposed by the Applicants in the instant proceeding can only proceed after the Commission has issued a certificate of public convenience. 66 Pa. C. S. §1102(a)(3).

However, Applicants have alleged that the proposed merger transaction does not require Commission approval because the proposed merger would not result in a “change in control” as required by the Act. Applicants’ Brief, pp. 5-9. Specifically, the Applicants maintain that since the common stock of PECO will continue to be held by Exelon Energy Delivery, which in turn, will continue to be a wholly-owned subsidiary of Exelon, no controlling interest of Exelon exists prior to or after the proposed merger. Applicant’s Brief, p. 6. In this regard, the Applicants assert that the only company to be affected by a change of control will be PSE&G, which is not a “public utility” for Pennsylvania regulatory purposes. Applicant’s Brief, pp. 6-7.

However, the record clearly indicates that the proposed transaction would require the issuance of a certificate of convenience because the merger would involve “an affiliated interest of a public utility.” *See, DQE, Inc., 186 PUR 4<sup>th</sup> 39, 46 (1998)*. In *DQE, Inc.*, the Commission determined that it had the authority to review the merger between the holding companies of West Penn Power Company and Duquesne Light

Company specifically because it involved an affiliated interest of the public utility. Similarly, the instant proceeding involves the merger of another corporate entity into a subsidiary of Exelon, which is an affiliate of PECO. Consequently, the Applicants are incorrect in concluding that a certificate of public convenience is not necessary in order to consummate the proposed merger.

In order to obtain the certificate of public convenience, PECO must demonstrate that such is “necessary or proper for the service, accommodation, convenience or safety of the public.” 66 Pa. C.S. §1103(a). Moreover, as OTS argued in its Main Brief, in order to obtain approval of the merger, Applicants must demonstrate that the merger “will affirmatively promote the ‘service, accommodation, convenience, or safety of the public’ in some substantial way.” See, *City of York v. Pennsylvania Public Utility Commission*, 449 Pa. 136, 141, 295 A.2d 825, 828 (Pa. 1972). In addition, Pennsylvania Commonwealth Court has found that a merger should not be granted unless the Commission can determine by substantial evidence that the public would benefit from the merger. See, *ARIPPA v. Pennsylvania Public Utility Commission*, 792 A.2d 636, 654-655 (Pa. Commonwealth Ct. 2002).

Finally, the Electricity Generation Customer Choice and Competition Act further provides the Commission with the responsibility to determine “whether the proposed merger ... is likely to result in anticompetitive or discriminatory conduct, including the unlawful exercise of market power, which will prevent retail electric customers in this Commonwealth from obtaining the benefits of a properly functioning and workable competitive retail electricity market.” 66 Pa. C.S. §2811(e)(1). Appropriately, the issue

of whether market power would be increased as a result of the merger, has been fully litigated in this proceeding.

Consequently, contrary to Applicants' statement in their Main Brief, the Commission must review the proposed 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. OTS has argued in its Main Brief that after the Commission performs this analysis, it should find that the proposed merger is in the public interest and the certificate of public convenience should be granted.

### III. CONCLUSION

**WHEREFORE**, for the reasons stated herein and in its Main Brief, the Office of Trial Staff respectfully requests that the Administrative Law Judge and the Commission adopt its recommendations in this proceeding and approve the Joint Petition for Settlement..

Respectfully submitted,



Kenneth L. Mickens  
Senior Prosecutor

Robert V. Eckenrod  
Prosecutor

Office of Trial Staff  
Pennsylvania Public  
Utility Commission

Dated: October 21, 2005

BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Joint Application of PECO Energy Company :  
and Public Service Electric and Gas :  
Company for Approval of the Merger of : Docket No. A-110550F0160  
Public Service Enterprise Group :  
Incorporated with and into Exelon :  
Corporation :

**CERTIFICATE OF SERVICE**

I hereby certify that I am serving the foregoing **Reply Brief** of the Office of  
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Dated: October 21, 2005  
Docket No. A-110550F0160

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RE: 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 No. A-110550F0160

Dear Secretary McNulty:

Enclosed for filing are an original and nine (9) copies of the Reply Brief of the  
Office of Consumer Advocate, in the above-referenced proceeding.

Copies have been served on the parties of record as indicated on the enclosed  
Certificate of Service.

Sincerely,

Tanya J. McCloskey  
Senior Assistant Consumer Advocate

Enclosure

cc: Parties of record

Honorable Marlane R. Chestnut, via overnight mail (served October 20, 2005)

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BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Joint Application of PECO Energy :  
Company and Public Service Electric :  
& Gas Company for Approval of : Docket No. A-110550F0160  
The Merger of Public Service Enterprise :  
Group, With and Into Exelon Corporation :

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REPLY BRIEF OF THE  
OFFICE OF CONSUMER ADVOCATE

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Date: October 20, 2005

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## I. INTRODUCTION

On October 14, 2005, in accordance with Prehearing Order # 7, the parties to this proceeding filed Main Briefs setting forth their positions. Main Briefs were filed by the Joint Applicants (PECO and PSE&G), the Office of Trial Staff (“OTS”), the Office of Small Business Advocate (“OSBA”), the Office of Consumer Advocate (“OCA”), Citizens for Pennsylvania’s Future, *et al.*, the Sustainable Development Fund, the City of Philadelphia, the Philadelphia Gas Works, PPL Electric Utilities, *et al.*, and the FirstEnergy Companies. Proposed Findings of Fact and Conclusions of Law were filed by the Action Alliance of Senior Citizens, *et al.* and the Department of Environmental Protection.

In its Main Brief, the OCA provided its support for the Joint Petition for Settlement of this merger proceeding. As set forth in its Main Brief, the OCA supports the Settlement in that the provisions of the Settlement secure protections for consumers and secure substantial affirmative benefits for PECO ratepayers and Pennsylvania. With these protections and with these substantial affirmative benefits to PECO’s ratepayers and Pennsylvania, the merger can meet the statutory requirements found in Sections 1102 and 1103, and as required by City of York, 449 Pa. 136, 295 A.2d 825 (1972).

The OCA continues to support the Joint Petition for Settlement. A review of the Main Briefs of the parties that oppose the Settlement has not altered the OCA’s position. It is important to note that the Main Briefs of PPL and FirstEnergy address primarily the market power issues that were raised by those parties. The Settlement provided for a continuation of the litigation of that issue by those parties. Only the City of Philadelphia and PGW challenge the specific provisions of the Joint Petition for Settlement. As explained in more detail below, the challenges to the Settlement by the City and PGW do not demonstrate that the Settlement is not

in the public interest. As the OCA has detailed, the Settlement reaches a fair balance of a wide array of interests and is supported by diverse parties. The OCA will not address every issue raised by every party in this Reply Brief, but will focus its Reply on a few limited areas that necessitate further response or clarification.

## II. REPLY ARGUMENT

### A. Legal Standard

A number of parties have discussed the legal standards that apply to this proceeding, including the Commission's jurisdiction to consider these matters and the requirements of the City of York standard for substantial affirmative benefits. As to jurisdiction, PECO continues to maintain its arguments, contained in its Application, that the Commission does not have jurisdiction over the merger. PECO Brief at 5-7. PECO relies primarily on the Commission's Statement of Policy in this regard. PECO Brief at 5-6. For purposes of this Settlement, however, this point is moot as the Company has waived any objection to the Commission's jurisdiction with respect to determining whether or not the Settlement is in the public interest. See, Joint Petition, ¶45. As such, the Commission need not reach this issue to consider the Settlement.

Most parties have also provided a discussion of the substantial affirmative benefits standard found in the City of York case as the Commission has applied that standard in other cases. As can be seen from a review of the cases referenced in the Briefs, the determination of whether a merger will "affirmatively promote the service, accommodation, safety or convenience of the public in some substantial way" can be dependent upon the specific facts and circumstances involved in a particular case or industry.

Given the importance of the facts and circumstances of the case, it is necessary to provide some additional clarification regarding two electric merger cases that were cited by many of the parties. Specifically, discussions regarding the Joint Application for Approval of GPU Energy and FirstEnergy Corp., Docket No. A-110300F0095, *et al.*, 2001 Pa. PUC LEXIS 23, and the subsequent appeal entitled ARIPPA v. Pa.P.U.C., 792 A.2d 636 (Pa. Commw. 2002),

and the discussions regarding the proposed merger between Duquesne Light Company and Allegheny Power System (Re: DQE, Inc., 88 Pa. PUC 467 (1998)) did not cover the full circumstances related to those cases or the full benefits that the Commission found to be appropriate in those cases. See, PECO Brief at 16, fn. 11.

As it concerns the merger of GPU and FirstEnergy, it is important to note that the Commission's Merger Order, which imposed various conditions on the merger, removed the issue of the treatment of the merger savings for further consideration in a collaborative. Joint Application for Approval of GPU Energy and FirstEnergy Corp., Docket No. A-110300F0095, *et al.*, (Order entered June 20, 2001), 2001 Pa. PUC LEXIS 23, \*57. As part of that collaborative, a settlement was reached among some of the parties that provided various merger benefits and resolved a related filing by the GPU Companies for a significant exception to the generation rate cap. Joint Application for Approval of GPU Energy and FirstEnergy Corp., Docket No. A-110300F0095, *et al.*, and Petition of Metropolitan Edison Company and Pennsylvania Electric Company, P-00001860, *et al.* (Order entered June 20, 2001), 2001 Pa. PUC LEXIS 16. The settlement resolved the rate cap exception case without increasing total rates. Id. On appeal of the case, the issue of merger savings was remanded by the Court for a determination of the amount of savings and the allocation of those savings. ARIPPA, 792 A.2d at 656-657. That matter is still pending before the Commission. Thus, the full extent of the benefits to be provided by the GPU/FirstEnergy merger has not yet been finally determined.

As it concerns the proposed merger between DQE, Inc. and the Allegheny Power System, the Commission first identified distribution-related savings and generation-related savings. In the context of the merger proceeding, the Commission accepted the OCA's proposal for the treatment of merger savings. Re: DQE, 88 Pa. PUC at 486. Under the OCA's proposal in

that case, the distribution savings were to be flowed through to ratepayers as a rate reduction and the generation-related savings were used in the restructuring proceeding as an offset to stranded cost. This was accepted and ordered as part of each company's restructuring proceeding. See, Application of Duquesne Light Company, 89 Pa. PUC 1, 71-72 (1998) and Application of West Penn Power Company, 88 Pa. PUC 494, 549-550 (1998) Thus, in addition to the distribution rate reductions ordered by the Commission as a benefit of the merger, there would have been a significant reduction in stranded cost as part of the restructuring proceeding if the merger had been consummated. The merger was not completed.

The OCA provides these clarifications in the event that the ALJ discusses these cases in detail in the Recommended Decision. The OCA does not believe that these clarifications change the fundamental point – that the Settlement proposed in this case provides substantial affirmative benefits and necessary protections to ratepayers.

B. The City of Philadelphia and PGW Have Not Shown That The Settlement Fails To Meet The Legal Standards For Approval.

In its Main Brief, the City of Philadelphia primarily argues that although the Settlement provides some benefits, it does not provide sufficient benefits to meet the requirements for approval. City Brief at 12-13. The OCA will not address every argument made by the City, but for the reasons set forth in the OCA's Main Brief and in the OCA's Statement in Support of the Settlement, the OCA believes that the Joint Petition for Settlement secures necessary protections and substantial affirmative benefits for PECO's ratepayers and the public interest. The OCA will respond briefly to some of the City's key arguments.

The City first criticizes the parties for compromising their litigation positions to reach a settlement and argues that these compromises do not serve the overall public good. City Brief at 12-13. The OCA respectfully disagrees. Initially, the OCA acknowledges that

compromises have to be made to reach a settlement of many cases. In this proceeding, all parties were required to compromise, including the Joint Applicants, to reach a comprehensive framework that would bring substantial benefits to PECO ratepayers and the public as required by the City of York. The Commission regulations encourage negotiated settlements and compromise is a part of such negotiations. 52 Pa. Code §§5.231, 69.391 and 69.401. The proposed Settlement was able to amicably resolve many difficult issues to arrive at a plan that satisfied a diverse array of interests and provided substantial affirmative benefits.

One of the disagreements with the Settlement that the City identifies is that the Settlement does not provide protections or benefits long enough into the future, *i.e.* beyond 2010. The OCA would note that its testimony in the proceeding addressed a rate plan that extended to 2010. OCA St. 1 (Redacted) at 23-25. The settlement is consistent with this rate plan in that the settlement calls for rate reductions and rate cap extensions for transmission and distribution service through 2010. The Settlement, and the OCA's original rate plan, provide for benefits over the next four to five years, consistent with the generation rate cap now in place for PECO. Additionally, some of the protections and benefits of the settlement, such as the improvements to the low-income programs and the corporate structure protections, will continue beyond 2010 as they become permanent parts of PECO's operation. Moreover, environmental and economic development programs that result from the settlement will continue to provide benefits far into the future.

The City also criticizes the Settlement provision that calls for PECO to maintain its historic levels of charitable giving in each year from 2007 through 2010. City M.B. at 25. The City argues that PECO should increase its charitable giving significantly, to \$8 million per year, for at least 5 years. The City cites to the testimony of OCA witness Alexander for support

of this proposition. So that the record is clear, the reference to the \$8 million in charitable and community giving in Ms. Alexander's testimony was to a broad category of giving that included community and economic development, energy assistance grants, as well as charitable giving. OCA St. 4-S at 26-27. The Settlement addresses these different forms of charitable and *community giving through different provisions, such as the universal service provisions and the energy and economic development provisions.* The \$3 million in charitable giving and sponsorships contained in Paragraph 50 of the Settlement cannot be compared to the \$8 million figure contained in OCA witness Alexander's testimony.

The City also takes issue with the Quality of Service Plan arguing that the Plan is no more than what the Company is required to do by the Commission and that the enforcement mechanism is flawed in that it does not contain automatic penalties. City Brief at 16. The OCA submits that this criticism is incorrect. The Settlement establishes specific thresholds that the Company must meet for various metrics that measure reliability and customer service. For those metrics that are related to customer service, such as the percentage of calls answered in 30 seconds, the call abandonment rate, the average busy-out rate, the percentage of residential bills not rendered every billing period, gas response time to safety calls, and OSHA Lost Work Days, the Company is not required to meet any specific metric set by the Commission. While the Company remains obligated to provide reliable, safe and adequate service, there is no particular standard set by the Commission in this regard for PECO. The Settlement establishes those standards and requires improvement over the levels committed to by PECO in the 2000 PECO/Unicom Merger.

As to the reliability standards, the Settlement requires the Company to maintain a SAIFI of at least 1.28 on a 12-month basis and a CAIDI of 125 on a 12-month basis. In contrast,

under the Commission's current requirements that would apply to PECO at the end of 2005 in the absence of the Settlement, PECO is required to achieve a SAIFI of 1.48 and a CAIDI of 134. Amended Reliability Benchmarks and Standards, Docket No. M-00991220 (Order entered May 11, 2004), 233 PUR 4<sup>th</sup> 447, 2004 Pa. PUC LEXIS 28. Since the higher numbers reflect worse performance, it is clear that the Settlement calls for better performance than the Commission's requirements for PECO.

The fact that the parties took a cooperative approach to enforcement does not mean that the Settlement cannot be in the public interest. The enforcement mechanism contained in the Settlement was the same as that contained in the PECO/Unicom Merger Settlement. The process requires the parties to work together to attempt to resolve any reliability or customer service problem that may arise before moving to litigation on these issues. Moreover, the Settlement requires that the Quality of Service Plan be included in the annual performance appraisal and compensation for the managerial employees, which will assist in ensuring that this area receives PECO's proper attention. While the OCA argued in its litigation position for automatic penalties, the OCA submits that the cooperative approach taken by the Settlement is a reasonable compromise under the circumstances of this case.

The City also argues that the staffing provisions found in Paragraph 51 of the Settlement are illusory since PECO can modify its workforce for reasons other than the merger. City Brief at 26. The City opines that any party claiming an inappropriate reduction in staffing would have to prove it stemmed from the merger, a task the City calls "formidable." Id. The Settlement does not place such a burden on a challenging party. PECO has agreed not to take certain actions and PECO will be required to show that it complied with the Settlement if any action is brought to enforce this provision of the Settlement.

The City and PGW both argue that the Joint Petition for Settlement does not resolve the competitive market issues that could arise from this merger.<sup>1</sup> City Brief at 18-21; PGW Brief at 37-38. As the OCA noted in its Main Brief, the settlement allowed for the continued litigation of these market power issues of non-signatory parties before this Commission, and allowed the signatory parties to continue to participate in the proceedings before the Federal Energy Regulatory Commission. Additionally, the Settlement calls for direct reporting to the Commission so that it is better able to monitor the effects of the merger. The Commission, and the parties (signatory and non-signatory), retain all of their rights under Section 2811 if problems develop.

Finally, the City and PGW argue that the Settlement does not go far enough to ensure due diligence and fact-finding via an expedited investigation into the consolidation of natural gas operations. As both the City and PGW acknowledge, however, significant fact-finding and due diligence is required in the consideration of such an endeavor. PGW Brief at 41-42; City Brief at 22-23. The Settlement provides a process for moving forward with this consideration. There is nothing in the Settlement that precludes the City or PGW from being fully involved in the process.

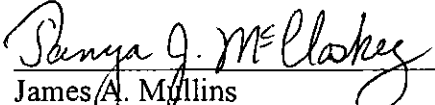
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<sup>1</sup> PPL and FirstEnergy also note that the Settlement does not resolve the issues that these parties have raised regarding market power. PPL and FirstEnergy acknowledge that the Settlement allows for continuation of the market power issues at the Commission.

III. CONCLUSION

For the reasons set forth above, and in the OCA's Main Brief and its Statement in Support of the Settlement, the OCA continues to urge approval of the Joint Petition for Settlement. The comprehensive Settlement reaches a fair balance of the many issues in this proceeding and is supported by parties with diverse interests. The Settlement ensures necessary protections and brings substantial affirmative benefits to PECO ratepayers and Pennsylvania. The Settlement is in the public interest and should be approved.

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Service Enterprise Group Incorporated :  
with and into Exelon Corporation :

I hereby certify that I have this day served a true copy of the foregoing document, the Main Brief of the Office of Consumer Advocate, upon parties of record in this proceeding in accordance with the requirements of 52 Pa. Code § 1.54 (relating to service by a participant), in the manner and upon the persons listed below:

Dated this 21<sup>st</sup> day of October 2005.

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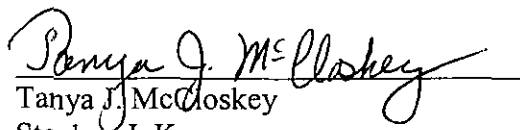
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October 21, 2005

**HAND DELIVERED**

James J. McNulty, Secretary  
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**Re: 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 No. A-110550F0160**

Dear Secretary McNulty:

Enclosed for filing are the original and nine (9) copies of the Reply Brief on behalf of the Office of Small Business Advocate in the above-docketed proceeding. As evidenced by the enclosed certificate of service, two copies have been served on all active parties in this case.

If you have any questions, please do not hesitate to contact me.

Sincerely,

**DOCUMENT  
FOLDER**

Carol F. Pennington  
Assistant Small Business Advocate

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Enclosures

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BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION

JOINT APPLICATION OF PECO ENERGY :  
COMPANY AND PUBLIC SERVICE :  
ELECTRIC & GAS COMPANY FOR :  
APPROVAL OF THE MERGER OF PUBLIC : DOCKET NO. A-110550F0160  
SERVICE ENTERPRISE GROUP, INC., :  
WITH AND INTO EXELON CORPORATION :

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REPLY BRIEF  
ON BEHALF OF THE  
OFFICE OF SMALL BUSINESS ADVOCATE

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## I. INTRODUCTION

On February 4, 2005, PECO Energy Company (“PECO”) and Public Service Electric and Gas Company (“PSE&G”) (collectively, “Joint Applicants”) filed with the Commission their Joint Application for Approval of the Merger of Public Service Enterprise Group (“PSEG”) with and into Exelon Corporation (“Exelon”). By their Joint Application, PECO and PSE&G requested the Commission’s approval of the Proposed Merger under Chapters 11, 22, and 28 of the Public Utility Code, 66 Pa. C.S. Ch. 11, 22, and 28. In the alternative, the Joint Applicants requested a declaratory order to the effect that the Commission’s approval of the Proposed Merger is not required.

On March 2, 2005, the OSBA filed a Notice of Intervention and Protest (“Protest”) with respect to the Joint Application. In addition to the OSBA, the active parties are PECO and PSE&G (“Joint Applicants”); the Office of Consumer Advocate (“OCA”); the Office of Trial Staff (“OTS”); the Philadelphia Area Industrial Users Group (“PAIEUG”); *Citizens for Pennsylvania’s Future*, Joy Bergey and Lisa Z. Leighton (“PennFuture”); the Department of Environmental Protection (“DEP”); the Energy Coordinating Agency (“ECA”); Exelon Utility Coordinated Council, Locals 614 and 777 of the International Brotherhood of Electrical Workers and Frank Kuders (“Labor Parties”); PPL Electric Utilities Corporation, PPL EnergyPlus, PPL Brunner Island, PPL Holtwood, PPL Martins Creek, PPL Montour, PPL University Park, Lower Mount Bethel Energy, and PPL Susquehanna (collectively, “PPL”); the City of Philadelphia (“Philadelphia”); Metropolitan Edison Company, Pennsylvania Electric Company, Pennsylvania Power Company and FirstEnergy Solutions, Corp. (collectively,

“FirstEnergy”); Action Alliance of Senior Citizens of Greater Philadelphia, Association of Community Organizations for Reform Now and Tenants’ Action Group (“Action Alliance”); The Reinvestment Fund, through its Sustainable Development Fund (“TRF”); Senator Anthony Williams (“Senator Williams”); and Philadelphia Gas Works (“PGW”).

The OSBA filed the direct, rebuttal, surrebuttal, and supplemental testimony of OSBA witness Brian Kalcic. *See*, respectively, OSBA St. No. 1, OSBA St. No. 2, OSBA St. No. 3, and OSBA St. No. 4. Each of these statements was admitted into the record of this proceeding with the exception of certain redacted portions pursuant to an agreement with the other parties. The OSBA actively participated in the negotiations which led to the filing, on September 12, 2005, of the Joint Petition for Settlement (“Settlement”) with the Secretary of the Commission.

The signatories to the Settlement are the Joint Applicants; the OSBA; the OTS; the OCA; the DEP; PennFuture; Action Alliance; the ECA; PIEUG; TRF; and Senator Williams (collectively, the “Joint Petitioners”).

On October 13, 2005, PGW, Philadelphia and the OCA filed main briefs and the DEP filed proposed findings of fact and conclusions of law. On October 14, 2005, the Joint Applicants, the OSBA, the OTS, PPL, PennFuture, First Energy and TRF filed main briefs and Action Alliance filed proposed findings of fact and conclusions of law.

In its main brief, the OSBA set forth reasons why the Settlement is in the public interest and cited record evidence in support of the Settlement. The OSBA files this reply brief in response to arguments raised in the main briefs of Philadelphia and PGW.

The OSBA also notes a typographical error in footnote 1 on page 5 and footnote 2 on page 7 of TRF's main brief. In both instances, TRF incorrectly identified OSBA witness Brian Kalcic as an OTS witness. However, the correct reference was made to the OSBA's testimony.

## II. REPLY ARGUMENT

### A. Philadelphia improperly criticizes the Settlement because it was the result of compromise.

On page 12 of its main brief, Philadelphia states that the “parties compromised their litigation positions in order to reach this Settlement” and that the Settlement does not meet the standards for approval because the compromises do not serve the public good overall. The OSBA submits that compromise is the essence of any settlement and that this Settlement provides many benefits that are in the public interest. The totality of the Settlement results in a Proposed Merger that meets the “affirmative benefit” test of *City of York v. Pennsylvania Public Utility Commission*, 449 Pa. 136, 141, 295 A.2d 825, 828 (Pa. 1972) (“York”).

Each party must make its own judgments concerning the various offers and counteroffers that are made in settlement negotiations. Philadelphia participated in the negotiations leading to this Settlement and, evidently, did not procure as many concessions as it wanted. As a result, Philadelphia elected to continue litigation of its issues and had an opportunity to object to the Settlement prior to the filing of its main brief. Philadelphia filed a statement in opposition to the Settlement but inexplicably failed to file any testimony against the Settlement.

On page 13 of its main brief, Philadelphia states that the Settlement achieves only “vague and illusory promises from PECO that will not ensure ratepayer benefit.” This is clearly not the case. As stated in the OSBA’s main brief, this Settlement provides \$120 million in rate reductions over the next four years in addition to \$43.6 million in other quantifiable ratepayer benefits. *See* OSBA M.B., pp. 11-12; Settlement, Par. 14, 33, 35a,

35c, 38, 50 and 52. The Settlement also provides many tangible but unquantifiable benefits, such as rate cap extensions. Altogether, there are \$163.6 million of concrete benefits in addition to the rate cap extensions – all of which are legally enforceable.

A review of the Joint Applicants' filed case provides a dramatic illustration of the benefits provided by the Settlement. On pages 4 through 12 of its main brief, Philadelphia correctly states that the Joint Application offered: (1) shareholder benefits but no ratepayer benefits (Philadelphia M.B., p. 7); (2) no improvement in day-to-day service (Philadelphia M.B., p. 7); (3) no promises to increase community contributions (Philadelphia M.B., pp. 7-8); (4) no sharing of merger savings from the non-regulated business segments (Philadelphia M.B., p. 8); (5) no proposal to decrease PECO's rates (Philadelphia M.B., p. 8); (6) and proposed reductions to PECO's workforce (Philadelphia M.B., pp. 11-12). Philadelphia has needlessly concentrated its attention and arguments on the original Joint Application which is now history, its provisions having been greatly modified by the Settlement.

Philadelphia refuses to recognize the considerable benefits provided by the Settlement because Philadelphia believes that it should have received more from PECO in the way of contributions and commitments. Nonetheless, the Settlement provides benefits that might not have materialized as the result of litigation. In total, this Settlement meets the "affirmative benefit" test of *York* and should, therefore, be approved.

**B. The rate caps and explicit rate reductions do not extend beyond 2010 because such relief was not requested by the settling parties in their litigation positions.**

Philadelphia criticizes the Settlement because the benefits from the rate reductions and the rate caps in the Settlement do not extend beyond 2010. Philadelphia M.B., pp. 13-14. That limitation is consistent with the litigation positions of the settling parties. None of the settling parties testified in favor of rate cuts or rate caps after 2010. Therefore, Philadelphia's complaint about the failure to cap rates beyond 2010 would not have been answered even if this case had been fully litigated. Furthermore, the monetary benefits of the merger will not cease after 2010 since 100 per cent of the distribution-related synergies will accrue to ratepayers via a reduced revenue requirement in PECO's next base rate case.

**C. PECO's generation rate cap must expire in 2010.**

Philadelphia laments the fact that ratepayers will be subject to the "vagaries of the market" after 2010. Philadelphia M.B., p. 14. This outcome is not a shortcoming of the Settlement, but rather a consequence of the provisions of the Electricity Customer Choice and Competition Act passed by the General Assembly in 1996, 66 Pa. C.S. § 2801, *et seq.* ("Competition Act"). In its Declaration of Policy, the General Assembly stated that "[c]ompetitive market forces are more effective than economic regulation in controlling the cost of generating electricity." 66 Pa. C.S. §2802(5). Rate caps on the cost of electric utility service are required to be in place during the transition period, but those rates caps expire when an electric utility completes the recovery of its stranded costs through its competitive transition charge ("CTC"). 66 Pa. C. S. § 2804(4). PECO's transition period

runs through the end of 2010. At that time, the Competition Act requires that PECO charge its customers market rates for generation. 66 Pa. C.S. § 2807(e)(3).

**D. Philadelphia fails to recognize the fact that the Settlement promotes significant economic development without an economic set-aside of nuclear power.**

In their Directed Question No. 3, Commissioners Shane and Cawley asked the parties to consider and comment upon the creation of a pool of energy and capacity (approximately 260 MW) which could be used for economic development purposes at the discretion of the Secretary of the Department of Community and Economic Development. Philadelphia criticizes the Settlement for not incorporating a set-aside of energy via PECO's virtual divestiture to provide economic development for the city and others within the PECO service territory. Philadelphia M.B., pp. 15-16. Philadelphia has not considered the various ramifications of a power set-aside.

In his Supplemental Testimony, OSBA witness Brian Kalcic discussed several of the problems with setting aside a portion of power for economic development purposes. First of all, such a pool of assets would have to be made available to the Commonwealth at below-market prices in order to be useful as an economic development tool. If PECO were to provide this power 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 would be fewer dollars for the rate cuts and other consumer, employee and community benefits Philadelphia claims are already too meager.

Setting aside a considerable amount of merger savings to be used only for economic development would lead to a misallocation of merger benefits across PECO's

rate classes. Most of the savings created by this merger are generation-related. It is, therefore, reasonable to conclude that generation-related merger savings would be needed to pay for any below-market power set-aside for economic development. However, generation-related savings are possible only because *all* PECO ratepayers have paid (and continue to pay) for PECO's generation assets. 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. It is simply not appropriate to allocate a disproportionate share of the merger savings to any class of customers, including PECO's business classes. OSBA St. No. 4, pp. 3-4.

Philadelphia also fails to recognize that the Settlement does promote economic development in the PECO service territory by providing about \$30 million in rate cuts for small business customers. Economic development will also be enhanced by the transmission and distribution rate cap extension. These economic development benefits will be available sooner, will be shared by more customers, and will be allocated more fairly than the benefits from any power set-aside. OSBA M.B., pp. 11-13.

**E. Any attempt by Exelon to influence gas prices can be addressed in PECO's gas cost proceedings under Section 1307(f).**

Philadelphia is concerned that, because of the "highly concentrated" post-merger PJM East gas market, the merged entity will be able to increase gas price volatility through the discretionary use of selected storage injection and withdrawal strategies. Philadelphia M.B., pp. 20-21. Both Philadelphia and PGW are concerned with potential market manipulation through the merged entity's ability to restrict the release of upstream pipeline capacity. Philadelphia M.B., p. 21; PGW M.B., pp. 16-17.

Each year, every major natural gas distribution company undergoes a thorough examination of its gas purchasing performance under Section 1307(f) of the Public Utility Code, 66 Pa. C.S. § 1307(f). Any failure by PECO to use its gas assets in a manner consistent with a least cost procurement policy under Sections 1317 and 1318 of the Public Utility Code, 66 Pa. C.S. §§ 1317 and 1318, could be pursued in its annual gas cost proceeding. Furthermore, under 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 other affiliated interest. *See Pennsylvania Public Utility Commission v. The Peoples Natural Gas Company, t/a Dominion Peoples*, Docket No. R-00050267 (Order entered September 30, 2005), Mimeo. pp. 11-14.

**F. The Settlement provides for redress in the event that Exelon unlawfully exercises market power.**

PGW asserts that the Settlement contains no provision to protect the electricity market from potential abuses in the gas market, especially since the market price report required by the Settlement will be of electricity prices and not of gas prices. PGW M.B., p. 37, fn. 20. However, if PGW is correct that manipulation in the gas market will affect prices in the electricity market, the report of electricity prices should help identify any manipulation in the gas market. Furthermore, the Settlement recognizes the right of the parties to seek a Commission investigation of the effect on the retail electricity market from manipulation in *any* PJM market—which will include gas markets if PGW's scenario arises. Settlement, Par. 53b.

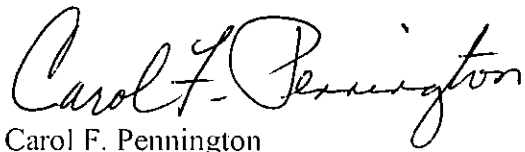
**G. The absence of an explicit penalty provision in the Settlement does not foreclose the possibility of a penalty in the event that Exelon or an affiliate unlawfully exercises market power.**

Philadelphia contends that the Settlement is deficient because the Settlement does not contain a penalty provision to discourage the illegal exercise of market power by Exelon or an affiliate. Philadelphia M.B., p. 21. However, the Settlement does allow for circumstances under which any Joint Petitioner may request that the Commission initiate an investigation. Settlement Par. 53b. If the Commission's investigation leads to the reasonable belief that Exelon or an affiliated interest has unlawfully exercised market power, Section 2811(d) of the Public Utility Code, 66 Pa. C.S. § 2811(d), requires the Commission to refer its findings to the Attorney General of Pennsylvania, the U. S. Department of Justice, the Securities and Exchange Commission, and the Federal Energy Regulatory Commission and empowers the Commission to seek intervention before those agencies. The results of the investigation would also be available for parties to use in proceedings regarding the approval of PECO's default service plan (*e.g.*, if PECO requests a risk premium or a reconcilable energy service charge), regarding the setting of the rate of return in a PECO distribution base rate proceeding, and regarding PECO's annual Section 1307(f) filing. Therefore, contrary to Philadelphia's contention, these Settlement provisions will serve to discourage the unlawful exercise of market power by PECO or an affiliate.

### III. CONCLUSION

The OSBA respectfully requests that the Administrative Law Judge and the Commission approve the Joint Petition for Settlement without modification. Furthermore, if the Settlement is approved without modification, the OSBA respectfully requests that the Administrative Law Judge and the Commission approve the Proposed Merger and issue a certificate of public convenience subject to the conditions set forth in the Settlement.

Respectfully submitted,



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October 21, 2005

BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION

JOINT APPLICATION OF PECO ENERGY :  
COMPANY AND PUBLIC SERVICE :  
ELECTRIC & GAS COMPANY FOR : DOCKET NO. A-110550F0160  
APPROVAL OF THE MERGER OF PUBLIC :  
SERVICE ENTERPRISE GROUP, INC., :  
WITH AND INTO EXELON CORPORATION :

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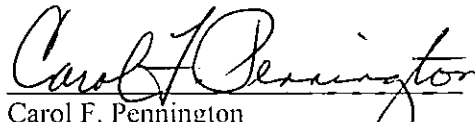
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