

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

Joint Application of West Penn Power Company d/b/a Allegheny Power, Trans-Allegheny Interstate Line Company and FirstEnergy Corp. for a Certificate of Public Convenience under Section 1102(a)(3) of the Public Utility Code approving a change of control of West Penn Power Company And Trans-Allegheny Interstate Line Company

**PUBLIC MEETING: February 24, 2011
2176520-OSA**

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

**DISSENTING STATEMENT OF
CHAIRMAN JAMES H. CAWLEY**

Before us is a proposed merger of four of Pennsylvania's electric distribution companies ("EDCs") which, if approved, will impact the electricity service provided to more than one-third of Pennsylvania's electric customers in a combined service territory covering approximately 70 percent of the Commonwealth. In this proceeding, FirstEnergy Corporation ("FirstEnergy") – which consists of Pennsylvania Electric Company ("Penelec"), Pennsylvania Power Company ("Penn Power"), and Metropolitan Edison Co. ("MetEd") – proposes to acquire West Penn Power Company d/b/a Allegheny Power ("Allegheny") and Trans-Allegheny Interstate Line Company ("TrAILCo") (collectively "Joint Applicants").

Given the significance of this merger and the record developed in this proceeding demonstrating that anticompetitive and/or discriminatory conduct is virtually certain to occur if this merger is approved without the imposition of significant conditions, this merger, as modified by the Joint Petition for Partial Settlement ("Partial Settlement"), should not be approved. Rather, the Partial Settlement must be substantially augmented to mitigate the likelihood of anticompetitive or discriminatory conduct post-merger. Additional conditions are necessary so as to foster development of a properly functioning competitive market with the goal of delivering competitive benefits to customers, including lower, more competitive prices and innovative services.

Statutory Standards

Before the Commission can approve this proposed change in control, it must find that the merger is "necessary or proper for the service, accommodation, convenience, or safety of the public." 66 Pa.C.S. § 1103(a). To satisfy this standard, the merger must be shown to produce "affirmative public benefits." *City of York v. Pa. Pub. Util. Comm'n*, 449 Pa. 136, 295 A.2d 825 (1972). Also, because the merger involves EDCs, the Commission must determine whether the merger is likely to result in anticompetitive or discriminatory conduct, including the unlawful exercise

of market power, which will prevent customers from enjoying the benefits of a properly functioning and workable competitive retail electricity market. 66 Pa.C.S. § 2811(e)(1). If the Commission finds that the merger is not necessary or proper and/or that the merger is likely to result in anticompetitive or discriminatory conduct that will result in a market that is not workably competitive, then the Commission must either reject the merger or impose appropriate conditions on the merger to cure the projected deficiencies. *Id.*, § 2811(e)(2).

Non-Unanimous Settlement

The Administrative Law Judges (“ALJs”) recommend approval of the merger as modified by a Partial Settlement. While many of the parties to the proceeding supported the Partial Settlement, it was not unanimous. Significantly, the Office of Small Business Advocate (“OSBA”), the Retail Energy Supply Association (“RESA”), Direct Energy Services, LLC (“Direct Energy”), and Citizens Power all opposed the Partial Settlement. All non-settling parties concluded that the Joint Applicants failed to meet their burden of proving that the merger should be approved pursuant to the statutory requirements of sections 1103(a) and 2811(e).

The Relevant Inquiry

Initially, because the settlement is not unanimous, the relevant inquiry is not whether the Partial Settlement is in the public interest. Rather, we are compelled to review the record as we would in a fully contested proceeding and make a determination of whether the merger, as modified by the concessions offered by the Joint Applicants in the Partial Settlement, satisfies the applicable standards discussed above. While Citizen Power recommended that the merger be rejected, OSBA, Direct Energy, and RESA offered conditions that, if imposed, would satisfy the statutory standards and the Commission’s obligations. As discussed below, these parties correctly alleged that the merger – even as modified by the Partial Settlement – does not meet the statutory merger standards. Additional conditions are needed for approval of the merger, in addition to those concessions offered by the Joint Applicants and the measures proposed by my colleagues.

Inadequacy of the Partial Settlement

The concessions agreed to by the Joint Applicants in their original filing, as well as in the Partial Settlement, address to some extent the legal requirement that the merger produce general “affirmative public benefits,” and minimally address widespread concerns about job loss and loss of Allegheny’s corporate presence in the Commonwealth. These concessions also provide modest rate decreases to customers, without which it would be difficult to conclude that the merger affirmatively benefited the public interest. They should, therefore, be required as a condition for approval by this Commission, not because they were part of a less than

unanimous settlement, but because, without them, the merger would fail even the “affirmative public benefits” test.

However, the concessions offered by the Joint Applicants do not adequately address the concomitant obligation to show that the merger will not create competitive concerns, as required by section 2811(e). This facet of merger review is particularly important here because what is proposed is the merger of four major EDCs after the termination of the generation “price caps” that have kept retail competition development on hold throughout Pennsylvania. In this posture, it is crucially important that, if this merger is to go forward, the merger must not frustrate the development of a workably competitive wholesale and retail market.

Unfortunately, the record does not permit a conclusion that a workable competitive market will likely result if the merger is approved with only the competitive conditions proposed in the Partial Settlement and the proposed conditions offered by my colleagues. In a related context, the Commission has found that a workable, or effectively competitive market is one in which there is:

- Participation in the market by many sellers so that an individual seller is not able to influence significantly the price of the commodity.
- Participation in the market by many buyers.
- Lack of substantial barriers to supplier entry and participation in the market.
- Lack of substantial barriers that may discourage customer participation in the market.
- Sellers offering buyers a variety of products and services.¹

A review of the evidence leads to the conclusion that the merger will likely prevent a market with these characteristics from developing. The principal reason for this is FirstEnergy’s proposed acquisition of Allegheny’s substantial generation and transmission assets, and particularly Allegheny’s substantial generating fleet which is capable of serving its Pennsylvania service territories in a highly economic manner. Access to these assets, together with FirstEnergy’s existing capacity, will put the merged company in a position to dominate the Pennsylvania market. In consequence, no real competition will exist and result in customers paying higher prices than if real competition were able to develop.

Ohio All Over Again

The evidence shows that the acquisition of Allegheny’s assets will permit FirstEnergy to deploy a “retail marketing strategy” in the Commonwealth that will result in most residential and small business customers taking service from FirstEnergy’s default service or from FirstEnergy’s electric generation supplier

¹ Investigation into the Natural Gas Supply Market: Report on Stakeholders’ Working Group (SEARCH), Docket No. I-00040103F0002 (Sept. 11, 2008).

affiliate, FirstEnergy Solutions. FirstEnergy intends to accomplish this by utilizing Allegheny's generation fleet to aggressively market at the retail level through three sales channels – (1) municipal aggregation; (2) direct sales to customers through its affiliated electric generation supplier (EGS); and, (3) indirectly to customers through the default service of affiliated EDCs (with power supplied by the affiliated-EGS which controls the FirstEnergy generation assets). FirstEnergy's "retail marketing strategy," enabled by its newly acquired assets, will result in the stifling of competition throughout the FirstEnergy service territory. The result will be higher prices and fewer choices for customers than if a fully competitive market was able to develop—the opposite of what the General Assembly intended when it enacted the Electricity Generation Customer Choice and Competition Act.

As FirstEnergy Corporation's Fourth Quarter 2010 Earnings Report makes plain, this generation-backed retail marketing strategy has been highly successful for FirstEnergy in Ohio, where, the record establishes, it serves approximately 81.4 percent of the retail customers, either through the competitive market, municipal aggregation, or default service.² Indeed, FirstEnergy made clear during the hearings that it fully intended to utilize the same three-pronged business strategy in Pennsylvania to achieve comparable results achieved in Ohio, through the acquisition of Allegheny's generating supply.³

² "FirstEnergy Solutions Increases Share of Sales at Affiliated Ohio Utilities to 81.4%" February 17, 2011

"FirstEnergy Solutions increased its share of sales in its affiliated franchised utility territories in Ohio to 81.4%, FirstEnergy Corp. disclosed in reporting fourth-quarter earnings.

"The 81.4% share for the quarter ending December 31, 2010, which includes POLR, aggregation and direct retail sales, compares to 80.7% during the quarter ending September 30, 2010, and 72.1% for the quarter ending December 31, 2009.

Through a combination of POLR, opt-out government aggregation, and direct sales to end users, FirstEnergy Solutions supplied 10,546 GWh of the total 12,950 GWh used by customers at its affiliated Ohio distribution companies.

"The breakdown was 2,959 GWh POLR sales, 3,475 GWh aggregation sales, and 4,112 GWh direct retail sales.

"Non-affiliated third parties accounted for only 2,404 GWh of supply at the FirstEnergy Ohio distribution companies, with such third-party supply split almost evenly between POLR sales and competitive retail sales.

"FirstEnergy Solutions also reported that, during the fourth quarter, it served 990 GWh of non-aggregation, non-POLR retail sales in Ohio outside of its affiliated service areas. In Pennsylvania, FirstEnergy Solutions served 561 GWh of direct retail sales in its affiliated service areas, and 812 GWh of direct retail sales outside of its affiliated service areas.

"FirstEnergy Solutions' current customer count is 1.5 million, versus 1.2 million as of late October 2010.

"FirstEnergy Solutions said that it continues to expand direct retail sales in Illinois, Michigan and Maryland, in addition to recently entered non-affiliate territories in Pennsylvania and southern Ohio.

"In 2010, FirstEnergy Solutions doubled its sales outside of Ohio."

<http://www.energychoicematters.com/stories/20110217d.html>

³ Tr. at 213-218 & Direct Energy Cross Examination Exh. 1 (FE-4(c)-19). The exhibit shows retail market "Take Rates" of 65% that Booz and Co. on March 22, 2010, projected could be achieved by Joint Applicants in the

With approval of this merger, several rural Pennsylvania towns will soon be offered “deals” similar to the one New Middletown, Ohio (just across the border from New Castle, Pennsylvania), recently received, as reported in the local online news source:

Also Monday, council advanced to a first reading legislation to accept a proposal from First Energy Solutions for a nine-year contract under electrical aggregation approved by village voters.

The village would agree to a fixed nine-year electric rate and First Energy would provide the village with a \$40,000 lump sum payment and would give residential and commercial customers in the village six and four percent discounts, respectively. Council would like public input and the measure needs two more readings.⁴

One is left to wonder how any Electric Generation Supplier, without a crystal ball accurately predicting generation costs far into the future, can offer anyone a fixed-price rate for nine years. FirstEnergy’s affiliate EGS can do so (and will do so) because of its parent’s existing generating assets and those it will acquire from Allegheny Power. And will competing EGSs be able to match the off-contract \$40,000 sweetener, or perhaps next time FES’s offer of a new fire truck or municipal swimming pool? Finally, will it be fair to the residents and businesses in Pennsylvania towns to offer them 4% and 6% discounts, respectively, when EGSs who have been able to compete in other Pennsylvania electric distribution companies’ territories routinely offer 10% - 15% discounts to residential customers (with a variety of products and inducements) and a whole panoply of tailored products and prices to businesses? But, of course, with the approval of the Partial Settlement without effective additional protections, there won’t be any competing EGSs because none will be able to acquire sufficient customers to make the effort worthwhile, even if they could obtain supply in the wholesale market at a price comparable to that which FES can obtain from its parent’s generation arm (which is highly unlikely).

Adverse Effects on the Wholesale Market

It is also very concerning that FirstEnergy’s acquisition of Allegheny’s generation will give the merged company the ability to raise prices in the wholesale market, which, in turn, will affect retail competition and wholesale pricing. While

Penelec, Met-Ed, and Duquesne Light Co. service territories (65%-70% in the West Penn service territory). This colloquy occurred at page 218 of the hearing transcript: Q. "So we are in agreement that your goal for the FE and Allegheny service territories if the merger is consummated is to try to achieve these kind of take shares through your three pronged retail marketing channels? A. (Alexander): Absolutely."

⁴ <http://www.vindy.com/news/2011/feb/16/trustee-why-the-animosity/>.

the merger has been approved by the Federal Energy Regulatory Commission (“FERC”) on the basis of its standard horizontal merger guidelines and the “delivered price test,” the Joint Applicants’ own FERC analysis showed that the merger resulted in several “screen failures” and near failures in both on and off peak periods. These screen failures occurred even with the exclusion of 2,700 MW⁵ of potential future capacity which FirstEnergy has announced its intention to develop. Furthermore, the Pennsylvania Office of Consumer Advocate (“OCA”) raised valid concerns about the Joint Applicants’ market power studies, mainly that they failed to adequately address relevant market definition concerns.

In making its determinations regarding market power, FERC uses the Herfindahl-Hirschman Index (HHI). The HHI is a widely accepted measure of market concentration, calculated by squaring the market share of each firm competing in the market and summing the results. The HHI increases both as the number of firms in the market decreases and as the disparity in size between those firms increases. Markets in which the HHI is less than 1,000 points are considered to be unconcentrated; markets in which the HHI is greater than or equal to 1,000 but less than 1,800 points are considered to be moderately concentrated; and markets in which the HHI is greater than or equal to 1,800 points are considered to be highly concentrated. The Commission has adopted the Federal Trade Commission/Department of Justice Horizontal Merger Guidelines, which state that, in a horizontal merger, an increase of more than 50 HHI points in a highly concentrated market or an increase of 100 HHI points in a moderately concentrated market fails its screen and warrants further review.

In the FERC proceeding, FERC admitted that the post merger HHIs for the summer off-peak, winter off-peak, and shoulder off-peak periods were 1,054, 1,000, and 1,014, with HHI increases of 111, 111, and 110, respectively. These screen failures exceed the criteria used to detect potential market power. OCA argued before the FERC that the Joint Applicants would have the ability and incentive to withhold coal unit generation during off-peak periods. Specifically, OCA noted that Allegheny has eight coal plants that are located on the flat portion of the supply curve which are candidates for withholding. OCA argued that the Joint Applicants could increase their net energy revenues by approximately \$100,000 per hour by withholding the plants in question. OCA further argued that economic withholding of these plants in the form of high bid prices could be detected by the Independent Market Monitor (IMM), but other forms of withholding, such as premature retirement, are beyond the purview of the IMM and the RTO, unless the units are necessary for regional reliability. Rather than investigating these marketing concerns, FERC opted to place the burden on OCA to prove these market power impacts, and further refused to institute an evidentiary proceeding to evaluate such market power impacts. Instead of addressing these concerns, FERC was content to rely on the IMM to ensure that economic withholding does not incur, rather than on

⁵ The Norton Energy Storage Project.

a truly competitive generation market to force competitive outcomes in the marketplace.

Similarly, OCA argued that the Joint Applicants' analysis was incomplete because it failed to analyze all the appropriate geographic and product markets. OCA contended that PJM West is one appropriate geographic market that the Joint Applicants overlooked. FERC dismissed OCA's concerns, finding once again that OCA failed to justify why PJM West should be treated as a separate submarket based on this standard. FERC stated that OCA did not cite any evidence, such as binding transmission constraints or price separation data, to support the existence of a separate PJM West submarket. Once again, FERC shifted the burden of proof to OCA and refused to hold an evidentiary hearing on this important issue of fact.

As to default service supply market power, OCA appropriately noted that generation market power is not the same as default service market power. A default service supplier must often provide a number of services, including energy, capacity, ancillary, and alternative energy acquisition services. To put this in perspective, while there are approximately 1,340 generation plants in PJM, there were only 8 winning bidders in Penelec's auctions, with 3 bidders accounting for over 77% of the supply. Similarly, there were approximately a dozen bidders in all of Allegheny's default service auctions, but only 4 winning bidders. Without revealing too much detail because of the potential confidential nature of these requests for proposals and auctions, FirstEnergy and Allegheny Energy Services were substantive competitors – competition that will be lost in this merger to the detriment of Penelec and Allegheny default service customers. OCA, before FERC, raised this same issue—that, because the Joint Applicants each control significant amounts of low cost generation, the Joint Applicants should have been required to analyze the market in relation to competitive procurement of power in Pennsylvania and other restructured PJM states. It is not apparent from the FERC Order that FERC even addressed this concern at all.

If FERC had taken the time to address product markets associated with default service bidding, market power screens for such markets would have consistently failed. In fact, all default service markets are highly concentrated. In the case of Penelec, the calculated HHI index for the residential and small commercial default service market, combined, would have been approximately 2800 pre-merger and over 4600 post merger, an HHI increase of over 1800. In the case of West Penn Power, individual default service class HHI indices were all approximately 4000 or higher, the combined residential and small commercial (rate class C-20) HHI index increased from approximately 3400 to 4200, and, combining all rate class procurement markets, the HHI index increased from approximately 2400 to 3000. These statistics clearly indicate that, if this merger is approved without the conditions proposed herein, it will be necessary for this Commission to significantly modify the provision of default service in the FirstEnergy companies' service territories.

The Joint Applicants' analysis also failed to take into account the evidence of existing structural deficiencies in several aspects of the PJM market, specifically, the energy, reserve, and capacity markets where PJM's own Independent Market Monitor could not say without exception that no participant had the power to affect prices. While this Commission has looked to the FERC analysis as an initial starting point in determining whether a merger would give the merged company wholesale market power, this Commission must go farther and review these data from the standpoint of Pennsylvania's unique statutory requirement: whether it is likely that the merged company will be able to engage in anticompetitive or discriminatory conduct that would harm retail competition. 66 Pa.C.S. § 2811(e)(2).

The Joint Applicants have not sufficiently responded to the potential that they could withhold generation, and thus raise prices in the wholesale energy, reserve, or capacity markets by exploiting the acknowledged existing structural deficiencies in the PJM market to the detriment of competitors and customers. Evidence provided in this proceeding clearly indicates that consumers must rely on the IMM and PJM's tariff to mitigate market prices, instead of relying on real competition. For example, the IMM has already noted that capacity markets are highly concentrated, leading the IMM to impose bid caps in all zones.⁶ This merger will only increase the concentration of generating capacity in the PJM market, and worsen the potential market power problems in the capacity market.⁷ Offer caps in the capacity market were applied to all sell offers. Morey next noted that the IMM found the reserve markets are highly concentrated, leading to serious market power problems.⁸ Thus, while many of these structural problems are well documented in the PJM market, approval of this merger without any mitigation will only aggravate an already highly concentrated market.

Adverse Effect on Default Service

In fact, the Joint Applicants' ability to control the market will be enhanced by FirstEnergy's status as default service provider throughout its service territory. While there has been a reasonable amount of switching in certain service territories (e.g., that of PPL Electric Utilities), the existing default service rules and structure will continue to make it more difficult for EGSs to make meaningful headway in persuading a majority of residential and small commercial customers to switch to competitive alternatives. It is the application of this default service structure (a structure that we have approved for use by all of the major Pennsylvania EDCs) *combined with* FirstEnergy's ability and intent to exploit that structure by coupling its sales with its newly expanded generation fleet and to have its EGS take advantage of its status as an affiliate of the longstanding "electric service provider" that ensures that the statutory merger standards will not be met.

⁶ Morey Stmt. 1 at 27.

⁷ *Id.*

⁸ *Id.* at 29.

Further, while there may be other EGSs making offers in the Met-Ed, Penelec, Penn Power, and Allegheny service territories, it will be very difficult for these competitors to have anything other than marginal success under the proposed merger and Partial Settlement. Without meaningful conditions, FirstEnergy will be able to exploit this tendency of smaller customers to do nothing or to remain with their longstanding “electric company,” resulting in a large portion of the market staying with either the incumbent utility or an affiliate of the incumbent (especially if it enjoys the incumbent’s brand name). The result will not be a market with many sellers and many buyers. Moreover, FirstEnergy’s generation advantage constitutes a significant barrier to entry such that non-affiliated competitors will find it difficult to develop the level of market share and presence that would make it worthwhile for them to offer attractive “value added” products, services, and promotions that are the hallmark of a workably competitive market. The evidence of record requires the conclusion that, if the merger is approved as presented, the retail market in the territories of Met-Ed, Penelec, Penn Power, and Allegheny will not result in a workably competitive market, as is required by 66 Pa.C.S. § 2811.

Despite the record evidence of serious problems that will detrimentally affect the competitive market post-merger, the Joint Applicants presented nothing to remedy these concerns. The Partial Settlement does not address the competitive retail market concerns resulting from this merger in any meaningful way.

Conditions That Should Have Been Imposed

In order to mitigate the competitive retail and wholesale competitive concerns, approval should have been conditioned upon the Joint Applicants’ acceptance of all of the conditions set forth in the Partial Settlement, the conditions imposed by the Commission pursuant to today’s approved motions, as well as the following appropriate and reasonable conditions. All of these conditions are intended to break the inherent bias in favor of FirstEnergy’s default service, to mitigate FirstEnergy Solution’s post-merger retail market power, and to bring a sufficient number of non-affiliated EGSs into the market to reduce the merged company’s ability to dominate the market. This result would have been in the public interest because it fulfills our statutory duty to assure not only that affirmative public benefits will result from a merger, but also that the environment post-merger will produce a fully functional and competitive retail and wholesale market wherein consumers are presented with a variety of competitive options for generation service as well as innovative, value added products.

Accordingly, the Commission should have imposed the following conditions on the merger, in addition to those agreed to by the Joint Applicants in the Partial Settlement:

First, the Joint Applicants should have agreed to exit the default service provider function. To accomplish this goal, the Commission could initiate a separate proceeding to select an alternative default service provider or providers. The Commission could convene a proceeding to determine the procedures and criteria for selecting an alternative default service provider or providers through the establishment of a competitive bidding process for all of the EDC affiliates of the Joint Applicants in Pennsylvania. This proceeding could examine the feasibility of designing a competitive bidding process (perhaps along the lines of FirstEnergy's wholesale default service declining block auction) to select one or more alternative default service providers through the auctioning of blocks of residential and small commercial customers at the lowest cleared auction price. This proceeding could include a determination of the appropriate levels of market share caps applied to First Energy affiliates, and appropriate contingency plans for the various auctions and suppliers. At the conclusion of this proceeding, Joint Applicants could hold the competitive auction consistent with the approved bid process. To address the requirement in Act 129 of 2008 that power procured by default service providers include a prudent mix of supplies, parties could propose modifications to Direct Energy's proposal which called for the alternative default supplier to procure power on the spot market. The alternative default supply provider or providers ultimately selected would ideally not take over responsibility for providing default service in the FirstEnergy-affiliated EDC service territory until the completion of the existing default service procurement period for the EDC affiliate, but no later than June 1, 2013.

Second, while we need not require FirstEnergy to establish a new unbundled affiliated entity to provide the billing, collections, call center, electronic data interchange (EDI) and other related customer service functions on a competitively neutral basis at this time, we should have required FirstEnergy to participate in the efforts of PPL Electric Utilities to design and implement an EGS consolidated billing process. It is not clear that such a billing affiliate would be any more responsive to EGS' needs. Instead, under EGS consolidated billing, EGSs could optimally address their desire to provide billing services that best meet the product and marketing needs of themselves and their customers. The Committee Handling Activities for Retail Growth in Electricity (CHARGE), or a separate working group established under CHARGE, should have been required to establish an appropriate process and timeline to establish standards for this billing mechanism. FirstEnergy should have been directed to accommodate EGS consolidated billing on a manual basis when requested initially, to develop statewide EDI-based EGS consolidated billing standards, and to implement these standards when economically efficient to do so.

Third, given the evidence of the potential for FirstEnergy to exploit existing PJM market deficiencies to exercise wholesale market power, FirstEnergy should have been required to divest generation assets in such a fashion as to mitigate any increase in the HHI in PJM markets. Joint Applicants should have been required

to file with the Commission a proposed generation divestiture plan within 90 days of the effective date of this Order. FirstEnergy should not have been permitted to close the merger until the Commission had made a determination on the compliance with a filed divestiture compliance plan. The prohibition against divestiture of facilities in section 2804(5), applicable to electric restructuring, is inapplicable to a merger proceeding where sections 1103(a) and 2811(e) are paramount.

In retrospect, this Commission should likely have requested the IMM to perform an independent market power study of this merger. For example, studies were prepared for the proposed Exelon Corporation-Public Service Electric and Gas Merger in 2005 at the request of the New Jersey Board of Public Utilities. That study identified market power concerns, and ultimately the merger was abandoned.

A \$22 Million Net Benefit?

Given the lack of this market study, lack of evidentiary support in the FERC docket for this merger, and clear evidence that the default service bidding markets are extremely concentrated as defined by existing market power indices, the net benefits of this merger are lacking. The Partial Settlement provides quantitative benefits of slightly less than \$22 million. In contrast to this, Allegheny Power shareholders would receive a \$1.2 billion premium on their investment if they cash out today, Allegheny Power senior executives will be paid \$43 million in change-of-control payments, and lawyers, investment bankers, and consultants will be paid \$58 million.

Additionally, when the merger was announced, FirstEnergy's S&P's rating was downgraded to BBB- from BBB, while FirstEnergy's senior unsecured rating was changed to BB+ from BBB-. Moody's and Fitch's ratings were unchanged after the announcement.⁹ It is important to note that, even though FirstEnergy's regulated subsidiaries maintain their own debt independent of the holding company, S & P downgraded the credit rating of all FirstEnergy subsidiary companies by one notch upon the announcement of the merger, in addition to the downgrade of the rating of the parent company. Such a downgrading can result in approximately a 25 basis point debt premium which could result in roughly \$40 million in net-present valued additional interest cost over a 15-year period when applied to the three FirstEnergy operating companies.¹⁰

As to the potential for higher default service premiums being imposed on consumers due to the highly concentrated nature of default service supplier markets, a mere \$1 per MWH increase in default service costs translates into roughly \$68 million and \$86 million when net present valued over a 15 year period

⁹ OCA St.1 at 9.

¹⁰ This reflects net present cost at 8%, assuming scheduled debt retirements and annual capital programs for Met-Ed, Penelec, and Penn Power of \$100 million, \$132.5 million, and \$27.5 million, respectively, escalated at 3%, and debt coverage of these capital programs of only 40%, 53.6%, and 40%, respectively.

for the Penelec and West Penn Power service territories, respectively.¹¹ If, on the other hand, FirstEnergy uses its expanded generation fleet to increase overall wholesale market prices only \$1 per MWH in its four Pennsylvania service territories, the net present value cost to consumers over a 15-year period explodes to roughly \$465 million.¹²

It should come as no shock that these costs are in line with the premium paid and the costs incurred by FirstEnergy to gain approval of this merger. How then, do we justify approval of such a merger in light of the miniscule guaranteed merger savings, relative to the enormous potential costs to consumers associated with higher energy costs? Only through further mitigation, as proposed herein, does this merger make any logical sense.

Kudos to Allegheny Power's Management and Employees

Mergers of distribution companies do have some credibility. The efficiencies gained through adjacent service territories can result in lower costs to customers if implemented efficiently. Here, however, there are again grave doubts as to such benefits. For example, in most categories of performance, Allegheny Power has often excelled, or performed at least as admirably as FirstEnergy. Complaint rates and call center performance are roughly similar, with Allegheny performing slightly better in some categories and slightly worse in other categories. In terms of the most important performance criteria—reliability—Allegheny is in compliance with our 3-year metrics, while FirstEnergy's Met-Ed subsidiary is again not meeting its 3-year performance standards. In other words, the evidence does not lead one to believe that "best practices" are going to lead to substantial customer benefits. As is typical of these types of mergers, the acquiring company will overshadow the acquired company, therefore leading to continued concerns about FirstEnergy reliability performance.

Allegheny Power has also demonstrated superior performance in managing bad debt and effectively managing universal service program (USP) costs. While the introduction of USP cost riders by FirstEnergy companies has been accompanied by the explosion of USP costs paid by FirstEnergy ratepayers, Allegheny Power has continued to manage these costs effectively within the context of its existing base rates. While the 2010 costs are still not in, which would likely further magnify the difference in cost management between these two companies, in 2009, Allegheny Power outperformed its FirstEnergy counterparts in all cost management statistics: USP annual spending per residential customer (\$15.07 vs. \$56.53) and average gross program annual cost per CAP customer (\$398 vs. \$911). Furthermore, while managing costs, Allegheny Power simultaneously performed far

¹¹ This assumes 80% customer retention of residential and commercial customers under default service, 0.8% annual market growth for Penelec, and 0.9% annual growth for West Penn Power.

¹² This assumes annual market growth for Met-Ed and Penn Power of 2.1% and 1.5%, respectively, applicable to all customer classes, present valued at 8%.

better in managing its bad debt. For example, 2.2% of Allegheny Power customers are in debt, while 5.24% of FirstEnergy customers are in debt. The weighted average arrearage of Allegheny Power is 1.51, while the FirstEnergy rate is 3.23. Similarly, bad debt write-offs are higher for FirstEnergy than for Allegheny Power for both residential customers and low-income customers.

Conclusion

In short, I cannot support this merger without significant conditions over and above those in the Partial Settlement. I do support the additional conditions imposed by my colleagues. These conditions may help, in a small degree, in mitigating some of the impacts of this merger, but, unfortunately, these additional conditions fall far short of mitigating the biggest cost effects – retail and wholesale price impacts. It seems we increasingly rely on the IMM to mitigate a moderately concentrated wholesale market, instead of taking needed steps to make the market effectively competitive, as the Electric Choice Act contemplated.

There will be no retail electric choice in most of Pennsylvania as a result of this merger. FirstEnergy's clever strategy of professing to countenance the competitive protections advocated by the non-settling parties while urging that they be applied, not just to FirstEnergy, but "generically" to all EDCs was designed to gain allies of those EDCs who, unlike FirstEnergy, are actively promoting electric choice and therefore will oppose the need for universal application of measures that are only needed in the FirstEnergy service territories. Once this merger closes, FirstEnergy will never countenance any interference with its three-pronged business strategy, and this Commission will have lost forever its ability to ensure robust electric choice in the FirstEnergy service territories. We are taking a *huge* step backward by approving this merger.

Thanks go to the hard working Allegheny Power employees. As noted, their performance has in many respects been outstanding. Many of these employees have performed admirably, and, in some circumstances, superior to their FirstEnergy counterparts. Regrettably, rather than rewarding this performance by expanding its presence in Pennsylvania, FirstEnergy has chosen only a few Allegheny Power managers to lead the merged entity while reducing its workforce in Pennsylvania.

In sum, rather than net benefits for Pennsylvania and its citizens from this merger, I see mostly negatives. The effects on retail electric choice will be devastating for most rural Pennsylvanians who will soon be given cause to wonder where we were when we were needed.

James H. Cawley, Chairman

Dated: February 24, 2011