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September 24, 2010

Via Electronic Filing
Rosemary Chiavetta, Secretary
PA Public Utility Commission
PO Box 3265
Harrisburg, PA 17105-3265

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

Dear Secretary Chiavetta:

Yesterday, we filed on behalf of Direct Energy Services, Inc. its Answer to the Joint Applicants' Motion *In Limine*. There was a typographical error on page 8 of the Answer. Accordingly, enclosed please find the original of Direct Energy's Amended Answer with a corrected page 8 along with the electronic filing confirmation page. Please note that the Non-Public version of the Answer contains Highly Confidential information and will only be provided to the Parties who executed the Protective Order. Copies have been served in accordance with the attached Certificate of Service.

Very truly yours,

Daniel Clearfield

Daniel Clearfield, Esq.

DC/lww
Enclosure

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

CERTIFICATE OF SERVICE

I hereby certify that this day I served a copy of Direct Energy's Amended Answer to Joint Applicants' Motion in Limine – PUBLIC VERSION – upon the persons listed below in the manner indicated in accordance with the requirements of 52 Pa. Code Section 1.54.

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Dated: September 24, 2010

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Joint Application of West Penn Power Company d/b/a Allegheny Power, Trans-Allegheny Interstate Line Company and FirstEnergy Corp. for a Certificate of Public Convenience under Section 1102(a)(3) of the Public Utility Code approving a change of control of West Penn Power Company And Trans-Allegheny Interstate Line Company	:	Docket No. A-2010-2176520 Docket No. A-2010-2176732

DIRECT ENERGY SERVICES, LLC'S
AMENDED ANSWER TO
JOINT APPLICANTS' MOTION *IN LIMINE*

PUBLIC VERSION

Pursuant to 52 Pa. Code § 5.103(c), Direct Energy Services, LLC ("Direct Energy") submits this Answer ("Answer") to the Motion *in Limine* filed by West Penn Power Company, Trans-Allegheny Interstate Line Company ("Allegheny") and FirstEnergy Corp. ("FE," collectively referred to as "Joint Applicants") seeking to strike substantial portions of the testimony presented by Direct Energy, based on an argument that Direct Energy's testimony is not related to the merger. As fully explained below, the testimony sought to be barred from the record is highly relevant to the key issues in this merger proceeding and, therefore, the Motion *in Limine* should be denied.

I. SUMMARY OF ARGUMENT

Before turning the substance of the Motion *in Limine*, Direct Energy submits that the Motion is inappropriate procedurally. Such motions are intended to prevent prejudice that may occur if certain evidence is presented before a jury. That concern is not present before the PUC because neither the ALJs assigned to a proceeding nor the full Commission will be prejudiced by

the mere receipt of evidence into the record, and the Commission has ruled as such when faced with similar attempts to limit the development of a full record. Therefore, the Motion *in Limine* should be denied outright.

Assuming that this Motion is even appropriately considered at this time, the Joint Applicants' mischaracterize Direct Energy's testimony as unrelated to the merger and as proposing remedies for "generic flaws" in the structure of the competitive retail market in Pennsylvania. They claim that only testimony that shows competitive harm as a result of the merger (that presumably would not occur absent the transaction) is legally relevant. The Joint Applicants' completely ignore the fact that Direct Energy's testimony is clearly relevant to determining compliance with the "affirmative public benefit" merger standard. The Commission and the courts have confirmed that mergers should be examined to determine if they will produce affirmative competitive benefits to customers. One reason for Direct Energy's testimony is to demonstrate the kinds of competitive enhancements that need to be agreed to by the Joint Applicants if the merger is to satisfy the "affirmative benefit" standard.

Moreover, the Joint Applicants' claims are based on an interpretation of the "workable competitive market" statutory standard in Section 2811(e), that has never been adopted by the Commission in any prior merger proceeding and does not comport with the plain statutory language. This section plainly requires the PUC to reject a merger if, after the merger, the newly merged retail market "is likely to result" in a market that will "prevent" customers from obtaining the benefits of a workably competitive retail electric market. Direct Energy's testimony sought to be excluded consistently discusses the Joint Applicants' discriminatory and anticompetitive conduct – in the form of an anticompetitive and discriminatory default service

structure – and shows how it is likely to result in a post-merger market that will deny a workable competitive market, thus requiring the merger's rejection.

In addition, however, even if the Commission were to accept the Joint Applicants' narrow view that the only anticompetitive and discriminatory conduct that can be considered relevant is conduct that will only take place if the merger goes forward, Direct Energy's most recent testimony alleges just that: if the merger is authorized, a change in the existing conduct of the merged companies' retail markets is likely to occur. Direct Energy's most recent testimony also shows how the changes in the existing default service structure it is proposing will help to lessen the likely competitive harm as a result of these actions.[1] Thus, Direct Energy's testimony meets even the Joint Applicants' unreasonably narrow interpretation of the statutory merger standards.

The fact that Direct Energy's testimony points to flaws in the retail electricity markets in the FE and Allegheny service territories that may also exist in other service territories does not make the testimony irrelevant or not related to the merger. Contrary to the Joint Applicants' repeated suggestions, all of Direct Energy's testimony is carefully structured to show that the Joint Applicants will not satisfy the dual, workably competitive market/affirmative benefit merger standards made relevant here by the Joint Applicants' voluntary decision to seek to merge. The existence of similar market structures in other EDC territories is not relevant because those service territories have not been reviewed in the context of a proposed merger of two neighboring Pennsylvania EDCs.

Nor is it relevant that Direct Energy's testimony may not follow precisely PUC regulations on default service procurement or changing the default service provider. First, Direct

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[1] This testimony is claimed by the Joint Applicants to be highly confidential and the substantive portions of this discussion are only reflected in a non-public version of this Answer.

Energy's plan is consistent with those rules (and or relevant statutory provisions) regarding default service. But, to the extent they diverge from the PUC's regulations, Direct Energy's testimony has been presented as a condition that should be imposed IF the merger is to be approved by the Commission. Certainly the PUC is not limited to following its non-merger rules and regulations when it imposes conditions that, in its view, are required to render the merger in the public interest and to alleviate competitive concerns. The PUC frequently has adopted merger conditions or requirements that direct the applicants to revise aspects of their rates, service or operations that have been previously approved by the Commission if they wish merger approval. The Joint Applicants' legal position would essentially reduce the PUC to either denying or approving a merger and limit severely its ability to condition it upon the applicants agreeing to take steps to benefit their customers or competition and render the merger in the public interest.

For the same reason, testimony that proposes, as a condition of the merger, that the Joint Applicants agree to create a separate billing subsidiary (essentially a structural version of the unbundling that the PUC has ordered in many other instances) in order to ameliorate the competitive concerns created by the proposed combination is plainly within the PUC's authority.

But in any event, a debate about the legal appropriateness of this part of Direct Energy's proposal should not be decided before the record in this case is even initiated. Indeed, it would be extremely inappropriate to limit testimony on this and all of the other points challenged by the Joint Applicants without the benefit of full briefing and the development of a full record. It is irrational and contrary to the public interest to limit the PUC's ability to at least consider these proposals at the time that it considers the propriety of the merger in general. The Joint Applicants and several other parties have fully responded to Direct Energy's proposals in their

rebuttal testimony.[2] No one will be prejudiced by permitting the record to be fully developed and to defer to the final decision resolution of the legal issues that are at the heart of the Joint Applicants' demand for testimony exclusion.

However, if the ALJs do decide to limit (in whole or in part) any portion of Direct Energy's testimony, Direct Energy respectfully reiterates its request that the ALJs stay the hearing schedule to permit Direct Energy to lodge an interlocutory appeal to the full Commission. Absent a stay, Direct Energy will be severely prejudiced in its ability to fully develop the record that its proposals are necessary and proper in order to make the merger consistent with the Public Utility Code.

II. ANSWER TO MOTION *IN LIMINE*

A. A Motion in Limine is an Inappropriate Device to Restrict The Type of Evidence at Issue Here

The Joint Applicants' Motion *in Limine* is procedurally improper at this phase of the proceeding. The Commission has held that a motion *in Limine* is an "inappropriate device for narrowing evidence to be presented in a proceeding."[3] The proper procedure to challenge the introduction of testimony in such a proceeding is a motion to strike.[4] But further, the clear implication of the Commission's call for a full and complete record is that a motion to strike is only appropriate where the issues are already defined and it is reasonably clear what evidence is

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2 See Joint Applicants St. 4-R; Joint Applicants St. 9-R; Joint Applicants St. 10-R; OSBA St. 3; OCA St. 1-R; and OCA St. 2-R.

3 *Application of Apollo Gas Company*, 1991 Pa. P.U.C. LEXIS 61 at *3 (1991), citing *In re Duquesne Light Company*, 57 Pa. P.U.C. 313 (1983).

4 *In re Duquesne Light Company*, 57 Pa. P.U.C. 313 at *6 (1983).

or is not germane to those issues.[5] However, the motion to strike (or a pre trial motion *in limine)* is not an issue-narrowing tool, as Joint Applicants have attempted to use it.

The Commission has explained that a motion *in Limine* is traditionally used to prevent prejudice that may occur if certain evidence is presented before a jury.[6] In an administrative proceeding, "prejudicing the trier of fact by the mere offering of the evidence is remote."[7] Furthermore, the elimination of all evidence prior to its being considered is improper when the trier of fact is capable of considering the relevance and materiality of each portion of the evidence.[8]

In the *PECO Energy*[9] merger proceedings case, the Commission explained that a motion *in Limine* would "prejudge the relevance and materiality [of evidence] . . . in future proceedings before the factual scenario and substantive issues are known and before the parties in interest have had the opportunity to present their arguments. Not only is this contrary to sound administrative and evidentiary principles, but it denies due process of law to parties in future proceedings."[10] The Commission concluded that the "exclusion of evidence prior to a determination of the relevance and materiality of evidence for *any purpose whatsoever*, is overly broad."[11] The same is true in this case.

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5 *Id.*, at 6-10.

6 *See In re Duquesne Light Company*, 57 Pa. P.U.C. 313 at *10 (1983).

7 *Id.*

8 *Id.*

9 *In re PECO Energy*, Docket No. A-00110550F0147 (June 22, 2000) (2000 WL 33963140).

10 *Id.*

11 *Id.* (emphasis in original).

Indeed, in this proceeding the Commission has signaled its interest in the development of a full and complete record in its submission of a series of questions that it directed be developed on the record.[12] Indeed, one of the questions specifically requests the parties to "[i]nvestigate the impact the proposed merger may have on the potential for anticompetitive behavior per 66 Pa. C.S. § 2811(e)(1) [and] [h]ow will the merger affect wholesale and retail competition for power/electric generation and transmission."[13] This is precisely what Direct Energy has done.

Thus granting this Motion would clearly be contrary to the Commission's interest in this proceeding as well as the public interest. The better and required course is to permit the full development of the record so that the legal points raised by the Joint Applicants in its Motion (as well as those raised by Direct below) may be properly considered by the presiding officers, and then the full Commission with the benefit of a full record.

B. Testimony Sought to be Excluded Is Specifically Related to the Statutory Merger Standards

The Joint Applicants' claim that Direct Energy's testimony on restructuring the default service rules in the Joint Applicants' service territory should be excluded because it is not related to the merger and because, the Joint Applicants claim, that the proposal "is not aimed at preserving existing market conditions." The Joint Applicants insist that Section 2811(e) requires some alleged specific "affirmative action" that would not occur absent the merger, before testimony about particular anti-competitive and discriminatory conduct is legally relevant. But the Joint Applicants are wrong both in their characterization of the basis for Direct Energy's claims as well as their claim about what the statute requires.

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12 *See* Secretarial Letter of June 3, 2010 at Docket Nos. A-2010-2176520 and A-2010-2176732.

13 *Id.* at question 11.

In addition to proposing that Joint Applicants divest a portion of their combined generation fleet to mitigate wholesale market power (which Joint Applicants have not objected to in their Motion *in Limine*), Direct Energy proposes the following conditions with respect to retail competition. As a condition of the merger, Direct Energy proposes that the Commission create a competitive market structure for Joint Applicants' combined service territories to replace the existing monopoly default service provider structure.[14] The Joint Applicants' electric distribution company ("EDC") affiliates would no longer be the default service providers ("DSP"). Instead, customers currently taking default service from the EDS would be assigned to competitive electric generation suppliers ("EGS") unless the customer opted out of the process and thereby elected to remain on default service. This assignment would be made on the basis of winning bids in an auction, with the auction proceeds (which could be as, much as $500 per customer) would be provided to customers. Additionally, Direct Energy proposes that the billing function be transferred to an entity that is affiliated with the EDC, which would then provide billing services to participating EGSs (as well as to the EDC).

Initially, it should be noted that Direct Energy's proposals have been presented not only in response to the merger requirements set forth in both Section 2811(e) but to Section 1102 as well. It is well-established that the merger may not be approved unless it is demonstrated that a proposed merger will affirmatively benefit the public and specifically will "affirmatively promote the 'service, accommodation, convenience or safety of the public' in some substantial way."[15] The Supreme Court of Pennsylvania has stated that "competitive impact is a substantial

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14 *See Direct Energy St. 2 at 2.*

15 *City of York v. Pennsylvania Public Utility Commission*, 449 Pa. 136, 141,295 A.2d 825, 282 (1973).

component of a rational net public benefits evaluation in the merger context."[16] Thus, it is well-established that the Commission must consider the competitive effect on existing and potential competition of a merger in assessing the affirmative public benefits of the transaction.[17] Just as the Commission may impose terms and conditions designed to promote competition in retail markets pursuant to Section 2811(e), the Commission may impose pro-competitive terms and conditions under Section 1102.[18]

Direct Energy's witnesses have testified that implementing Direct Energy's proposals will result in a more competitive retail electricity market, with attendant benefits to consumers. Thus, Direct Energy's testimony is irrefutably relevant from the standpoint of considering whether the merger satisfies the "affirmative public benefit[19] test. Dr. Morey specifically cited the "affirmative benefit" standard in his testimony as one of the legal bases on which his recommendations to revise the default service structure in FE's service was based.[20]

In this respect, Direct Energy's testimony is not unlike the recommendations of most of the other parties to the proceeding, suggesting that, as a condition of approval, the PUC should order the Joint Applicants' to agree to a variety of modifications to their rates, service and

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16 *Popowsky v. Pennsylvania Public Utility Commission*, 937 A.2d 1040, 1056 (2007).

17 *See, e.g., Joint Application of Commonwealth Telephone, CTSI, LLC and CT Telecom, LLC*, Docket No. A-310800F0010, et al. (Order entered February 8, 2007); *Joint Application of Verizon Communications, Inc. and MCI, Inc. For Approval of Agreement and Plan of Merger*, Docket No. A-310580F0009, et al. (Order entered January 11,2006).

18 *See* Exhibit A hereto.

19 *Popowsky, supra.*

20 Direct Energy St. 1 at 7-8.

operations in order to produce the required affirmative public benefit.[21] At a minimum, Direct Energy's testimony at issue is relevant on this ground and cannot properly be excluded.

In addition, Mr. Morey's testimony concludes that, due in large respect to the way in which default service will be priced and structured in the post-merger environment, the post-merger residential and small business markets will not be competitive, with the majority of customers being served by default service and competitors not being able to achieve the economies of scale and scope to offer products that will overcome the regulatory rules and "status quo bias" that keeps most customers on default service. Thus, the merger "fails to promote the benefits of a properly functioning and workable competitive retail electricity market to residential and small business customers."[22] In this regard, Direct Energy's proposal to condition the merger approval on a restructuring of the default service/retail market is specifically designed to supply terms and conditions that would permit the Commission to approve the merger pursuant to Section 2811(e), *i.e.*, that the post-merger retail market will be properly functioning and workable.

The Joint Applicants' are simply incorrect in their assertion that Section 2811(e) only covers anticompetitive or discriminatory conduct that will occur only if the merger occurs.[23] The statutory language plainly states that, in considering any electric public utility merger the

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21 *See* discussion at n. 22, *infra.*

22 *Id.* at 8, 9-19. The first question in this portion of Dr. Morey's testimony is "Why does the merger result in anticompetitive or discriminatory conduct which prevents customers from obtaining the benefits of a properly functioning, workable competitive retail electricity market?" Direct Energy St. 1 at 9. *See, e.g.*, Direct Energy St. 2 (Brownell) at 5 (explaining why Direct Energy's proposal to condition merger approval *inter alia* on "having FE's EDCs 'exit' the merger function);" Direct Energy's St. 3 (Lacey) at 3 (explaining Direct Energy's market restructuring proposal in light of the testimony of "Direct Energy witness Dr. Morey [who] has demonstrated that to meet the standard for approval of a merger, any approval of the merger should be on condition that FirstEnergy agree to modify its post-merger market structure by removing FirstEnergy and its affiliates from the default service function in Pennsylvania."

23 Motion *in Limine* at 6-8.

Commission must examine whether the proposed combination "is likely to result in [not "cause"] anticompetitive or discriminatory conduct including the unlawful exercise of market power, which will prevent customers ... from obtaining the benefits of a properly functioning and workable competitive market."[24] Thus, the statute simply does not say that it is limited to new conduct that occurs as a result of the merger. It merely requires that the anticompetitive or discriminatory conduct will occur after the merger – regardless of whether or not it existed prior to the combination.[25]

Here, Direct Energy's witnesses have testified that the way in which default service procurements will be conducted after the merger is highly discriminatory in favor of a majority of customers staying on default service, which will, in turn, prevent the development of a properly functioning and workable competitive market."[26] Thus, Direct Energy's testimony specifically and repeatedly addresses this statutory merger standard.[27]

However, even if one were to conclude that Section 2811(e) only applies to new conduct that will only occur but for the merger, Direct Energy has presented additional, supplemental

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24 66 Pa. C.S. § 2811(e)(1).

25 Joint Applicants err in reading Section 2811(e) as only allowing the Commission to impose competitive conditions that preserve the status quo. Joint Applicants completely disregard the fact that Section 2811(e)(1) requires the Commission to consider whether the proposed merger will "prevent retail electricity customers . . . from obtaining the benefits of a properly functioning and workable competitive retail electricity market." This provision cannot reasonably be said to be limited to preservation of status quo suboptimal competition, as it focuses on whether the merger will in any way "prevent" competition. Moreover, Joint Applicants' assertion that the word "preserve" in Section 2811(e)(2) constrains the Commission's ability to exercise its separate grant of authority under that paragraph is equally misguided. One definition of "preserve" is "to keep safe from injury, harm, or destruction: protect." (Merriam-Webster Online Dictionary, www.merriam-webster.com/netdict/preserve). Thus, this language reasonably must be interpreted to require the Commission to take action to "protect" the benefits of a workably competitive market if the post-merger conditions would make it likely that a competitive market is not going to develop. That is just what Direct Energy's proposals aim to do.

26 Direct Energy St. 1, at 2-10, 18-22, 32-43; Direct Energy St. 2 at 6-8, 12-17, 19; Direct Energy St. 3 at 3-4, 18-20.

27 *Id.*

evidence that shows just that. In the Supplemental testimony of Direct Energy's witness Morey, he explained that **BEGIN HIGHLY PROPRIETARY**

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[30] **END HIGHLY PROPRIETARY**

Allegheny's CEO has proclaimed that the merger would create a combined company in Pennsylvania that would be able to be "dominant" in the post-merger environment.[31] Certainly, Direct Energy has a right to present testimony on the likelihood that such conduct will prevent the development of a properly functioning and workable competitive market and to suggest remedies to mitigate the adverse effects of such conduct on competition.

The Joint Applicants may disagree with Dr. Morey's supplemental testimony, but there can be no doubt that such testimony alleges that, as a result of the merger, anticompetitive and

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[28] Direct Energy St. 1-Supp. at 2-7.

[29] Direct Energy St. 1-Supp. at 3.

[30] Direct Energy St. 1 Supp. at 3.

[31] *Energy Choice Matters* Sept. 16, 2010, p. 1.

discriminatory conduct will occur such that retail customers will be prevented from obtaining the benefits of a competitive market. Dr. Morey's proposal to revise the existing default service structure is designed to remedy those effects and to "preserve the benefits of a workable competitive market."

It should be plain therefore, that the testimony sought to be excluded by the Joint Applicants does not merely reflect some "generic proposal," but is related directly to the statutory standards that the Commission must apply to judge whether this merger legally may be approved. The Joint Applicants' Motion is plainly without merit and must be denied.

C. Joint Applicants' Claim That Direct Energy's Testimony Involving Default Service Modifications Is Barred Because It Conflicts With The PUC's Existing Default Service Rules and Orders Is Not A Proper Basis to Exclude Testimony

The Joint Applicants' second tact for trying to exclude Direct Energy's testimony from the case is to claim that Direct Energy did not follow (and its proposal allegedly does not comply with) the existing default service procurement rules, including the PUC rule dealing with replacing the existing EDC as the default service provider, and that Direct Energy's testimony represents an improper collateral attack on the Commission's previous default service plan rulings.[32]

First, the Joint Applicants do not even bother to explain how this claim might properly make Direct Energy's testimony excludable via a motion *in limine*. At most, this assertion is a legal defense that might be asserted as part of the Joint Applicants' legal presentation in their briefs.

More to the point, the Joint Applicants argument rests on the obviously specious tactic of pretending that Direct Energy's testimony is completely removed from the issues to be decided

[32] Motion *in Limine* at 8-10.

by the merger. Indeed, the Joint Applicants repeatedly mischaracterize Direct Energy's testimony as a stand-alone proposal when in fact in every instance Direct Energy's witnesses stated that the default service modifications offered were being considered in the context of the merger standards, and as remedies for the Joint Applicants' failures to satisfy those standards.[33] In each instance, Direct Energy's witness explained that they were recommending that the Commission order these modifications as conditions of merger approval, not as separate independent steps.[34] If the Commission accepts Direct Energy's recommendations, the Joint Applicants would be required to implement these steps only if they wished the merger to be approved by the PUC. Thus, it would have been wholly inappropriate in this instance for Direct Energy to have filed a "petition" to be the default service provider in FE's service territory as part of or in parallel to this docket – because Direct Energy's proposals are specifically tied to the Joint Applicants' proposal of a merger that is fundamentally anticompetitive and discriminatory, and bereft of affirmative benefits for any group other than FE shareholders.

Similarly, the Joint Applicants' implicit claim that merger conditions may not alter existing PUC rules and regulations is wholly specious. First, the Joint Applicants mischaracterize (once again) Direct's testimony. Direct Energy's proposals, in material respects are consistent with the PUC's regulations. For example, Direct Energy's witnesses argue that, as a merger condition, the Joint Applicants should be asked to agree to a subsequent process in

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33 *See, e.g.,* Direct Energy St. 1 at 2 (The "imposition of these conditions will provide affirmative benefits to the customers in the post-merger service territory, and especially to residential and small business customers, that the merger alone will not provide, and without which the merger fails to meet the standard for approval by the Commission."); Direct Energy St. 2 at 13 ("It is important, in my view, to condition merger approval not only on requiring FE to exit the merchant function but also on the implementation of other remedies being recommended by the Direct witnesses, such as requiring FE to divest a certain portion of its generating fleet and strengthening the rules governing FE's competitive operations and its relationship to its EDC."); Direct Energy St. 3, at 13 ("In order to alleviate this condition and allow the merger to proceed the Commission should order an alternative Default Service Provider ("DSP") across the FE/ AP footprint as a condition of merger approval.").

34 *Id.*

which a non-FE affiliated default service provider is selected. That process could, and likely would incorporate the terms and conditions for such selection as set forth in the PUC's regulations.[35] Similarly, the recommendation that the reassigned default service be priced on the basis of quarterly changing, monthly average spot market prices is well within the existing regulatory and statutory framework.[36]

Even if Direct Energy's proposal ultimately requires the Commission to waive its regulations, the Joint Applicants cite no PUC orders or court decisions to support their claim that the PUC is limited in the types of conditions it imposes to those that are consistent with its existing regulations. The Joint Applicants certainly have not made similar claims regarding the plethora of other testimony that proposes a host of modifications and enhancements to the Joint Applicants' existing rates,[37] service,[38] the existing default service procurement plan,[39] as well as many other things.[40]

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[35] Note that the Joint Applicants' are wrong in their bold assertion that the PUC regulations permit a replacement default service provider only if the existing EDC default service provider is found to be incapable of providing the service in a reasonable way. In fact, the regulations say nothing of the sort. While the regulation indicates that the process should include an "evaluation" of the existing provider (52 Pa Code § 54.183(c)), there is no requirement that the EDC must be found deficient. Moreover, according to the regulation, the obligation may be reassigned when the Commission finds the reassignment to be "necessary for the accommodation, safety and convenience of the public." *Id.* Certainly, this language is broad enough to permit reassignment if the Commission found it necessary to enhance the chance that a workably competitive market will develop.

[36] For example, while Act 129 requires that default service be provided from a "prudent mix" of short, long and spot market contracts (66 Pa. C.S. § 2807(e)(3.2)) the Commission has already found that default service for a particular class, or for all default service customers may consist solely of spot market purchases and still satisfy and be a "prudent mix." *See, Petition of Pike County Power and Light for Expedited Approval of its Default Service Implementation Plan*, Docket No. P-2008-2044561, (Opinion and Order entered March 23, 2009).

[37] *See* OCA St. 1 at 3, 20-21 (rates should "be reduced by $27 million on an annual basis, and that these reduced rates be held at this level for three years"); Penn State St. 1 at 14-15 (an across-the-board reduction in their distribution rates in an amount equal to the 17 estimated potential net savings identified by Joint Applicants).

[38] *See, e.g.,* OTS St 1, pp. 6-16 (relating to changes to customer service and reliability standards); OSBA St. 1 at 33-34 (relating to changes to customer service and reliability standards); OCA St. 2 at 4-5, 25- 30 (Section IV, relating to service quality performance standards).

[39] *See, e.g.,* OSBA St. 1 at 22-23 (harmonization of the procurement methodologies used by FirstEnergy and Allegheny would require some major changes); DEP St. 3 at 2-5 (relating to the procurement of energy under

Moreover, as that attached Appendix shows, the PUC has regularly and frequently approved mergers in which changes to existing rates, service standards and competitive supply rules have been approved.[41] While several of these were the products of settlement, some were not; in all events, the condition being ordered had to be within the Commission's legal authority. Of course, the Commission always has the authority to waive its own rules and policy statements when it has a justification to do so.[42] Such justification clearly exists here.

Adoption of FE's legal position would virtually eliminate the Commission's ability to order merger conditions, since most all relevant conditions affect some aspect of the utility's operation that has previously been reviewed and or approved by the PUC. The Commission thus would essentially be reduced to either denying or approving a merger and limit severely its ability to condition approval upon the applicants agreeing to take steps to benefit their customers or competition and render the merger in the public interest. This argument would be very bad policy and is inconsistent with the Commission's plain statutory authority set forth in Section 1103(a), specifically authorizing the Commission to condition merger approval.

The argument is without merit and should be rejected.

Alternative Energy Portfolio Act using long-term contracts); CAC St. 1 at 13-15 (relating to the procurement of Tier I from new wind generation under Alternative Energy Portfolio Act); PennFuture St. 2 at 6-9 (relating to the procurement of energy under Alternative Energy Portfolio Act using long-term contracts).

40 *See, e.g.,* OCA St. 2 at 6, 34-35 (Section VI, relating to universal service plans); PennFuture St. 1 at 4-12 (relating to financing of existing energy efficiency programs); CAC St. 1 at 9-13 (relating to improving or expanding LIURP); DEP St. 3 at 5-6 (relating to smart meter plans).

41 Exhibit A hereto.

42 It is well settled that an administrative agency, such as the PUC, has the discretionary power to waive its own rules and regulations or excuse noncompliance. See, *e.g., Pennsylvania Public Utility Commission v. Pike County Light & Power Company*, Docket No. P-00062205, Opinion and Order entered June 28, 2006 at 7-13; *Keys v. Unemployment Compensation Board of Review*, 183 Pa. Super. 164, 1957 Pa. Super. LEXIS 326 (1957); *Associacion De Puertorriquenos En Marcha, Inc. v. Department of Health*, 931 A.2d 752 (Pa.Cmwlth. 2007).

D. Direct Energy's Support of the November 2009 DSP Settlement is not Inconsistent with its Position Here

Joint Applicants shamelessly invoke Direct Energy's participation in the Joint Applicants' Pennsylvania utilities' DSP proceedings to characterize Direct Energy's testimony in this case as a "collateral attack on the Commission's final orders in those proceedings . . ." and the related settlements. However, Joint Applicants fail to make any rationale case for this absurd allegation. As Joint Applicants note, "The DSP programs of Met-Ed and Penelec were approved in November 2009;" and that "West Penn's DSP program was approved . . . in 2008 . . . ."[43] Of course, Joint Applicants fail to mention that the proposed merger was not announced until February 2010, which makes it impossible that Direct Energy would have raised the issues it raises in this proceeding at the time those Joint Applicants' utilities' DSP programs were litigated. Further, Joint Applicants note that Penn Power's DSP program was resolved in a settlement filed on July 23, 2010.

It seems highly likely that, to the extent Direct Energy raised potential merger conditions in the Penn Power DSP proceedings, FE would have cried bloody murder and insisted that these issues were not germane and designed to hold up the DSP proceeding. In any case, Joint Applicants ignore the possibility that their merger may not be consummated. In that case, the existing DSP orders will stand, demonstrating the procedural propriety of not having raised potential merger conditions in even the Penn Power proceeding.[44]

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[43] Motion *in Limine*, at 10.

[44] It is also useful to note that Direct Energy specifically indicated that its proposed retail market modifications should only be implemented after the FE and Allegheny existing default service plans are terminated. See, Direct Energy St. 3 at 6.

It should be noted that the Joint Applicants claim that synergies will result from the proposed merger.[45] In other words, they claim that the post-merger "whole" is greater than the sum of the pre-merger "parts." But, the Joint Applicants contend that Commission's prior orders on the parts (*e.g.*, pre-merger DSP plans) precludes a fresh look by Direct Energy at the consolidated whole (*e.g.*, post-merger DSP plans). This is an absurd result because program modifications are inevitable in the case of company mergers. This is especially true for a merger that will serve some 2 million Pennsylvania customers, more than 35% of the Commonwealth's total customer count, while encompassing 70% of the state on a geographic basis.

E. Direct Testimony on Structurally Unbundling FE's Billing Function is Not Properly Excluded

Joint Applicants' assertion that the Commission lacks the authority to implement Direct Energy's proposal with respect to the billing function is merely a smoke screen. First, these contentions, to the extent they are relevant at all, are simply not a basis for excluding evidence. If the Joint Applicants wish to claim that the Commission may not condition the merger on acceptance of this part of Direct Energy's proposal they are free to do so in their briefs. But their assertion of legal insufficiency is not a basis for exclusion at this point.

On the substance of the claim, the Joint Applicants argue that the proposal "could not be implemented unless an EDC agreed to divest its billing function and voluntarily filed an application for a certificate of public convenience to obtain Commission approval of the divestiture."[46] This argument ignores the fact that all merger conditions imposed by the Commission are implemented only with the consent of the applicants. To the extent a subsequent certificate of public convenience application was required to implement the Billco

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45 See, e.g., Joint Applicants St. 2; Joint Applicants St. 5; Joint Applicants St. 11-R.

46 Motion *In Limine* at 12.

proposal pursuant to a Commission order approving the merger in this proceeding, Joint Applicants would be free to either agree to make that filing, or forego the merger transaction. Moreover, Joint Applicants ignore the fact that the Commission has imposed all manner of divestiture requirements on merger applicants in the past, including for example, the divestiture of generating facilities[47] and telecommunications assets,[48] without running afoul of Chapter 11.

Joint Applicants make the conclusory and self-serving statement that the billing function is inextricably intertwined with the distribution function, such that Section 2802(16) precludes the Commission from making an "involuntary re-assignment of EDCs' public service obligation to furnish bills for distribution service."[49] Section 2802(16) does contain a statement indicating that, "It is in the public interest for the transmission and distribution of electricity to continue to be regulated as a natural monopoly subject to the jurisdiction and active supervision of the commission."[50] However, Joint Applicants fail to even attempt to explain how extricating the billing function from the other EDC functions is inconsistent with this provision. Moreover, Direct Energy's proposal does not in any way suggest that billing and collection for regulated services would not continue to be regulated as a public utility. A regulated utility is free to contract with affiliates to provide billing (or other) services, assuming of course that the affiliate adheres to all applicable Commission rules and regulations. In any event, the legal and policy

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47 *Re: DQE, Inc.*, 1998 Pa. P.U.C. LEXIS 48; 186 P.U.R.4th 39 (April 30, 1998) (finding that the Commission may utilize divestiture - and other structural remedies - whenever it deems appropriate pursuant to its authority under Section 2811 of the Electric Competition Act).

48 Divestiture is a remedy which has its basis in express and implied provisions of the Public Utility Code. See, generally Joint Application of SBC Communications, Inc., and AT&T Corp., 2005 Pa. PUC LEXIS 37 (Order entered October 6, 2005); *Bell v. Pa.PUC, also Re: Structural Separation of Bell Atlantic-Pennsylvania, Inc. Retail and Wholesale Operations*, Docket No. M-00001353 (Order entered April 11, 2001).

49 Motion *In Limine* at 11.

50 66 Pa. C.S. § 2803(16).

implications of this part of Direct Energy's remedy proposal are more properly resolved after a full record is developed.

F. Denying Joint Applicants' Motion *in Limine* will not Unfairly Prejudice any Party, Including the Joint Applicants, and will Prevent Direct Energy from Being Prejudiced

In its Motion to Suspend, Direct Energy explained the need to suspend the schedule to permit the Motion *in Limine* to be fully resolved prior to the hearings in this proceeding and how this issue has arisen completely because of Joint Applicants' decision to employ this fairly unusual procedural device almost one month after it first received Direct Energy's testimony in the case. Thus, any delay in the resolution of the Joint Applicants' merger approval application is entirely of Joint Applicants' own doing.

With respect to Your Honors' decision on the Joint Applicants' Motion *in Limine*, granting Joint Applicants' motion will result in Direct Energy being prejudiced because it will be effectively barred from pursuing its legitimate objective of seeking to convince the Commission that the reasonable pro-competitive conditions it proposes are necessary in order that the Commission approve this merger under the relevant statutory standards. Joint Applicants' proposal that Direct Energy is free to pursue its objectives under Section 54.183(c) does not provide Direct Energy the process it is due as a party in the instant proceeding.

In contrast, denying the Motion *in Limine* will fully preserve Joint Applicants' due process rights. Joint Applicants will have the opportunity to file surrebuttal testimony and cross examine Direct Energy witnesses at hearing. Most pertinently, Joint Applicants will retain the right to make their tortured statutory arguments in the post-hearing briefs, where they ostensibly belong. Subsequent to briefing, the Commission will properly come to its legal conclusions and, to the extent those conclusions include a determination that the Commission has the authority to

impose the merger conditions Direct Energy proposes, the Commission will go on to consider the weight of each parties' testimony in that regard in the normal course.

II. CONCLUSION

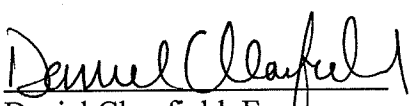
For the reasons set forth above, Direct Energy submits that the Motion *in Limine* should be disposed of as procedurally improper. In the alternative, Direct Energy submits that the relief it requests in the form of pro-competitive merger conditions is fully within the power of the Commission to order; that therefore Direct Energy's testimony is highly relevant to the subject matter of this proceeding; and that the Motion *in Limine* should be denied on the merits, with prejudice.

WHEREFORE, Direct Energy requests that Your Honors and the Pennsylvania Public Utility Commission:

(1) deny the Motion *in Limine*;

(2) grant any other relief deemed appropriate.

Respectfully submitted,



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Dated: September 23, 2010

Exhibit A
Examples of Terms and Conditions imposed in prior Transactions

- *Joint Application for Approval of the Transfer of the Issued and Outstanding Share of Capital Stock of the Peoples Natural Gas Company, d/b/a Dominion Peoples, currently owned by Dominion Resources, Inc., the Peoples Hope Gas Companies, LLC, and to Approve the Resulting Change in Control of The Peoples Natural Gas Company, d/b/a Dominion Peoples; Petition for Interlocutory Review, Answer to Material Question and Certification of the Record*, Docket No. A-2008-2063737, Ordered entered November 19, 2009, at 14, 16-20, 22-26.

    - Section 1308 rate issues – (1) exclusion of acquisition premium from rate base; (2) no deferral or rate case claim for "Transaction and Transition" costs and related tax effects; (3) distribution rate credit to customers; (4) cap on existing base rates; (5) exclusion from base rates of costs for certain non-regulated capital projects; (6) limitations on capital structure for ratemaking purposes; (7) limitation on dividend payment to affiliate; (8) corporate cost allocations; (9) shareholder contributions to Hardship Fund; and (10) ratemaking treatment of deferred taxes.

    - Customer Services issues (Sections 523, 526, 1301, 1308 and 1501) – (1) establishment of specific quality of service metrics; (2) establishment of procedure to choose vendor for customer service arrangements; and (3) reporting requirements regarding service quality metrics.

    - Universal Service issues (Sections 523, 526, 1301, 1307, 1308 and 1501) – increased LIURP funding.

    - Section 1307(f) rate issues – (1) designation of personnel and processes concerning provision of gas purchasing and supply arrangements; and (2) directive concerning investigation and review of measures to reduce lost and unaccounted for gas (LUFG) and required reporting.

    - Retail Competition issues (Section 2210) – collaborative to develop strategy to promote retail natural gas supply completion.

- *Joint Application of UGI Utilities, Inc. and PPL Gas Utilities Corporation for a Certificate or Certificates of Public Convenience approving the transfer by sale of 100% of the issued and outstanding stock of PPL Gas Utilities Corporation to UGI Utilities, Inc.*, Docket Nos. A-2008-2034045, A-2008-2034047, G-2008-2034115, G-2008-2034132, Order entered August 21, 2008, at 11-13, 23-25.

    - Section 1308 rate issues – (1) limitation on general rate increase filing; (2) prohibition on flowing pension plan overfunding to shareholders; (3) exclusion of acquisition premium and transaction costs and related tax effects from base rates; (4) ratemaking treatment of deferred taxes; (5) annual base rate credit; (6) limitation on recovery of increased LIURP funding; and (7) collective bargaining agreement matters.

- Service Quality issues (Sections 523, 526, 1301, 1308 and 1501) – (1) additional requirements for service quality reporting; and (2) commitment to establish service quality performance goals.

- Universal Service issues (Sections 523, 526, 1301, 1307, 1308 and 1501) – (1) increased funding for LIURP; and (2) commitment to collaborative concerning CAP changes.

- Retail Competition issues (Section 2210) – collaborative to address "best practices," with specific timelines and directive to address balancing and other tariff issues.

- *Joint Application of Equitable Resources, Inc., and The Peoples Natural Gas Company, d/b/a Dominion Peoples, for approval of the transfer of all stock and right of The Peoples Natural Gas Company to Equitable Resources, Inc., and for the approval of the transfer of all stock of Hope Gas, Inc., dba Dominion Hope, to Equitable Resources, Inc.*, Docket No. A-122250F5000, Order entered April 13, 2007, at 19, 22, 35-46, 73-81.

  - Section 1308 rate issues – (1) exclusion of acquisition premium and transaction costs and related tax effects from base rates; (2) no deferral of acquisition expenses and capital costs for future recovery; (3) modification and termination of tariffed "agency service"; and (4) uniform gathering rates.

  - Customer Service issues (Sections 523, 526, 1301, 1308 and 1501) – (1) establishment of specific quality of service metrics; (2) additional reporting requirements regarding service quality metrics; and (3) duration of new service quality performance standards.

  - Universal Service issues (Sections 523, 526, 1301, 1307, 1308 and 1501) – (1) increased funding for community organizations and Hardship Fund; (2) removal of barriers to CAP enrollment; and (3) collaborative to assist Equitable's development of future plans for low-income and energy conservation programs.

  - Gas Safety issues (Sections 1301, 1307(f), 1317, 1318 and 1501) – require use of specific measures and personnel to improve safety of pipelines.

  - Section 1307(f) rate issues – (1) elimination of interstate pipeline contracts to reduce annual PGC costs by $10 million; (2) combination of utilities' purchased gas costs function; and (3) adoption of different operational rules and practices.

  - Retail Competition issues (Section 2210) – (1) commitments for the merging utilities to (i) combine tariffs, (ii) file tariff provisions that promote competitive retail market development in "superior fashion" to merging utilities, (iii) use marketer/users group to develop competitive tariff revisions, and (iv) revise

electronic data interface system; and (2) specific measures to enhance production and use of Pennsylvania natural gas.

- *Application of Duquesne Light Company for a Certificate of Public Convenience under Section 1102(a)(3) of the Public Utility Code approving the acquisition of Duquesne Light Holding, Inc. by Merger*, Docket No. A-110150F0035, and *Application of DQE Communications Network Services, LLC, for a Certificate of Public Convenience under Section 1101(a)(3) of the Public Utility Code approving the acquisition of Duquesne Light Holding, Inc. by Merger*, Docket No. A-311233F0002, Order entered April 24, 2007 (adopting ALJ Initial Decision (ID) dated March 20, 2007); ALJ ID at 5-6, 8-9, 11-17.

    - Section 1308 rate issues – (1) exclusion of acquisition premium and transaction costs and related tax effects from future distribution and transmission rates; (2) limitation of claim for increase in cost of capital; (3) limitations on general distribution rate increase; and (4) limitation on capital structure for ratemaking purposes.

    - Customer Service issues (Sections 523, 526, 1301, 1308 and 1501) – establishment of specific quality of service metrics and additional reporting requirements.

    - Universal Service issues (Sections 523, 526, 1301, 1307, 1308 and 1501) – (1) collaborative to discuss increasing involvement of other organizations with respect to referrals for LIURP; (2) increase number of customers served by Smart Comfort program by stated amounts and stated time periods; (3) raise income eligibility %, expand outreach efforts and increase customers served by LIURP; and (4) no transfer of LIURP funds to other universal service programs.

    - Retail Competition issues (Section 2811) – (1) establishment of Economic Development Program for PA industrial employers; and (2) independent audit of costs/services provided to Duquesne's unregulated EGS affiliate.

- *Joint Application of Approval of the Merger of GPU, Inc. with FirstEnergy Corp.;* Docket Nos. A-110300F0095, A-110400F0040, Order adopted May 24, 2001, and entered June 20, 2001, at 26-38, 42-44, 52-55, 75-76; *ARIPPA v. Pa.P.U.C.*, 792 A.2d 636, 668-69 (Code of Conduct).

    - Section 1308 rate issues – (1) extension of distribution and transmission rate caps; (2) limitations on recovery of nuclear costs; and (3) ratemaking effects of transfer of pension funds.

    - Customer Service issues (Sections 523, 526, 1301, 1308 and 1501) – adoption of a Service Quality Index to improve reliability and customer service, including specific measurement criteria and reporting requirements.

    - Retail Competition issues (Section 2811) – application of GENCO Code of Conduct to FirstEnergy post-merger.

- *Application of PECO Energy Company, Pursuant to Chapters 11, 19, 21, 22 and 28 of the Public Utility Code, for Approval of (1) a Plan of Corporate Restructuring, Including the Creation of a Holding Company and (2) the Merger of the Newly Formed Holding Company and Unicom Corporation*, Docket No. A-110550F0147, Order entered June 22, 2000, at 8-11; *see also* Order adopted November 29, 2000 (CDS) and Order adopted September 26, 2001 (City of Philadelphia special contract).

    - Section 1308 rate issues – (1) distribution rate reductions for all customers; (2) extension of distribution rate cap; (3) limitations on recovery of nuclear costs; (4) implementation of changes to Rate RS through committee to establish standardized metering and billing practices; and (5) changes to reconciliation of CTC/ITC revenues.

    - Other tariff/rate issues – (1) modification of tariff provisions for certification and interconnection of generation facilities not exceeding 40 kW; (2) process for adopting technical standards, procedural and expense requirements for interconnection of generation facilities over 40 kW; (3) option for lump-sum buyout of Transition Charges for Amtrak; and (4) granting City of Philadelphia additional rights and options under its special contract.

    - Customer Service issues (Sections 523, 526, 1301, 1308 and 1501) – (1) establishment of additional specific quality benchmarks and performance measurement criteria; and (2) additional reporting requirements regarding service quality metrics.

    - Universal Service issues (Sections 523, 526, 1301, 1307, 1308 and 1501) – (1) increased funding to county fuel fund agencies; (2) creation of data warehouse; (3) process to determine whether "special needs" component should be added to CAP Rate programs; and (4) increased enrollment in Electric CAP.

    - Section 1307 rate issues – (1) establish level of incremental CAP Rate cost credits recoverable through Universal Service Fund Cost mechanism; (2) limitation on other costs recoverable through the USFC; and (3) approval of recovery of new "special needs" program costs through the USFC.

Retail Competition issues (Sections 2210 and 2811) – (1) provision of specified quantities of ICAP to EGSs; (2) improved procedures for release of customer historical billing data; (3) process for changing customer load profile; (4) limitation on marketing PLR service; (5) revisions to existing Competitive Default Service (CDS) auction process; and (6) new "Fresh Start" option for special contract customers to terminate contracts.