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PA PUBLIC UTILITY COMMISSION
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November 3, 2010

VIA FEDERAL EXPRESS

Rosemary Chiavetta, Secretary
Pennsylvania Public Utility Commission
Commonwealth Keystone Building
400 North Street
P.O. Box 3265
Harrisburg, PA 17120

Re: Joint Application of West Penn Power Company doing business as 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, A-2010-2176732

Dear Secretary Chiavetta:

Enclosed for filing are an original and nine copies of the **Initial Brief Of Joint Applicants West Penn Power Company, Trans-Allegheny Interstate Line Company, and FirstEnergy Corp.** in the above-captioned matter. A copy of the Brief in searchable PDF format is also enclosed. As evidenced by the attached Certificate of Service, a copy of the Brief is being served upon Administrative Law Judges Wayne L. Weismandel and Mary D. Long and all parties.

Pursuant to 52 Pa. Code § 1.11(2), the enclosed Brief shall be deemed filed on the date shown on the express delivery receipt attached to the delivery envelope.

Please date stamp the extra copy of the Brief and this letter which we have enclosed and return to us in the envelope provided.

Should you have any questions regarding this matter, please do not hesitate to contact me.

Sincerely,

Thomas P. Gadsden

TPG/ap
Enclosures

c: Per Certificate of Service

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November 3, 2010

VIA FEDERAL EXPRESS

Honorable Wayne L. Weismandel
Office of Administrative Law Judge
Pennsylvania Public Utility Commission
Commonwealth Keystone Building, 2nd Floor
400 North Street
Harrisburg, PA 17120

Honorable Mary D. Long
Office of Administrative Law Judge
Pennsylvania Public Utility Commission
Piatt Place, Room 220
301 Fifth Avenue
Pittsburgh, PA 15222

Re: Joint Application of West Penn Power Company doing business as 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, A-2010-2176732

Dear Judge Weismandel and Judge Long:

Enclosed please find copies of the **Initial Brief Of Joint Applicants West Penn Power Company, Trans-Allegheny Interstate Line Company And FirstEnergy Corp.**, in the above-referenced matter.

As indicated in the transmittal letter to Secretary Chiavetta and the accompanying Certificate of Service, which are also enclosed, the Brief has been filed with the Public Utility Commission and served on all parties. Separately, we are transmitting a copy of the Brief in Microsoft Word format to you by electronic mail.

Sincerely,

Thomas P. Gadsden

TPG/tp
Enclosures
cc: All parties of record

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**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

JOINT APPLICATION OF WEST PENN POWER COMPANY doing business as 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 A-2010-2176732**

INITIAL BRIEF OF JOINT APPLICANTS WEST PENN POWER COMPANY, TRANS-ALLEGHENY INTERSTATE LINE COMPANY AND FIRSTENERGY CORP.

**Before *Administrative* Law Judges
Wayne L. Weismandel And Mary D. Long**

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TABLE OF CONTENTS

Page

I. INTRODUCTION 1

A. Statement Of The Case 1

1. History Of Proceeding 1

2. Description Of The Transaction 4

3. Regulatory Approvals Sought 6

B. The Joint Petition For Partial Settlement 8

C. The Non-Settling Parties 9

II. STATEMENT OF THE QUESTIONS PRESENTED 9

III. OVERVIEW AND SUMMARY OF ARGUMENT 10

IV. LEGAL STANDARD 11

A. Section 1102(a) And The Commission's Statement Of Policy On "Change In Control" Transactions 11

B. Section 2811(e) 14

C. Section 2102(b) 15

V. THE JOINT APPLICANTS HAVE SATISFIED THE LEGAL STANDARD FOR COMMISSION APPROVAL OF THE PROPOSED CHANGE IN CONTROL OF WEST PENN AND TRAILCO 15

A. The Transaction, As Supplemented By The Joint Petition For Partial Settlement, Will Affirmatively Benefit The Public In Substantial Ways 15

B. The Transaction Will Not Result In Anticompetitive Or Discriminatory Conduct, Nor Prevent Customers From Obtaining The Benefits Of A Properly Functioning And Workable Competitive Retail Electricity Market 21

1. The Merger Does Not Raise Wholesale Market Power Concerns 21

2. The Merger Does Not Raise Retail Market Power Concerns 34

VI. THE NON-SETTLING PARTIES HAVE NOT PRESENTED ANY VALID REASON FOR THE COMMISSION TO EITHER WITHHOLD APPROVAL OF THE TRANSACTION OR TO ATTACH FURTHER CONDITIONS TO ITS APPROVAL 36

A. Direct Energy's Attempt To Dismantle Pennsylvania's Default Service Model Should Be Rejected 36

1. Overview Of The Direct Energy Plan 36

2. Direct Energy's Proposals Should Be Rejected As A Matter Of Law 37

TABLE OF CONTENTS
(continued)

Page

3. Direct Energy Has Failed To Demonstrate That Adoption Of Its Plan Is Either Necessary Or In The Public Interest 47

B. The Commission Should Not Attach To Its Approval Of The Merger The Additional Conditions Sought By The OSBA 59

C. The Commission Should Not Attach To Its Approval Of The Merger The Additional Conditions Sought By RESA 70

1. Default Service Procurement Issues 72

2. Retail Market Changes 73

3. Appointment of Cost Allocation Expert 75

4. Imposition of Alternative Code of Conduct 76

CONCLUSION 78

APPENDIX A: QUESTIONS POSED IN THE COMMISSION'S JUNE 3, 2010 SECRETARIAL LETTER WERE APPROPRIATELY ADDRESSED ON THE RECORD

APPENDIX B: JOINT APPLICANTS' PROPOSED FINDINGS OF FACT, CONCLUSIONS OF LAW AND ORDERING PARAGRAPHS

TABLE OF AUTHORITIES

Page(s)

COURT CASES

ARIPPA v. Pennsylvania Public Util. Comm'n,
792 A.2d 636 (2002) 22, 64, 65

Central Hudson Gas & Elec. Corp. v. Pub. Serv. Comm'n of New York,
447 U.S. 557 (1980) 46

City of Philadelphia v. Schweiker
579 Pa. 591 (2004) 61

Edenfield v. Fane,
507 U.S. 761 (1993) 46

Pa. P.U.C. v. General Waterworks Corp.
7 Pa. Cmwlth. 352, 300 A.2d 280 (1973) 11

Pennsylvania Human Relations Comm'n v. Norristown Area Sch. Dist.,
473 Pa. 334, 374 A.2d 671 (1977) 12

Popowsky v. Pa. P.U.C.,
594 Pa. 583, 937 A.2d 1040 (2007) 13, 14

York v. Pa. P.U.C.,
449 Pa. 136, 295 A.2d 825 (1972) 10, 12, 13, 14

ADMINISTRATIVE CASES

Application of MCI Airsignal of Pennsylvania, Inc.,
Docket No. A-330035 (July 15, 1986) 11

Application of Airsignal Int'l of Pittsburgh, Pennsylvania, Inc.,
Docket No. A-101365 (January 14, 1980) 11

Commonwealth Edison Co.,
91 F.E.R.C. ¶ 61,036 (2000) 26

Re Commonwealth Tel. Co., et al.,
Docket No. A-310800F0006, 1993 WL 855885 (October 22, 1993 11

Re: DQE, Inc.,
186 PUR4th 39 (1998) 22, 57

Joint Application of Paging Network of Pittsburgh, Inc. & Paging Network of Philadelphia, Inc.,
80 Pa. P.U.C. 562 (1993)....................11

Joint Application of PECO Energy Co. & Pub. Serv. Elec. & Gas Co for Approval of the Merger of Pub. Serv. Enter. Group, Inc. with and into Exelon Corp.,
248 PUR4th 1 (2005)....................22

Joint Application of SBC Communications, Inc. and AT&T Corp.,
Docket Nos. A-31163F0006, A-310213F0008 and A-310258F0005, 2005 Pa. PUC LEXIS 37 (October 6, 2005)....................22

Joint Petition Of Metropolitan Edison Co. & Pennsylvania Elec. Co. For Approval Of Their Default Service Plans,
Docket Nos. P-2009-2093053 and P-2009-2093054, 2009 WL 3778375 (November 6, 2009)....................41, 72

Petition of Dominion Retail, Inc. for an Order Declaring that Opt-Out Municipal Aggregation Programs Are Illegal for Home Rule and Other Municipalities in the Absence of Legislation Authorizing Such Programs (October 29, 2010)....................62

Petition of Pennsylvania Power Co. for Approval of Default Service Program for Period from January 1, 2011 through May 31, 2013,
Docket No. P-2010-2157862 (September 3, 2010)....................74

Petition of the Retail Energy Supply Association for Investigation and Issuance of Declaratory Order Regarding the Propriety of the Implementation of Municipal Electric Aggregation Programs Absent Statutory Authorization (October 28, 2010)....................62

Petition Of West Penn Power Co. d/b/a Allegheny Power For Approval Of Its Retail Elec. Default Serv. Program & Competitive Procurement Plan For Serv. At The Conclusion Of The Restructuring Transition Period,
Docket No. P-00072342, 2008 Pa. PUC LEXIS 30 (July 25, 2008)....................42

Petition Of West Penn Power Co. d/b/a Allegheny Power For Approval Of Its Retail Elec. Default Serv. Program & Competitive Procurement Plan For Serv. At The Conclusion Of The Restructuring Transition Period,
Docket No. P-00072342, 2008 Pa. PUC LEXIS 44 (May 21, 2008)....................42

Re Natural Gas Supply Mkt.
100 Pa. P.U.C. 386 (2005)....................21

Ohio Edison Co.,
94 F.E.R.C. ¶ 61,291 (2001)....26

Re PECO Energy Co..
101 Pa. P.U.C. 99 (2006)....21

USGen. New England, Inc.,
109 F.E.R.C. ¶ 61,361 (2004)....26

STATUTES AND REGULATIONS

15 U.S.C. § 78n-1....68

18 C.F.R. § 33.3....22

FERC Stats. & Regs. ¶ 31,111 (2000)....24

Energy Policy Act §§ 1283-84....28

52 Pa. Code § 54.183(a)....39

52 Pa. Code § 54.183(b)....40

52 Pa. Code § 54.183(c)....40

52 Pa. Code § 69.901....6, 12

66 Pa. C.S. §§ 505, 516, & 2101 *et seq*....76

66 Pa. C.S. §1102(a)....6, 9, 44

66 Pa. C.S. § 1102(a)(3)....11, 44

66 Pa. C.S. § 1103(a)....12

66 Pa. C.S. § 2102(b)....15

66 Pa. C.S. § 2108....10

66 Pa. C.S. § 2802(16)....44

66 Pa. C.S. § 2804(5)....45

66 Pa. C.S. § 2807(e)....41

66 Pa.C.S. § 2807(e)(3.1)-(3.2) & (3.4) 42

66 Pa. C.S. § 2807(e)(3.7) 42

66 Pa. C.S. § 2811(e) 6, 14, 38, 39

66 Pa. C.S. § 2811(e)(1) 14, 21

I. INTRODUCTION

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A. Statement Of The Case

1. History Of Proceeding

On May 14, 2010, West Penn Power Company ("West Penn"), doing business as Allegheny Power, Trans-Allegheny Interstate Line Company ("TrAILCo") and FirstEnergy Corp. ("FirstEnergy") filed a Joint Application to obtain the approval of the Pennsylvania Public Utility Commission ("PUC" or the "Commission") under Chapters 11 and 28 of the Public Utility Code ("Code") for a change in control of West Penn and TrAILCo to be effected by the merger of Allegheny Energy, Inc. ("Allegheny") with Element Merger Sub., Inc. ("Merger Sub"), a wholly-owned subsidiary of FirstEnergy (the "Merger").[1] The Joint Applicants also asked for the Commission's approval under Chapter 21 of the Code to revise certain affiliated interest arrangements to facilitate sharing services between the Allegheny and FirstEnergy systems and, in that way, to take advantage of the synergies that the Merger is expected to produce.

Accompanying the Joint Application, the Joint Applicants submitted written testimony and exhibits describing the Merger and discussing the substantial benefits the post-merger combined company ("Company") is expected to produce for its customers and the communities the Company will serve. The testimony and supporting information also explained that the Merger will not result in the unlawful exercise of market power or otherwise prevent retail electricity customers in Pennsylvania from obtaining the benefits of a properly functioning competitive retail electricity market and, in fact, may facilitate additional competition.

---

[1] As explained in Paragraph 12 of the Joint Application, the Joint Applicants are also requesting approval of an alternative, post-Merger corporate alignment in which West Penn and TrAILCo would be direct subsidiaries of FirstEnergy.

A notice of the filing of the Joint Application was published in the *Pennsylvania Bulletin* on May 29, 2010. Additionally, as directed by the Commission, notice of the filing of the Joint Application was published in the *Pittsburgh Post-Gazette* on May 28, 2010.

On May 24, 2010, a Prehearing Conference Order was issued scheduling a Prehearing Conference for June 22, 2010. The Prehearing Conference Order noted that Administrative Law Judges Wayne L. Weismandel and Mary D. Long (the "ALJs") would preside over this proceeding and directed the parties to file and serve Initial Prehearing Conference Memoranda on or before June 15, 2010.

On June 3, 2010, the Commission issued a letter identifying twelve areas it expected the parties to address on the record. For the most part, the topics identified by the Commission had been discussed in detail in the Joint Application and accompanying testimony. In response to the Commission's letter, the Joint Applicants submitted supplemental testimony on July 15, 2010.

On June 22, 2010, a Prehearing Conference was held at which a schedule was established for the submission of testimony and the conduct of hearings. Under the approved schedule all case-in-chief, supplemental, rebuttal and surrebuttal testimony would be submitted in writing in advance of hearings. Evidentiary hearings were scheduled for October 12 through 15, 2010, at which all testimony and exhibits would be placed in the record and all witnesses presented for cross-examination, if any, thereon.

Petitions to Intervene, Protests or Notices of Appearance in this proceeding were filed by the following parties:

1. The Commission's Office of Trial Staff ("OTS")
2. The Pennsylvania Office of Consumer Advocate ("OCA")
3. The Pennsylvania Office of Small Business Advocate ("OSBA")
4. The Pennsylvania Department of Environmental Protection ("DEP")
5. The International Brotherhood of Electrical Workers ("IBEW")
6. The Utility Workers of America, AFL-CIO ("UWUA") and UWUA System Local No. 102 ("Local 102") (collectively, "UWUA Intervenors")

7. The Pennsylvania State University ("PSU")
8. The Met-Ed Industrial Users Group ("MEIUG") and the Penelec Industrial Customer Alliance ("PICA") (collectively, "MEIUG/PICA")
9. The West Penn Power Industrial Intervenors ("WWPII")
10. The Pennsylvania Rural Electric Association ("PREA")
11. The Pennsylvania Mountains Healthcare Alliance ("PMHA")
12. The West Penn Power Sustainable Energy Fund ("WPPSEF")
13. The York County Solid Waste and Refuse Authority ("YCSWA")
14. The Anthracite Region Independent Power Producers Association ("ARIPPA")
15. The Clean Air Council ("CAC")
16. Citizens for Pennsylvania's Future ("PennFuture")
17. Citizen Power, Inc. ("Citizen Power")
18. Constellation NewEnergy, Inc. and Constellation Energy Commodities Group, Inc. ("Constellation")
19. The Retail Energy Supply Association ("RESA")
20. Direct Energy Services, LLC ("Direct Energy")
21. Duquesne Light Company ("Duquesne")

All of the foregoing intervenors and protestants were granted party status either by operation of law or by ruling of the presiding officers. However, on August 20, 2010, the ALJs granted Duquesne's Petition for Leave to Withdraw, and Duquesne is no longer a party to this case.

On July 15, 2010, the Joint Applicants submitted two statements of supplemental direct testimony. On or before August 17, 2010, OTS, OCA, OSBA, DEP, Direct Energy, RESA, Constellation, PSU, PMHA, CAC, WPPSEF and PennFuture served approximately eighteen written statements and accompanying exhibits constituting their direct testimony in this case. (Certain statements of intervenor direct testimony were not entered into evidence.)

On September 13, 2010, the Joint Applicants, OCA, OSBA, RESA, and WPPSEF submitted approximately fifteen statements and accompanying exhibits constituting their rebuttal testimony. On October 1, 2010, the Joint Applicants, OSBA, Direct Energy, OCA, Constellation, PSU, OTS, CAC, WPPSEF, PennFuture and DEP submitted approximately fourteen surrebuttal statements, some of which were not entered into evidence.

Two public input hearings were held in Greensburg, Pennsylvania, starting at 1:00 p.m. and 6:00 p.m., respectively, on August 3, 2010. Evidentiary hearings were held in Harrisburg on October 12 through 15, 2010.

Consistent with the Commission's policy of encouraging settlements, the parties held settlement conferences beginning on September 7, 2010, and continuing thereafter. As a result of those negotiations, all but four of the parties to this proceeding were able to reach a settlement ("Settlement"). Accordingly, at the hearing held on October 15, 2010, the Joint Applicants, advised the ALJs that the Settlement had been achieved. On October 25, 2010, the settling parties filed a Joint Petition For Partial Settlement, which was served on the ALJs and all active parties; Statements in Support of the Joint Petition were filed on or about October 29, 2010.

2. Description Of The Transaction

FirstEnergy[2], Allegheny[3] and Merger Sub[4] are parties to an Agreement and Plan of Merger (the "Merger Agreement") (Exhibit E to Jt. App. Ex. 1). Under the terms of the Merger Agreement, Allegheny will merge with Merger Sub and, as the surviving corporation, Allegheny

[2] FirstEnergy owns, directly or indirectly, all of the outstanding common stock of seven electric utility operating subsidiaries in four states: Metropolitan Edison Company ("Met-Ed"), Pennsylvania Electric Company ("Penelec"), and Pennsylvania Power Company ("Penn Power"), in Pennsylvania and, in the case of Penelec, The Waverly Electric Light and Power Company, in New York; Ohio Edison Company, The Cleveland Electric Illuminating Company and The Toledo Edison Company, in Ohio; and Jersey Central Power & Light Company ("JCP&L"), in New Jersey (collectively, the "FirstEnergy Utilities"). The FirstEnergy Utilities comprise the nation's fifth largest investor-owned electric system based on customers served, with 4.5 million customers in Ohio, Pennsylvania, New Jersey and New York. In addition, FirstEnergy subsidiaries and affiliates are involved in the generation and transmission of electricity, energy management and other energy-related services. Through its subsidiaries, FirstEnergy owns electric generation totaling more than 14,000 MW of capacity. *See* Jt. App. Ex. 1 (pp. 2-3)

[3] Allegheny is a public utility holding company and has three direct public utility subsidiaries that conduct business as Allegheny Power: West Penn, in Pennsylvania; Monongahela Power Company ("Mon Power"), in West Virginia; and The Potomac Edison Company ("Potomac Edison"), in Maryland, West Virginia, and Virginia (collectively, the "Allegheny Power Utilities"). The Allegheny Power Utilities serve 1.6 million customers in four states. In addition, TrAILCo is an indirect public utility subsidiary of Allegheny. *See* Jt. App. Ex. 1, pp. 2-3.

[4] Merger Sub is a wholly owned subsidiary of FirstEnergy that was formed for the sole purpose of effecting the Merger. When the Merger is completed, Merger Sub will be subsumed, by operation of law, into Allegheny and cease to exist as a separate corporate entity.

will become a wholly-owned subsidiary of FirstEnergy. When the Merger is completed, each Allegheny shareholder will be entitled to receive 0.667 shares of FirstEnergy common stock for each share of Allegheny common stock that he or she holds. Each issued and outstanding share of FirstEnergy common stock will remain outstanding following the Merger, and each FirstEnergy shareholder will hold the same number of shares of FirstEnergy common stock that the shareholder held immediately prior to the Merger. Following the Merger, the existing shareholders of FirstEnergy will own approximately 73% and the former shareholders of Allegheny will own approximately 27% of the combined company.

FirstEnergy will remain the ultimate corporate parent of Met-Ed, Penelec and Penn Power (the "FirstEnergy Pennsylvania Utilities") and all other FirstEnergy subsidiaries and will become the ultimate corporate parent of Allegheny and all of the Allegheny subsidiaries, including West Penn and TrAILCo. *See* Ex. F-1 to Jt. App. Ex. 1. The Joint Applicants may elect to adopt an alternative corporate structure under which the Allegheny Power Utilities would be first tier subsidiaries of FirstEnergy. To avoid the time and expense of a second "change-in-control" filing to recognize what would simply amount to an internal reorganization (and no change in ultimate control), the Joint Applicants have requested that the Commission approve this alternative corporate structure as well. *See* Jt. App. Ex. 1, pp. 4-5.

The combined company's corporate headquarters will be in Akron, Ohio. The corporate headquarters of Allegheny Energy, located in Greensburg, Pennsylvania, will become the regional headquarters of West Penn. Immediately following the Merger, FirstEnergy will increase its Board of Directors from eleven to thirteen members and will fill the two new positions by appointing two members of the Allegheny Board of Directors to the FirstEnergy Board of Directors. Mr. Anthony J. Alexander, the current Chief Executive Officer and

President of FirstEnergy, will serve as Chief Executive Officer and President of FirstEnergy following the Merger. Mr. Paul J. Evanson, the current Chief Executive Officer of Allegheny, will become the Executive Vice Chairman of FirstEnergy and will report to Mr. Alexander.

After the Merger, Met-Ed, Penelec, Penn Power, West Penn and TrAILCo will continue to operate as Pennsylvania electric public utilities and will remain subject to the continuing jurisdiction of the Commission without any reduction of the Commission's existing oversight or any diminishment in the Commission's authority over these public utilities. Thus, the Merger will not adversely affect the day-to-day operations of these utilities. Indeed, as set forth in more detail below, the Merger will enhance the capabilities of these utilities to fulfill their obligations to provide safe, adequate and reliable service to their retail customers in Pennsylvania.

3. Regulatory Approvals Sought

a. Change In Control

The Joint Applicants request that the Commission issue certificates of public convenience evidencing its approval, under Section 1102(a) of the Code, as interpreted by the Commission's Statement of Policy at 52 Pa. Code § 69.901, for a change in control of West Penn and TrAILCo. Additionally, pursuant to Section 2811(e) of the Code, the Joint Applicants request that the Commission find, as part of its approval granted under Section 1102, that the Merger will not result in anti-competitive or discriminatory conduct, including the unlawful exercise of market power, which will prevent retail electricity customers in the Commonwealth from obtaining the benefits of a properly functioning and workable competitive retail electricity market.

b. Affiliated Interest Agreements

The Joint Applicants also request that the Commission approve, under Chapter 21 of the Code, certain modifications in affiliated interest agreements to become effective upon consummation of the Merger. The proposed modifications add the Allegheny operating

companies to existing affiliated interest agreements to which Met-Ed, Penelec and Penn Power are parties.

Allegheny and FirstEnergy have service company subsidiaries that provide a range of accounting, financial, legal and other services to their respective operating companies. At Allegheny, all employees are employed by Allegheny Energy Service Company ("AESC") and are assigned to provide services to Allegheny and its affiliates, including the Allegheny Power Utilities. At FirstEnergy, certain employees are employed by the FirstEnergy Utilities while other employees who provide administrative and technical support services are employed by FirstEnergy Service Company ("FESC") (Jt. App. Ex. 1, p. 9).

Met-Ed, Penelec and Penn Power are parties to a Service Agreement with FESC that was approved by the Commission's Order entered February 4, 2003, at Docket No. G-00020987. In addition, the three FirstEnergy Pennsylvania Utilities are parties to a pending Mutual Assistance Agreement, which allows them to share services among themselves and with other FirstEnergy Utilities. The FirstEnergy Pennsylvania Utilities are also parties to an Intercompany Income Tax Allocation Agreement, which established the terms under which the utilities participate in FirstEnergy's filing of a consolidated federal income tax return (Jt. App. Ex. 1, p. 9).

The merging companies have established transition teams to determine how AESC's employees, the Allegheny Power Utilities and other Allegheny entities will be integrated into the FirstEnergy organizational model. Although this process is still on-going, the Joint Applicants believe that substantial benefits can be derived by enabling FESC and the FirstEnergy Utilities to provide services to West Penn and TrAILCo and for West Penn and TrAILCo to share services with the FirstEnergy Utilities. The Joint Applicants, therefore, request that the Commission approve the following modifications to the FirstEnergy Service Agreement, Mutual Assistance

Agreement, and Intercompany Income Tax Allocation Agreement to become effective upon the close of the Merger:

(a) The addition of certain Allegheny operating companies, including West Penn and TrAILCo, each as a "Client Company", to the FirstEnergy Service Agreement. *See* Ex. G-1 to Jt. App. Ex. 1;

(b) The addition of certain Allegheny operating companies, including West Penn and TrAILCo as parties to the Mutual Assistance Agreement. *See* Ex. G-2 to Jt. App. Ex. 1; and

(c) The addition of certain Allegheny operating companies, including West Penn and TrAILCo as parties to the Intercompany Income Tax Allocation Agreement. *See* Ex. G-3 to Jt. App. Ex. 1.

The proposed modifications, which have not been opposed, will give the combined company the operational flexibility to share best practices and to make the most productive use of all available resources as soon as possible after the Merger. If any additional changes to the scope, manner, terms or conditions of the existing affiliated interest agreements are necessary or desired in the future, further Commission approvals will be sought under Section 2102 of the Code.

B. The Joint Petition For Partial Settlement

On October 25, 2010, the Joint Applicants filed with the Commission and served on the ALJs and all active parties a Joint Petition for Partial Settlement ("Joint Petition") executed by all of the active parties except the OSBA, Citizen Power, RESA and Direct Energy (the "Joint Petitioners"). The Joint Petition resolves all issues among the Joint Petitioners. The Joint Petitioners are in full agreement that the Merger, as described in the Joint Application and as supplemented by the Joint Petition, will provide substantial affirmative public benefits, which are summarized in Paragraph 58 thereof. Additionally, the Joint Petitioners agree that consummating the Merger on the terms set forth in the Joint Application as supplemented by the Joint Petition is in the public interest, as explained in Paragraph 59 thereof, and express their full

support for the Settlement, as evidenced by the Statements in Support each filed on or before October 29, 2010. The terms of the Joint Petition include commitments regarding employment levels, rate stay-out provisions, rate credits, and enhancements in a variety of areas including customer service and reliability, universal service, alternative and sustainable energy, financial governance, and retail competition, as discussed further in the Joint Applicants' Statement in Support and Section V, *infra*.

C. The Non-Settling Parties

The Joint Applicants – indeed, all of the settling parties – have worked diligently to try to resolve the objections of the non-settling parties, but have been unable to do so. As a consequence, the OSBA, Citizen Power, RESA and Direct Energy are not parties to the Joint Petition. The reasons for the OSBA's, RESA's and Direct Energy's opposition are, presumably, those previously articulated in the testimony submitted on their behalf in this case. Issues raised by that testimony are addressed in Section VI, *infra*. Citizen Power did not submit testimony in this case and, therefore, the Joint Petitioners await receipt of the Citizen Power's Brief to find out if Citizen Power opposes the Joint Petition and, if so, on what grounds. As necessary, the Joint Applicants will respond to Citizen Power in their Reply Brief.

II. STATEMENT OF THE QUESTIONS PRESENTED

1. Whether the Merger, implemented in accordance with the terms and conditions of the Joint Application as supplemented by the Joint Petition, satisfies the requirements of Section 1102(a) of the Code?

2. Whether the Merger, implemented in accordance with the terms and conditions of the Joint Application as supplemented by the Joint Petition, satisfies the requirements of Section 2811(e) of the Code?

3. Whether the proposed revisions to the FirstEnergy Service Agreement, the Mutual Assistance Agreement and the Intercompany Tax Allocation Agreement should be approved under Section 2102 of the Code?

The questions presented should be answered in the affirmative.

III. OVERVIEW AND SUMMARY OF ARGUMENT

The Joint Applicants presented substantial evidence establishing that the Merger, as proposed in the Joint Application, satisfies the "affirmative benefit" test for Commission approval delineated in *York v. Pa. P.U.C.*, 449 Pa. 136, 295 A.2d 825 (1972) ("*City of York*"). In addition, the Joint Applicants and the vast majority of the active parties in this case have agreed to a settlement that provides the means for many of the Merger benefits to have further immediate positive effects on the Joint Applicants' customers, the economy of the Joint Applicants' service area, and the Commonwealth overall. As previously noted, these further benefits include commitments regarding employee levels in Greensburg, rate stay-out provisions, rate credits, and enhancements in a variety of areas including customer service and reliability, universal service, alternative and sustainable energy, financial governance, and retail competition.

The Joint Applicants also presented substantial evidence demonstrating that the Merger will not create market power in the market for electricity. Consequently, there is no basis for the Commission to find that the Merger would result in anti-competitive or discriminatory conduct, would lead to the unlawful exercise of market power, or would prevent customers from obtaining the benefits of a properly functioning and workable retail electricity market.

The Joint Applicants also presented substantial, unrebutted evidence that the proposed revisions to the affiliated interest agreements are reasonable, lawful and should be approved. In fact, and as noted previously, no party opposes the proposed revisions.

IV. LEGAL STANDARD

A. Section 1102(a) And The Commission's Statement Of Policy On "Change In Control" Transactions

Section 1102(a)(3) of the Code (66 Pa. C.S. § 1102(a)(3)) provides that the Commission's prior approval, evidenced by a Certificate of Public Convenience, is required:

> For any public utility ... to acquire from, or transfer to, any person or corporation ... by any method or device whatsoever, including the sale or transfer of stock and including a consolidation, merger, sale or lease, the title to, or the possession or use of, any tangible or intangible property used or useful in the public service.

Until 1993, the Commission had held that Section 1102(a)(3) did not apply to transfers of stock constituting a controlling interest in a corporation that held a public utility as a subsidiary.[5] However, in reviewing transactions involving telecommunications companies, the Commission revisited the issue of parent company stock transfers[6] and, on October 22, 1994, issued a Statement of Policy "to establish clear standards regarding what transfer of voting interest

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5 *Application of MCI Airsignal of Pennsylvania, Inc.*, Docket No. A-330035 (July 15, 1986); *Application of Airsignal Int'l of Pittsburgh, Pennsylvania, Inc.*, Docket No. A-101365 (January 14, 1980). The Commission's decisions were supported by *Pa. P.U.C. v. General Waterworks Corp.*, 7 Pa. Cmwlth. 352, 300 A.2d 280 (1973), which held that transfers of stock in the parent of a public utility were not subject to the Commission approval requirement of Section 1102 (a)(3).

6 In *Re Commonwealth Tel. Co., et al.*, Docket No. A-310800F0006, 80 Pa. P.U.C. 562 (1993), the Commission stated that it was departing from its holdings in *Airsignal International* and *MCI Airsignal, supra*, and, thereafter, Section 1102(a)(3) would be extended to the transfer of stock of "a utility or of its parent or grandparent affiliates, regardless of the remoteness of the transaction" if the transfer effected a "transfer of control of the utility." *Accord Joint Application of Paging Network of Pittsburgh, Inc. & Paging Network of Philadelphia, Inc.*, Docket No. A-33013F0005, 1993 WL 855885 (October 29, 1993).

constitutes a change in *de facto* control of the utility." (52 Pa. Code § 69.901).[7] The Statement of Policy provides that "[a] transaction or series of transactions resulting in a new controlling interest is jurisdictional when the transaction or transactions result in a different entity becoming the beneficial holder of the largest voting interest in the utility or parent, regardless of the tier." Applying the standards set forth in the Statement of Policy, the Merger would effect a "change in control" of West Penn and TrAILCo requiring the Commission's approval. The Joint Applicants respectfully submit that the Merger satisfies the standards that have evolved for approving changes in control of jurisdictional utilities.

Section 1103(a) of the Code provides that a Certificate of Public Convenience evidencing the Commission's approval under Section 1102 shall issue only upon a showing that granting such approval is "necessary or proper for the service, accommodation, convenience, or safety of the public" (66 Pa. C.S. § 1103(a)). In *City of York*, 449 Pa. 136, 295 A.2d 825, 828 (1972), the Pennsylvania Supreme Court held that those seeking approval of a utility merger must demonstrate that the merger "will affirmatively promote the 'service, accommodation, convenience, or safety of the public' in some substantial way."[8]

The Commission has consistently held that the *City of York* test does **not** require applicants to prove, or the Commission to find, that a utility merger or acquisition will generate quantifiable benefits in all aspects of the utility's operations or to all potentially affected stakeholders. Rather, the Commission has held that the *City of York* test is satisfied when the

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[7] Under Pennsylvania law, a statement of policy, unlike a regulation, does not have the force and effect of law. Rather, it announces the policy the agency hopes to implement in future adjudications. *Pennsylvania Human Relations Comm'n v. Norristown Area Sch. Dist.*, 473 Pa. 334, 350, 374 A.2d 671 (1977).

[8] *City of York* differed from the instant case because, among other reasons, it involved the merger of public utilities themselves, not the merger or change in control of the parent of a utility.

record evidence shows that a proposed transaction, viewed as a whole, will produce an affirmative public benefit:

> When we view the Merger in context, we would agree with the Joint Applicants that the standards of the *City of York* need not only be addressed by a quantification of the specific effects of alleged savings, particularly a specific level of capital investment by the merged entity in Pennsylvania (*See* Joint App. MB at 10). Rather, we must view the public interest benefits in the context of the telecommunications industry in Pennsylvania as a whole.

Joint Application of SBC Communications, Inc. and AT&T Corp., Docket Nos. A-31163F0006, A-310213F0008 and A-310258F0005, 2005 Pa. PUC LEXIS 37, *38 (October 6, 2005).

The Commission's application of the *City of York* standard was affirmed by the Pennsylvania Supreme Court in *Popowsky v. Pa. P.U.C.*, 594 Pa. 583, 937 A.2d 1040 (2007) ("*Popowsky/Verizon*") where the Court upheld the Commission's order approving the merger of Verizon Communications, Inc. and MCI, Inc. Significantly, the Supreme Court reversed a Commonwealth Court decision that had overturned the Commission's order for purportedly using an insufficiently rigorous test to evaluate whether the merger was likely to "affirmatively promote the 'service, accommodation, convenience, or safety of the public' in some substantial way." In so doing, the Supreme Court held that the *City of York* standard did not require the Commission "to secure legally binding commitments," nor did it require the Commission "to quantify benefits where this may be impractical, burdensome, or impossible."

> As reflected in the [discussion] above, *City of York* does not support the requirement advanced by the OCA, and implicit in the Commonwealth Court's decision, that the Commission must secure legally binding commitments to assure public benefit from a merger. Rather, as Appellants argue, *City of York* merely credited the Commission's preponderance [of the evidence]-based finding of public benefit grounded upon the testimony of an industry professional and references to the Commission's judgment.

*   *   *

> In conducting the underlying inquiry, the Commission is not required to secure legally binding commitments or to quantify benefits where this may be impractical, burdensome, or impossible; rather, the PUC properly applies a preponderance of the evidence standard to make factually-based determinations (including predictive ones informed by expert judgment) concerning certification matters.

594 Pa. at 609, 611, 937 A.2d at 1055 and 1057.

Additionally, the Supreme Court rejected the Commonwealth Court's view that the applicants had to describe with specificity the public benefits they anticipated the merger would produce in order to satisfy the *City of York* standard. 594 Pa. at 612-613, 937 A.2d at 1057-1058.

As explained in Section V., *infra*, the Merger will produce substantial affirmative benefits that clearly satisfy the *City of York* test.

B. Section 2811(e)

Section 2811(e) requires the Commission to consider the potential anti-competitive effects of a merger or combination "in the exercise of *authority the commission otherwise may have* to approve mergers or consolidations" (emphasis added) involving electric utilities (66 Pa. C.S. § 2811(e)(1)). Section 2811(e) does not confer any authority upon the Commission to approve mergers or consolidations of public utilities or a change in control of a public utility beyond the authority the Commission otherwise possesses under Chapter 11 of the Code.

There is no basis for the Commission to find that the Merger would result in anti-competitive or discriminatory conduct, would lead to the unlawful exercise of market power, or would prevent customers from obtaining the benefits of properly functioning and workable competitive retail natural gas and electricity markets. As explained in Joint Applicants' St. Nos. 4, 4-R, 9-R and 10-R, the Merger will have no adverse competitive effects on either the

wholesale market within the PJM Interconnection LLC ("PJM") or Pennsylvania's retail energy markets and, indeed, will likely promote increased retail competition.

C. Section 2102(b)

Section 2102(b) of the Public Utility Code provides that the Commission shall approve a proposed affiliated interest agreement if it finds that such agreement is "reasonable and consistent with the public interest." As previously explained, the proposed revisions for which approval is sought would add West Penn and TrAILCo to existing or pending affiliated interest agreements that are reasonable and consistent with the public interest. Accordingly, the statutory standard has been satisfied.

V. THE JOINT APPLICANTS HAVE SATISFIED THE LEGAL STANDARD FOR COMMISSION APPROVAL OF THE PROPOSED CHANGE IN CONTROL OF WEST PENN AND TRAILCO

A. The Transaction, As Supplemented By The Joint Petition For Partial Settlement, Will Affirmatively Benefit The Public In Substantial Ways

It is abundantly clear that the Merger satisfies the *City of York* "affirmative benefit" test, as described *supra*. The substantial affirmative benefits of the Merger were set out in detail in the Joint Application (pp. 11-16) and summarized in the direct testimony of FirstEnergy's President and Chief Executive Officer, Mr. Anthony J. Alexander (Jt. App. St. 1, pp. 8-12), as follows:

> ***Increased Scale and Scope; Diversification.*** There are many benefits that should be derived from the increased scale, scope and diversification of the combined company . . ., including improved service, reliability and operational flexibility, and increased financial stability for West Penn, TrAILCo, Met-Ed, Penelec, Penn Power, and all other FirstEnergy and Allegheny public utility subsidiaries. . . .
>
> ***Increased Financial Strength and Flexibility.*** The increased scale and scope is ultimately expected to strengthen the balance sheet of the combined company, creating a larger, financially

stronger parent company that is better positioned to compete for and attract capital on reasonable terms for its public utility subsidiaries. In addition, the diversification of the energy delivery and generation portfolios of the combined company should result in a more stable cash flow. The all-stock transaction is expected to improve financial metrics of the combined company. . . .

Enhanced Expertise in Competitive Energy Markets, Energy Technologies, and Regional Issues. The combined company is expected to be able to draw upon the intellectual capital, technical expertise and experience of a deeper and more diverse workforce, with particular skills in managing distribution companies in competitive energy markets. The Merger is a natural alliance of companies with adjoining service territories and interconnected transmission systems, which should be beneficial in the integration and management of the combined company. The combined company should also be better able to invest in and deploy new processes and technologies, including innovations anticipated as part of the Act 129 Energy Efficiency and Conservation plans being implemented by West Penn, Met-Ed, Penelec, and Penn Power. . . .

Enhanced Customer Service and Reliability. FirstEnergy and Allegheny share a strong commitment to enhancing customer service and reliability. The Merger will facilitate and build upon the combined companies' areas of expertise, allowing the deployment of "best practices" derived from ten electric utilities and additional, experienced resources when needed to meet emergencies, storm outages or other similar circumstances. As part of the Merger integration process, FirstEnergy and Allegheny intend to conduct a review of their existing procedures and policies to determine "best practices" and how to implement them. The combined company will work to maintain the current levels of reliability of West Penn, as measured and determined using West Penn's current methodology for measuring reliability, and will conduct a study to determine if opportunities exist to improve reliability. The combined company's commitment to streamlining operations, reducing overall complexity and reliance upon a regional focus will ensure a continued high level of management attention on distribution system reliability and overall customer service . . . .

Synergies, Efficiencies and Cost Savings. The Joint Applicants are confident that the Merger will generate synergies and result in overall aggregate cost saving opportunities for the combined company. The synergies that will accrue to the Pennsylvania utilities over time should, at least in part, offset the increasing cost

> of providing regulated retail utility service and, thereby, may reduce the size of future rate increase requests . . .

Mr. Alexander also explained that the Merger will provide expanded opportunities for career advancement and professional growth for Allegheny employees who remain with the Company. He also detailed the specific commitments by FirstEnergy to maintain West Penn's regional headquarters in Greensburg, Pennsylvania, as well as its commitments to employees after the Merger regarding employment levels and existing employee collective bargaining agreements and benefits. Jt. App. St. 1, pp. 13-15. Furthermore, he testified that FirstEnergy had agreed that, for a period of three years, it will maintain at least Allegheny's current levels of charitable support in local communities. Thereafter, FirstEnergy will continue to support local charities at levels consistent with its commitments to other communities it serves. In addition, FirstEnergy will expand its network of Power System Institutes ("PSIs") by adding a new PSI program within West Penn's service territory to help students earn an associate's degree in applied science or in technical studies with a focus on electric utility technology. Jt. App. St. 1, pp. 15-16.

The Settlement, which is supported by a broad and diverse stakeholder coalition that includes the Commonwealth of Pennsylvania, representatives of the residential and industrial customer classes, organized labor, and environmental and sustainable energy groups, ensures that there will be affirmative benefits in the immediate future and over time in addition to those described in the Joint Application. These further benefits include:

Expanded Employment Commitments to Employees. Under the Settlement, in addition to the commitments made in the Joint Application, specific net employment level commitments have been made for employees of FirstEnergy and its affiliates in Greensburg and Westmoreland County. *See* Jt. Pet. ¶ 14. The corporate headquarters of Allegheny Energy in Greensburg will

become the regional headquarters of West Penn; the regional headquarters of Met-Ed will remain in Reading; and the regional headquarters of Penelec will remain in Erie for a period of at least five years. *Id.* ¶¶ 14-15.

Immediate and Continuing Rate Relief for FirstEnergy and West Penn Customers. Upon consummation of the Merger, West Penn's residential customers will receive distribution rate credits of **$3.57 million per year for three years.** Additional rate credits will be provided to customers receiving service under existing West Penn Tariff 37. (Jt. Pet. ¶ 17) Also, the FirstEnergy Pennsylvania Utilities will not seek any distribution rate increases to be effective before October 1, 2012 (except for extraordinary storm expense or changes by the Federal Energy Regulatory Commission in facilities included in transmission rates). (Jt. Pet. ¶ 16) In addition, **a credit of $6.19 million** will be provided to commercial customers under specified rate schedule to address increases in Energy Efficiency & Conservation ("EE&C") costs under West Penn's revised EE&C Plan.

Reliability and Customer Service Improvements. The Joint Applicants commit to achieving specific levels in the Commission's Customer Average Interruption Duration Index ("CAIDI") and System Average Interruption Duration Index ("SAIDI") for West Penn, as well as West Penn's average speed of answering customer calls. In addition, the Joint Applicants commit to continued reliability investments for rural electric cooperatives and to establish a Joint Utility-Industrial Customer Committee to identify, discuss and address local power and service quality issues for industrial customers. (Jt. Pet. ¶¶ 49, 50-52)

Increased Universal Service. The Joint Applicants commit to attaining a 55% penetration level for West Penn's Customer Assistance Program over a five-year period (based upon additional spending of $750,000 per year) as well as an increase in funding for West Penn's

Low-Income Usage Reduction Program (rising to an additional $1.8 million in the fifth year after the Merger). (Jt. Pet. ¶¶ 20 & 22) In addition, FirstEnergy will review methods used by West Penn in raising money for its Hardship Fund and adopt any "best practices" to achieve additional fundraising success for the hardship programs of the FirstEnergy Pennsylvania Utilities. (Jt. Pet. ¶ 21)

More Renewable Energy. West Penn and the FirstEnergy Pennsylvania Utilities will procure 40% of their solar requirements under Pennsylvania's Alternative Energy Portfolio Standards Act through 2021 using long-term contracts. (Jt. Pet. ¶¶ 25-26) In addition, FirstEnergy will contribute $1 million to the Pennsylvania Sunshine Program to support solar energy and $1 million to the Keystone Home Energy Loan Program, as well as provide additional support to the West Penn Sustainable Energy Fund. (Jt. Pet. ¶¶ 27-29).

New Retail Market Enhancements in West Penn's Service Territory. Consistent with programs offered to support competitive retail electric supply in the service territories of the FirstEnergy Pennsylvania Utilities, West Penn will modify its proposed purchase of receivables program, appoint a representative to perform retail ombudsman services, and introduce expanded billing options and access for suppliers to interval and non-interval consumption information via Electronic Data Interchange ("EDI") as well as submit several additional EDI change requests. (Jt. Pet. ¶¶ 38-48)

More Financial Protection for Customers. FirstEnergy will ensure that utility customers are financially protected in a variety of ways, including: (i) ensuring that each FirstEnergy Pennsylvania Utility operating company issues its own debt after obtaining appropriate regulatory authorization; (ii) ensuring that each FirstEnergy Pennsylvania Utility operating company maintains its own credit rating so long as it has debt outstanding and credit rating

agencies are willing to provide such rating; (iii) ensuring that no individual FirstEnergy Pennsylvania Utility operating company will assume debt issued by the holding company without Commission approval; and (iv) maintaining separate financial statements reflecting each FirstEnergy Pennsylvania Utility's own assets and liabilities; and 6) ensure that each FirstEnergy Pennsylvania Utility operating company has its own capital structure, which is a function of its own debt and equity. (Jt. Pet. ¶¶ 35-36)

Additional Information and Analysis of Wholesale Electricity Markets. West Penn and the FirstEnergy Pennsylvania Utilities will provide detailed information about default supply procurements to the OCA, OTS and OSBA and also prepare annual reports through 2015 addressing wholesale market prices and trends in the PJM markets. (Jt. Pet. ¶ 54)

Sharing of Earnings. As part of the Settlement, each of the FirstEnergy Pennsylvania Utilities will credit customers to the extent the utility earns a return on equity that exceeds 10.1% (subject to adjustments for pension normalization) between the consummation of the Merger and October 1, 2012. (Jt. Pet. ¶ 16)

Together, the Joint Application and the Settlement ensure that the Merger will result in substantial affirmative benefits for the customers of West Penn, TrAILCo, the FirstEnergy Pennsylvania Utilities and all citizens of the Commonwealth of Pennsylvania.

B. The Transaction Will Not Result In Anticompetitive Or Discriminatory Conduct, Nor Prevent Customers From Obtaining The Benefits Of A Properly Functioning And Workable Competitive Retail Electricity Market

1. The Merger Does Not Raise Wholesale Market Power Concerns

a. The Commission Follows FERC's Approach to Evaluating Wholesale Market Power Issues

Under the legal standard applicable to the Commission's review of market power issues associated with electric utility mergers, the Commission is required to determine whether the merger:

> is likely to result in anticompetitive or discriminatory conduct, including the unlawful exercise of market power, which will prevent retail electricity customers in this Commonwealth from obtaining the benefits of *a properly functioning and workable competitive retail electricity market.*

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

Thus, the Commission's market power focus is on whether a proposed merger will disrupt *competitive retail* markets. As the Commission has recognized previously, however, the competitiveness of retail markets is directly related to the competitiveness of wholesale electric markets. *See, e.g., Re PECO Energy Co.*, 101 Pa. P.U.C. 99 (2006), 2006 WL 559274 at *65-66; *see also*, *Re Natural Gas Supply Mkt.*, 100 Pa. P.U.C. 386, 2005 WL 2916370 at *19. Consequently, the Commission also considers wholesale market power issues as an important component of its approach to evaluating the effects of a merger on competitive retail markets.

The Commission's long-standing approach to evaluating the effect of a merger on wholesale competition is to apply the same merger-related wholesale competition analysis that is

applied by FERC – the agency vested with exclusive jurisdiction over wholesale markets and wholesale power transactions.[9]

To be sure, the Commission must conduct its own independent review of the wholesale market power analysis presented by the Joint Applicants based on the record in this proceeding and is not obligated to reach the same conclusions as FERC from that analysis. However, in conducting that review, the Commission can rely on its previous findings that the type of analysis required by FERC is an appropriate way to evaluate wholesale market power issues. Further, the Commission should require any party making arguments that the FERC analysis is inappropriate to support such arguments with record evidence demonstrating both the validity of an alternative approach and that a wholesale market power problem is demonstrated under such alternative approach.

b. Dr. Hieronymus Has Demonstrated that the Merger Will Not Raise Market Power Concerns in Electric Markets

(1) Overview of FERC Appendix A Analysis

Dr. William H. Hieronymus presented what is known as an "Appendix A" analysis of the impact of the Merger prepared in accordance with FERC's regulations and merger precedents. *See* 18 C.F.R. § 33.3. This analysis applies the "delivered price test," based on the type of analysis that is described in the Department of Justice's ("DOJs") Merger Guidelines that are used to evaluate mergers under the Hart-Scott-Rodino Act. Jt. App. St. 4, Ex. WHH-1, Ex. J-1 at 27-29. This test is intended to determine whether merger applicants will have the ability to

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9 *See Re: DQE, Inc.*, 186 PUR4th 39 at 62-65 (1998); *Joint Application of PECO Energy Co. And Pub. Serv. Elec. & Gas Co. for Approval of the Merger of Pub. Serv. Enter. Group, Inc. with and into Exelon Corp.*, 248 PUR4th 1 at 54 (2005) ("this Commission's market power methodology adopt[s] the FERC approach"). See also *ARIPPA v. Pennsylvania Public Utility Comm'n*, 792 A.2d 636, 657-58 (Pa. Commonwealth 2002) (upholding the Commission's reliance on the fact that FERC had reviewed the merger and found that it would not have any anticompetitive effects).

exercise market power, which is defined as the ability to increase market prices for a sustained period of time. *Id.* at 23.

The delivered price test requires a determination of how much generation capacity can be delivered into a particular market during various seasons (summer, winter, shoulder) and under various load conditions (off-peak, peak, super peak) at the prevailing market price, plus five percent. It then uses market shares and the Herfindahl-Hirschman Index ("HHI") to evaluate how concentrated the market is before the merger and after the merger. If the increase in market concentration caused by the merger exceeds certain levels, FERC will conclude that there is a "screen failure" that requires a more detailed look at that market.

Under FERC's Appendix A analysis, the significance of this increase depends on the total HHI in a market subsequent to the merger. If the post-merger HHI is below 1,000, then the post-merger market is deemed to be unconcentrated and FERC does not find a problem regardless of the total increase in HHI caused by the merger. Jt. App. St. 4, Ex. WHH-1, Ex. J-1 at 27. If the post-merger HHI is between 1,000 and 1,800, then the market is deemed to be moderately concentrated. If the merger-related HHI increase in a moderately concentrated market is above 100, then the screen is considered to be violated and further examination is required – while an increase below 100 reflects an immaterial change in market concentration. *Id.* If the post-merger HHI is above 1,800, then the market is deemed to be highly concentrated and the threshold for a screen failure drops to an increase of 50. *Id.* at 27-28.

Under FERC's regulations, a screen failure (*i.e.*, an HHI increase of above 100 for a moderately concentrated market or an HHI increase of above 50 for a highly concentrated market) does not necessarily mean that there is a competitive problem. Rather, a screen violation indicates a need for a more detailed consideration of whether there may be a competitive

problem. Mergers that present no screen violations routinely are approved without a hearing. *Id.* at 28. Because the HHI screen is a conservative test, it is entirely possible for a merger to produce several screen failures and still not present any competitive problems. *See Revised Filing Requirements Under Part 33 of the Commission's Regulations*, FERC Stats. & Regs. ¶ 31,111 at 31,882 (2000)(" Concentration statistics ... *are not the end of the analysis.* We note that *in many cases, the Commission has moved quickly beyond market concentration statistics* in evaluating the competitive effects of proposed mergers."). (emphasis added)

As Dr. Hieronymus noted, the HHI thresholds adopted by FERC in 1996 were taken from the *Horizontal Merger Guidelines* established by the DOJ and the Federal Trade Commission ("FTC") for their use in evaluating mergers. *Id.* at 27. Recently, however, the DOJ and FTC revised the *Horizontal Merger Guidelines* to increase the thresholds for establishing screen failures. Most important to this proceeding, under the revised thresholds, post-merger markets with an HHI level below 1,500 are deemed to be unconcentrated and no further analysis of such markets is required. Tr. at 673-74 (Hieronymus). Although FERC has not yet adopted these revised thresholds, Dr. Hieronymus testified that, because FERC based its thresholds on the thresholds in the original DOJ/FTC *Horizontal Merger Guidelines*, it is logical to conclude that FERC will revise its thresholds to accord with the new DOJ/FTC approach. *Id.* at 660.

(2) Dr. Hieronymus' Appendix A Analysis

In accordance with FERC's regulations, Dr. Hieronymus performed an Appendix A analysis showing the impacts on wholesale energy markets of the Merger of the Joint Applicants. Because all of the merged company's generation assets will be located in PJM after FirstEnergy integrates its Midwest ISO assets into PJM, Dr. Hieronymus focused his analysis on the PJM market that will exist after June 1, 2011, when generation and transmission assets in the

American Transmission Systems, Inc. ("ATSI")[10] footprint (including generation assets not owned by FirstEnergy) are integrated into PJM, which he calls his "Base Case". Dr. Hieronymus also analyzed alternative geographic markets to give the PUC further assurance that the transaction will not have an adverse impact on competition. This included an analysis of: (1) PJM before ATSI is integrated into PJM, (2) the MISO before ATSI is integrated into PJM, (3) PJM East; (4) a combined PJM-MISO market; and (5) a "Midwest Market" consisting of the western portion of PJM and portions of the MISO market. Jt. App. St. 4, Ex. WHH-1, Ex. J-1 at 4.

As explained in more detail in Exhibit J, Dr. Hieronymus found that, even after the transaction, the markets he analyzes (both his base case and the alternative markets) are almost entirely large, unconcentrated markets with post-transaction HHIs below 1000. Jt. App. St. 4, Ex. WHH-1, Ex. J-1 at 46-47. On average, the post-transaction HHIs are below the current threshold for defining an unconcentrated market, and in only three off-peak seasonal periods do the HHI levels slightly exceed 1000.

As Dr. Hieronymus explained, the minor screen failures that he found in his analysis here do not raise any competitive concerns. They occur only during off-peak periods where the generating units setting the market price are large baseload nuclear and coal units. Dr. Hieronymus explained that these baseload coal and nuclear units are particularly unsuited to being withheld from the market, which is how a generation owner would go about attempting to raise market prices. Jt. App. St. 4, Ex. WHH-1, Ex. J-1 at 46-47. *See also* Tr. at 641. As a result, minor screen failures in off-peak periods do not indicate any material increase in the Joint

[10] ATSI is a wholly owned subsidiary of FirstEnergy and owns transmission assets which operate as part of the Midwest Independent System Operator ("MISO"). Those transmission assets will be integrated into PJM in 2011.

Applicants' ability to exercise market power. This is a conclusion that FERC has reached on several occasions.[11]

Moreover, as noted above, the DOJ and the FTC have recently made changes to their Horizontal Merger Guidelines to, among other things, raise the threshold for defining unconcentrated markets from 1,000 to 1,500. Under the updated definition, the post-transaction market would be well within the unconcentrated range even in the three off-peak periods, where the highest post-transaction HHI is only 1054. Thus, under the revised thresholds adopted by DOJ/FTC, the Merger would easily pass all market power screens.

c. The Attacks on Dr. Hieronymus' Analysis Have No Merit

A number of parties attacked Dr. Hieronymus' analysis. None of these attacks has any merit, however, as discussed below.

(1) General Assertions that a Different Analysis Should Have Been Performed

Some parties attacked Dr. Hieronymus' analysis by making general assertions that his analysis is not an appropriate method for analyzing market power resulting from a merger and that some other type of analysis should have been performed. For example, Direct Energy witness Morey asserted that Dr. Hieronymus' analysis "does not measure FE's ability to exercise market power in its post-merger service territories." Direct Energy St. 1-SR at 16. Similarly, OCA witness Hahn stated that "this Commission need not, indeed should not, accept FERC's determination on any merger. The Commission should analyze the merits of the case and make its own independent findings." OCA St. 1-S at 12.

The Joint Applicants agree that this Commission must make its own independent findings. However, as noted, this Commission has adopted the FERC approach to analyzing

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[11] *See US Gen. New England, Inc.*, 109 FERC ¶ 61,361 at P 23 (2004); *Ohio Edison Co.*, 94 FERC ¶ 61,291 at 62,044 (2001); *Commonwealth Edison Co.*, 91 FERC ¶ 61,036 at 61,134 (2000).

wholesale market power resulting from mergers. The general assertions advanced by Direct Energy, OCA, and others that some other undefined analysis should have been conducted instead cannot overcome the Commission's prior determinations as to the proper approach for analyzing the effect of a merger on wholesale markets. This is particularly the case given the lack of evidence that such an alternative analysis would reveal any market power problems. Consequently, the general attacks on Dr. Hieronymus' use of the FERC analysis should be rejected.

(2) Mr. Hahn's Illustrative Example of Withholding

Mr. Hahn, who appeared on behalf of the OCA,[12] took issue with Dr. Hieronymus' analysis.

In his direct testimony Mr. Hahn presented an illustration of what he claimed might happen to PJM market prices if Allegheny's low cost coal generation units "are hypothetically removed." OCA St. 1 at 32-34. This analysis assumes the simultaneous withholding of eight Allegheny coal units for a single hour and when load is at the level where such withholding would have the greatest possible effect on market prices. Mr. Hahn purports to show that the merged company would increase its net energy revenues by $100,000 in that hour as a consequence of the hypothetical withholding. *Id.*

Dr. Hieronymus refuted Mr. Hahn's hypothetical, however. Dr. Hieronymus noted that the coal units involved in the hypothetical cannot, as an operational matter, be withheld for a single hour. He performed a study, using the exact same methodology as Mr. Hahn, but in which

[12] The OCA is a signatory to the Joint Petition and, as such, is no longer asserting or defending the positions espoused by Mr. Hahn. The Joint Applicants nonetheless address Mr. Hahn's testimony below for two reasons. First, because the OCA had joined in the Settlement, the Joint Applicants believe it is appropriate to discuss the record evidence that establish a sound basis for terms of the Settlement. Second, it is possible that non-settling parties, who have raised wholesale market power issues which they may choose to pursue, could try to rely on Mr. Hahn's testimony in support of their positions. In that event, the Joint Petitioners' discussion of Mr. Hahn's testimony is necessary to show that those parties' reliance thereon is misplaced.

the hypothetical withholding occurred not in a single hour but lasted for an entire day. This assumption is more representative of the minimum amount of time that a coal unit would have to be taken out of service in order to be withheld from the market. Dr. Hieronymus' study showed that, rather than increasing the merged company's net energy revenues, the withholding strategy posited by Mr. Hahn would cause a *loss* of $420,000 to the merged company. Jt. App. St. 4-R at 14-16; Tr. at 640-41.

In addition, Dr. Hieronymus described several other reasons why the amount of increased energy revenues calculated by Mr. Hahn resulting from withholding generation was overstated, thus making the hypothetical strategy even less attractive to the merged company. These reasons included the following:

(1) Mr. Hahn's example is highly dependent on the hour when the coal units are withdrawn. Under many circumstances, the strategy would lose money even if it were possible to withhold coal units for just a single hour.

(2) Mr. Hahn ignores the potential for imports from outside of PJM that could replace the supplies lost if the coal units were to be withheld.

(3) Mr. Hahn ignores that the Joint Applicants have fixed price contracts that do not fluctuate with hourly fluctuations in the market price, and thus would not benefit from the price increases posited by Mr. Hahn even if market prices increased as he assumes.

(4) Mr. Hahn also ignores the increase in prices that the Joint Applicants would face for any power that they purchase in the hour in which the units are assumed to be withheld. This increase in costs for purchased power would offset any increased revenues from the sale of power.

(5) Mr. Hahn ignores the operating expense that would be incurred by the Joint Applicants to shut down and then start up the units being withheld.

(6) Mr. Hahn's analysis assumes that the PJM Market Monitor would not detect this strategy. While Mr. Hahn goes on after presenting his hypothetical to acknowledge the likelihood of detection,[13] he asserts that PJM could not detect or

[13] The consequences of market manipulation being detected by the PJM Monitor are potentially quite severe. Under the Energy Policy Act of 2005, a new Section 222 was added to the Federal Power Act that prohibits market manipulation, and then Sections 306, 316 and 316A of the Federal Power Act increase FERC's ability to impose civil and criminal penalties of up to $1 million/day. *See* Energy Policy Act of 2005, §§ 1283-84.

> prevent the premature retirement of the units involved. However, premature retirement would result in the loss of energy revenues in all hours of the year, as well as capacity and ancillary services revenues and thus, as demonstrated by Dr. Hieronymus' study, would be highly unprofitable.

Jt. App. St. 4-R at 10-20. Dr. Hieronymus' study alone shows that Mr. Hahn's hypothetical does not demonstrate the existence of a competitive problem. When that study is combined with all of the other problems identified by Dr. Hieronymus, it is clear that the Merger would not make the type of withholding strategy posited by Mr. Hahn more likely or, indeed, even possible.

(3) Mr. Hahn's Claim that a PJM West Market Should Have Been Analyzed

Mr. Hahn also asserts that Dr. Hieronymus should have analyzed an undefined "PJM West" market to determine the effect of the Merger on this market. OCA St. 1 at 34; OCA St. 1-S at 11-12. However, Mr. Hahn presented no evidence describing exactly what is included in his PJM West market or suggesting that this undefined market should be considered a separate geographic market. Nor did Mr. Hahn present any analysis suggesting that the Merger would create market power issues in his PJM West market if it were to be analyzed separately.

Such vague, unsupported allegations cannot constitute evidence of a market power problem. It always is possible to identify a potential geographic market that in theory could be studied. If all that is required to attack a market power study is to name one more potential geographic market to be analyzed, then it never would be possible to complete the competition analysis and it never would be possible to reach any conclusions regarding the effect of the merger on wholesale competition. Mr. Hahn's unsupported assertions should be rejected.

Moreover, Mr. Hahn ignored that Dr. Hieronymus *did analyze* a Midwest Market similar to the PJM West market that Mr. Hahn urged should have been analyzed. Unlike Mr. Hahn, Dr. Hieronymus analyzed transmission data and market price data to provide a factual basis for establishing the boundaries of the Midwest Market to be examined. Dr. Hieronymus' analysis

showed that the Merger will have no adverse effect on this Midwest market. Jt. App. St. 4, Ex. WHH-1, Ex. J-1 at 13-17. As a result, to the extent that the Commission believes that Dr. Hieronymus should have analyzed a Midwest market that does not include central and eastern PJM, Dr. Hieronymus has performed such an analysis and demonstrated that it will not be adversely affected by the Merger.

(4) Claims that a Default Services Auction Market Should Have Been Analyzed

Mr. Hahn and Dr. Wilson both claim that Dr. Hieronymus should have analyzed a product market for sales through the default service wholesale auctions that are used for default service providers to obtain the power that they sell to their retail default service customers. OCA St. 1 at 34-35; OCA St. 1-S at 12-13; OSBA St. 1 at 20-21. Neither witness specifies exactly what this market is or how it should be analyzed. Nor does either witness present any evidence suggesting that, if the market were to be analyzed, it would reveal any competitive problems. Indeed, Mr. Hahn concedes that "there is little publicly available data to support an analysis of this market and product." OCA St. 1 at 35.

Moreover, as Dr. Hieronymus explained, it is not necessary to conduct a separate analysis of this product market. The products being sold into the default service auctions are wholesale energy, wholesale capacity, and wholesale ancillary services, all of which Dr. Hieronymus *did* analyze. As Dr. Hieronymus explained, "if wholesale power markets are workably competitive, the [default service] auction markets also will be workably competitive since the auction markets rely on the same, or even a greater set of suppliers (i.e. marketers in addition to generators)." Jt. App. St. 4 at 3 n. 1. *See also* Jt. App. St. 4-R at 31-32; Tr. at 642-43. Because Dr. Hieronymus analyzed the wholesale markets for market power issues related to the products being sold into

the default service auctions, there was no need to analyze the default service auctions as a separate market.

In surrebuttal testimony, Mr. Hahn asserted that it is necessary to conduct a separate analysis of the default service auction product market because not every owner of generation has the necessary creditworthiness to meet the collateral requirements necessary to bid. OCA St. 1-S at 12. He again argued that, as a result, it is necessary for Dr. Hieronymus to have conducted some kind of unspecified analysis of this market. Mr. Hahn provided no information suggesting that the Merger would have any adverse competitive effects in this market. *Id.*

In response to this assertion, Dr. Hieronymus agreed that smaller generators might not be able to meet the necessary creditworthiness standards to participate directly in the default service auctions. However, most generators do participate directly, as do marketers who do not own any generation – "anybody with a checkbook, a computer, and a risk manager, can enter this market." Tr. at 644. Further, even the smaller generators who are not able to participate directly in the default service auctions are able to participate indirectly by selling to the marketers who do participate in the market. *Id.* As a consequence, while the default service auction market might be "slightly different than the underlying wholesale market," the default service auction market nevertheless is "a competitive market in its own right." *Id.* Mr. Hahn's and Dr. Wilson's unsupported contentions otherwise should be rejected.

(5) Dr. Morey's References to the PJM Market Monitor's State of the Market Report

Dr. Morey's testimony on wholesale market power issues consists almost entirely of quoting from selected portions of the PJM Market Monitor's State of the Market Report ("SOM Report") for 2009. Direct Energy St. 1 at 22-30. Dr. Morey acknowledged that the SOM Report does not in any way evaluate the merger that is the subject of this proceeding. Tr. at 758. He

nevertheless argues that the discussion of various structural issues contained in the 2009 SOM Report somehow implies that the Merger would have adverse effects on wholesale markets in PJM. Direct Energy St. 1 at 30.

Dr. Morey's assertions in this regard should be rejected. First of all, as he admitted at the hearing, the 2009 State of the Market Report observes that the results of the various PJM wholesale markets in 2009 were competitive. Tr. at 760. *See also* Jt. App. Cross Exam. Ex. 6 (2009 SOM Report Vol. 1) at 2 (reporting that the results of the PJM wholesale markets were competitive).[14] Thus, to the extent that any conditions arose in PJM where the level of competition was not sufficient, the PJM Market Monitor's monitoring and market power mitigation activities were successful. Tr. at 760-61. Dr. Morey presented no reasons whatsoever for the Commission to conclude that the Merger would materially change the competitiveness of the PJM markets or would make the PJM Market Monitor's monitoring and mitigation activities any less effective or successful.

Second, the PJM Market Monitor consistently has concluded in his SOM Reports since 1999 that, although there are structural issues in PJM, the results of the markets have been competitive. *See* Jt. App. Cross Exam. Ex. 7. This has been the case even though there have other mergers since 1999. Tr. at 765. Again, Dr. Morey has given no reason why the effect of this Merger on PJM wholesale markets should be any different from that of prior mergers.

Third, Dr. Morey asserts that there can be local market power in energy markets in certain PJM zones when there is transmission congestion. However, the only two PJM zones that he identifies that could be affected by the Merger are the Penelec and Allegheny Power

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[14] The 2009 SOM Report did conclude that the results of the Regulation Market were not competitive, but that was not because of uncompetitive behavior by the market participants but rather because it is the PJM Market Monitor's belief that the price-setting mechanism for regulation service results in a price that is too high. Tr. at 761; Jt. App. Cross Exam. Ex. 6 at 2 n. 4.

zones. Direct Energy St. 1 at 23-26. This assertion ignores the fact that Allegheny has no generation in the Penelec zone and FirstEnergy has no generation in the Allegheny zone, so the combination of the two companies does not increase market power in either zone. Jt. App. St. 4-R at 20-21. Moreover, FirstEnergy has divested almost all of its generation in the Penelec zone. *Id.* at 26. Thus, neither of the Joint Applicants has any material amount of generation in the Penelec zone.

Furthermore, the PJM Market Monitor has a policy of implementing offer caps whenever local market power problems resulting from transmission congestion arise. The 2009 SOM Report indicates that this is a very rare occurrence – 0.1% of all hours in the day-ahead market and 0.4% of all hours in the real-time markets. Tr. at 667-68.; Jt. App. Cross Exam. Ex. 6 at 14-15. But when the conditions for exercising local market power problems do occur, the PJM Market Monitor has concluded that "Offer capping is an effective means of addressing local market power." *Id.* at 14.[15] As a consequence, the PJM Market Monitor concluded that, "the PJM Energy Market results were competitive in 2009." *Id.* at 19.

Dr. Morey's discussion of the PJM capacity markets is similarly devoid of any explanation as to why the Merger would have any adverse effect on the capacity markets. As Dr. Hieronymus explains, the Merger will not cause the relevant capacity markets to fail any of the PJM Market Monitor's market power tests any more than already is the case. Jt. App. St. 4-R at 22-23. Furthermore, Dr. Morey was forced to admit that the PJM Market Monitor has stated, without qualification, that capacity market mitigation effectively mitigates market power

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[15] Dr. Morey notes that later in the 2009 SOM Report, the Market Monitor states that the offer capping is effective "in most cases," the implication being that offer capping is not always effective. Direct Energy St. 1 at 23. Dr. Morey provides no explanation, however, as to why this qualification does not appear earlier in the report, which states without qualification that offer capping is effective. Tr. at 767. Nor does Dr. Morey explain when offer capping would not be effective, or identify any instances where it would not be effective in mitigating any local market power that otherwise might result when an interface is congested.

problems. Tr. at 768-69. *See also* Jt App. Cross Exam. Ex. 6 at 53. As a consequence, the PJM Market Monitor concluded that "[t]he PJM Capacity Market results were competitive during calendar year 2009." *Id.*

The final market discussed by Dr. Morey is the RFC Tier 2 Synchronized Reserve Market. Direct Energy St. 1 at 29-30. Again, however, Dr. Morey ignores that FirstEnergy has almost no generation participating in this market, so the Merger will not increase market concentration in that market. Jt. App. St. 4-R at 23. He also ignores that the PJM Market Monitor has concluded that the mitigation in place for this market is effective and that the results of the market in 2009 were competitive. *Id. See also* Jt. App. Cross Exam. Ex. 6 at 64.

Thus, although Dr. Morey is correct that there are structural market power issues in PJM, he has failed to establish any connection between these structural issues and the Merger under review in this proceeding. In particular, Dr. Morey has failed to show either that the Merger increases the merged company's post-merger market power in PJM or that the market power mitigation tools available to the PJM Market Monitor would not adequately mitigate any attempt by the merged company to exercise market power. As a consequence, the Commission should reject Dr. Morey's attempt to use the 2009 SOM Report to demonstrate any adverse effect on wholesale competition resulting from the Merger.

2. The Merger Does Not Raise Retail Market Power Concerns

As discussed *supra* in Section IV.B, the Merger will have no adverse effect on Pennsylvania's competitive retail electric and natural gas markets. Dr. Hieronymus testified that the combined company's share of electric generation after the transaction will not allow it to control the market price of energy that retail electric suppliers use to meet their retail service obligations, and the loss of Allegheny Energy Supply as a competitor will have only a trivial impact on the market due to its small size. Jt. App. St. 4, pp. 12-16; Jt. App. St. No 4-R, p. 38.

Joint Applicant witness Michael M. Schnitzer emphasized that the Merger would also not have any adverse impact on either the provision of default service or the ability of EGSs to serve retail mass market customers. In default service supply solicitations, many suppliers compete to provide supply on the basis of lowest price to customers and the timing and definitions of products procured are established through a Commission proceeding; the combined company will have no ability to unilaterally alter those decisions. Jt. App. St. 9-R, p. 12. Similarly, EGSs that want to serve default service customers must now compete against other EGSs and the default service approved by the Commission; after the Merger, the situation is unchanged. *See id.*, p. 14.

Joint Applicant witness Frank C. Graves also testified that the ownership of low-cost generation resources by a wholesale supplier does not provide it with an unfair pricing advantage in retail electricity markets, and that there was no basis to conclude that the proposed Merger would result in reduced competition in default service supply auctions. Jt. App. St. 10-R, pp. 6-12. He also underscored that the Merger would not in any way affect the barriers to entering or exiting the Pennsylvania retail electricity market, and concluded that with the ending of rate caps, there will be a sufficient number of EGSs active in Pennsylvania to support a workably competitive market in retail electricity after the Merger. *See id.*, pp. 15-16.

VI. THE NON-SETTLING PARTIES HAVE NOT PRESENTED ANY VALID REASON FOR THE COMMISSION TO EITHER WITHHOLD APPROVAL OF THE TRANSACTION OR TO ATTACH FURTHER CONDITIONS TO ITS APPROVAL

A. Direct Energy's Attempt To Dismantle Pennsylvania's Default Service Model Should Be Rejected

1. Overview Of The Direct Energy Plan

In what can only be characterized as an attempted end-run around years of Commission rulemakings, stakeholder collaboratives and individual company proceedings, Direct Energy has recommended that the proposed Merger be conditioned on a fundamental restructuring of Pennsylvania's default service provider ("DSP") model (at least as applied to the Joint Applicants). The principal components of the Direct Energy Plan are as follows:

- Require the merged entity's four EDCs to exit the DSP business and have the Commission appoint one or more alternative DSPs to take over that role in the Met-Ed, Penelec, Penn Power and West Penn service territories;
- Have the new DSP(s) auction off existing residential and small business ("Mass Market") default service customers to EGSs, unless such customers affirmatively "opt out." After an initial one-year period, the EGSs, at their discretion, would be free to charge the assigned customers whatever prices they wished;
- Mandate that the only DSP product to be offered the "opt out" Mass Market customers be a completely unhedged, 100% hourly spot priced service;
- Require the merged entity to unbundle its billing function and distribution rates through the creation of a separate "BillCo"; and
- Require the merged entity to divest an undefined amount of generation.

As explained by Joint Applicants witness Schnitzer, the potential implications of Direct Energy's Plan are dramatic:

> Mass Market customers who today choose not to choose default to a largely fixed price service, which is competitively procured in the wholesale market under the oversight of this Commission. Under Direct Energy's proposal, the actual default service is involuntary assignment. Those same choose not to choose customers would be involuntarily

> assigned to an EGS whose pricing, after an initial one year period, would not be subject to Commission oversight. Customers wishing to avoid such involuntary assignment and receive a Commission sanctioned default service would have to affirmatively elect such service, but they would not be able to obtain the stable pricing to which they are accustomed. The only service offering under the Commission's jurisdiction would be a completely unhedged and volatile spot price offering.

Jt. App. St. 9-R, p. 8.

As became apparent during the hearings held in this matter, Direct Energy's Plan has nothing to do with the proposed Merger and certainly is not intended to advance retail competition in any meaningful way. In fact, Direct Energy does not want to compete for customers; rather, it hopes to buy them, with the Commission's blessing. But, as discussed hereinafter, its proposals are contrary to law in several critical respects; key components of its Plan were never fully explained or supported; and its recommended dismantling of Pennsylvania's default service model, if approved, would constitute a giant step backwards in terms of regulatory policy. Direct Energy's Plan, therefore, must be rejected.

2. Direct Energy's Proposals Should Be Rejected As A Matter Of Law

a. This Is Not The Appropriate Proceeding To Reexamine The Manner In Which Default Service Is Provided

Direct Energy's proposals are allegedly designed to address what its own witnesses describe as generic flaws in the structure of the competitive retail market in Pennsylvania arising from the way the Commission has implemented the Electric Competition Act for **all** Pennsylvania EDCs, not just West Penn and the FirstEnergy Pennsylvania Utilities. For example, Direct Energy witness Matthew J. Morey stated:

> I am not suggesting that the utility is behaving in a discriminatory or anticompetitive manner. What I am saying is that *the model for DSP [default service provider] service itself, which is the product of well-intentioned public policies, results in an anticompetitive and discriminatory market structure.* The existing DSP model has far-outlived those good intentions, however, and this proposed merger requires the

> Commission to deal with the fact that *the DSP model that "defaults" the overwhelming majority of customers to bundled utility service is by its nature, a discriminatory mechanism* that undermines the development of a robust competitive retail market.

Direct Energy St. 1, p. 12 (emphasis added).

Throughout his testimony, Dr. Morey repeats this premise, namely that Direct Energy's proposals to "unbundle" both default service and certain billing functions should be adopted not because anything inherently "discriminatory" or "anticompetitive" will arise from the proposed Merger but, instead, because of alleged structural flaws that, in his opinion: (i) already plague the retail market in Pennsylvania; and (ii) will remain even if the proposed Merger is **not** approved:

- "The DSP model in use in Pennsylvania . . . is not consistent with the concept of a competitive retail electricity sector." (Direct Energy St. 1, p. 11)
- "Default service is an anachronism that inhibits market efficiency . . . ." (Direct Energy St. 1, p. 32)
- "[T]he notion of default service can be interpreted as a vestige of history under the traditional cost of service monopoly." (Direct Energy St. 1, p. 33)

Direct Energy's testimony pays little more than lip service to the transaction for which the Joint Applicants seek Commission approval. Rather, as became evident early on, Direct Energy is using this proceeding as a platform to level broad-based criticisms against the entire, state-wide DSP model and to force fundamental changes in that model. This is not the forum in which to consider those kinds of changes.

As previously discussed, Section 2811(e) of the Code authorizes the Commission to condition its approval of a proposed merger or acquisition if it finds that the transaction "is likely to result in anticompetitive or discriminatory conduct" that would "*prevent* retail electricity customers . . . from obtaining the benefits of a properly functioning and workable competitive retail electricity market." In that event, the Commission may impose conditions on its approval that are "*necessary to preserve* the benefits of a properly functioning and workable

competitive retail electricity market" (emphasis added). In short, Section 2811(e) empowers the Commission to "prevent" a proposed transaction from improperly compromising the functioning of an existing "workable and competitive retail electricity market" and to "preserve" the benefits that customers already are able to obtain in that market. However, Direct Energy's testimony repeatedly opines that a "properly functioning and workable competitive retail electricity market" does not now exist and would not exist even if the proposed transaction is denied and the status quo is maintained.

In other words, Direct Energy's proposal is not aimed at "preserving" existing competitive market conditions but, instead, is designed to create an entirely new set of ground rules that Direct Energy believes is needed whether or not the Joint Application is granted. In other words, Direct Energy asks the Commission, in the context of this case, to go far beyond the scope of action authorized by Section 2811(e) by dramatically re-shaping the structure of the existing retail electricity market. Leaving aside the question of whether the Commission has the authority under any circumstances to undertake what Direct Energy proposes, it is clear that Section 2811(e) does not provide the authority for it to do so **in this case**.

b. Direct Energy Has Disregarded The Procedural And Substantive Requirements Imposed By The Commission's Default Service Regulations

The Commission's default service regulations provide that: "[t]he DSP shall be the incumbent EDC in each certificated service territory except as provided for under subsection (b)" (52 Pa. Code § 54.183(a)). Subsection (b) authorizes only three "processes" by which a DSP may be changed: (1) upon petition by an EDC to be relieved of its DSP obligation; (2) upon petition of an EGS to be assigned the DSP role for a particular EDC service territory; and (3) upon the Commission's own motion to relieve an EDC of its DSP obligation. Additionally,

subsection (c) specifies the findings the Commission must make as a condition precedent to relieving an EDC of its DSP obligations:

> The Commission may reassign the default service obligation for the entire service territory, or for specific customer classes, to one or more alternative DSPs *when it finds it to be necessary for the accommodation, safety and convenience of the public.* A finding would include an evaluation of the incumbent EDC's *operational and financial fitness to serve retail customers, and its ability to provide default service under reasonable rates and conditions.* In these circumstances, the Commission will announce, through an order, a competitive process to determine the alternative DSP. (emphasis added)

At the outset, Direct Energy failed to comply with the procedural requirements of Section 54.183(b) because it did not file a Petition. This is more than a technical omission because the filing of a Petition would trigger different notice requirements than those employed for the Joint Application that initiated this proceeding. Obviously, notices of the filing of the Joint Application did not – nor could they – have alerted interested parties and other stakeholders that the filing would prompt another intervenor to propose a comprehensive change in the structure of default service in Pennsylvania. Accordingly, the unorthodox manner Direct Energy chose to present its proposal raises serious due process issues.

Direct Energy's proposal also contains substantive deficiencies that would be even more apparent if Direct Energy had filed a Petition that attempted to track the requirements of the default service regulations. For example, Direct Energy made no attempt to address the findings that Section 54.183(c) requires before the Commission can "reassign the default service obligation." As noted above, such findings must include "an evaluation of the incumbent EDC's *operational and financial fitness to serve retail customers*, and *its ability to provide default service under reasonable rates and conditions*." (emphasis added) Notably, Direct Energy has not alleged that Met-Ed, Penelec, Penn Power or West Penn lacks the "operational and financial

fitness" to continue to serve as a DSP in its service area, nor has it claimed that those companies have lost the "ability to provide default service under reasonable rates and conditions." And, there would be no basis for such averments even if they had been made.

At the conclusion of DSP proceedings **in which Direct participated fully**, the Commission found that Met-Ed, Penelec, Penn Power and West Penn were fit to perform the duties of a DSP and that their respective DSP programs satisfied the requirements of 66 Pa. C.S. § 2807(e) for competitive procurement of generation supplies for default service customers. The DSP programs of Met-Ed and Penelec were approved in November 2009;[16] Penn Power's most recent DSP program was resolved by a Joint Petition for Settlement filed on July 23, 2010, to which Direct Energy was a signatory;[17] and West Penn's DSP program was approved by the Commission in a fully litigated 2008 proceeding.[18] Direct Energy's proposal in this case, which seeks to strip the Allegheny and FirstEnergy Pennsylvania Utilities of their DSP status, is an improper collateral attack on the Commission's final orders in those proceedings and an equally improper collateral attack on the Settlements that Direct Energy executed and endorsed in its Statements in Support.

Finally, the Joint Applicants note that in West Penn's last default service proceeding, only two years ago, RESA (whose membership includes Direct Energy), requested that the Commission open a new proceeding to explore which entities, other than the incumbent EDC, should serve as the DSP or, in the alternative, to develop a process for an auction of default

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16 *See Joint Petition Of Metropolitan Edison Co. & Pennsylvania Elec. Co. For Approval Of Their Default Service Plans*, Docket Nos. P-2009-2093053 and P-2009-2093054, 2009 WL 3778375 (November 6, 2009).

17 Joint Petition for Settlement approved October 21, 2010 at Docket No. P-2010-2157862 (Order pending).

18 Petition of the West Penn Power Co. d/b/a Allegheny Power for Approval of its Retail Elec. Default Serv. Program & Competitive Procurement Plan for Serv. at the Conclusion of the Restructuring Transition Period, Docket No. P-00072342, 2008 Pa. PUC LEXIS 30 (July 25, 2008).

service customers. In dismissing the Direct/RESA proposal, the presiding ALJ reasoned as follows:

> Allegheny [West Penn] had not petitioned the Commission to be relieved of the default service obligation in this proceeding. An EGS had not petitioned the Commission to be assigned the default service role for Allegheny [West Penn] in this proceeding. And there was no evidence that Allegheny [West Penn] should be relieved of its default service obligation. Therefore, I reject RESA's recommendation that the Commission open a proceeding to consider alternative default service providers. I also agree with the advocate that there was no evidence to support a retail auction of customers and therefore reject that proposal, too.[19]

See also Tr. 999. Direct Energy's efforts in this proceeding to restructure the provision of default service should be rejected again.

c. Direct Energy's Hourly Pricing Proposal For Default Service Customers Violates Act 129

Act 129 of 2008 amended the default service provisions of the Code to require the use of "competitive procurement processes" to obtain a "prudent mix" of contracts that is designed to ensure "adequate and reliable service" at the "least cost to customers over time." 66 Pa. C.S. § 2807(e)(3.1)-(3.2) & (3.4). In approving a default service provider's plan, the Commission must make specific findings that "the default service provider's plan includes prudent steps necessary to negotiate favorable generation supply contracts . . . [and] includes prudent steps necessary to obtain least cost generation supply contracts on a long-term, short-term and spot market basis." 66 Pa. C.S. § 2807(e)(3.7). In addition, the preamble of Act 129 expressly states that the

[19] *Petition Of West Penn Power Co. d/b/a Allegheny Power For Approval Of Its Retail Elec. Default Serv. Program & Competitive Procurement Plan For Serv. At The Conclusion Of The Restructuring Transition Period*, Docket No. P-00072342, (Rec'd Dec.) 2008 Pa. PUC LEXIS 44 *274-278 (May 21, 2008). The Commission's final Order did not specifically discuss this issue. However, the Commission adopted the Recommended Decision (except as expressly modified) and, therefore, adopted the Administrative Law Judge's ruling . 2008 Pa. PUC LEXIS 30 (July 25, 2008).

Commission's consideration of "least cost" should "[take] into account any benefits of price stability."

Under the Direct Energy Plan, Mass Market customers who affirmatively "opt out" of the proposed auction and do not choose an EGS on their own will receive an unhedged hourly priced product from the new DSP. Although Dr. Morey sought to downplay the potential volatility to which default service customers would be exposed, his rationalization was less than convincing:

> Q. . . . [W]hat you state is, customers on default service will not therefore be subject to hourly, daily or monthly spot price volatility as Mr. Schnitzer implies; quite the contrary. Do you see that?
>
> A. Yes, I do.
>
> Q. Now, isn't it true that under the Direct Energy proposal there will be a true-up or reconciliation adjustment at the end of each quarter to capture variations in the actual hourly prices from the fixed price that is set at the beginning of the three-month period?
>
> A. There would be an adjustment, but I don't think that that changes my point here, which is they're not subject to hourly spot price [volatility].
>
> Q. Well, let me ask you this. Wouldn't it be more accurate to say that customers will be exposed to hourly spot price volatility, but just won't see the impact of that volatility until they get their bills at the end of three months?
>
> A. The volatility will be clearly smoothed out over time. And when you think about the forward market the forward market can be viewed as even more volatile than the spot market.

Tr. 802-803.[20]

Whether or not the volatility would be "smoothed out over time," as Dr. Morey contends, the fact remains that during periods of rapidly rising spot market prices, customers could be in

[20] Mr. Lacey also claimed that the Direct Energy proposal was largely indistinguishable from the EDCs' approved DSP plans, which similarly provide for quarterly adjustment (Direct Energy St. 3-SR, p. 11). The difference, of course, is that most EDCs' supply portfolios include a reconcilable spot purchase component for residential customers of only 5%-10% (West Penn at 20%) (Jt. App. St. 9-R, pp. 28-29). In contrast, under the Direct Energy Plan, the entire supply (i.e., 100%) would be subject to after-the-fact price adjustment.

for a very unpleasant surprise when their new DSP sends them a bill at the end of three months. In any event, it is clear that Direct Energy's Plan does not consider the benefits of price stability or the "prudent mix" of long-term, short-term and spot purchases required by Act 129.

d. The Public Utility Code Does Not Authorize The Divestiture Of An EDC's Billing Function

Direct Energy's Plan calls for the four EDCs to divest their billing function to a separate entity. As discussed *infra*, there is some confusion as to whether the so-called "BillCo" would be a public utility or not. However, and regardless of Direct Energy's intentions, billing is part of distribution service and, as such, remains subject to regulation as a public utility function under the Code. 66 Pa. C.S. § 2802(16). Accordingly, billing services are not part of the default service function, and the Commission's authority to reassign DSP obligations does not extend to an involuntary reassignment of an EDC's public service obligation to furnish bills for distribution service.

Furthermore, the unbundling of the billing function is not something that can be imposed on an EDC as a condition of merger approval, as Direct Energy assumes. The Electric Competition Act did not authorize the Commission to deregulate functions, such as billing, that are inherent in distribution service and, therefore, retain their character as public utility service. *See* 66 Pa. C.S. § 2802(16). Additionally, the divestiture of an EDC's billing function would require the EDC to transfer property used and useful in providing public utility service and, therefore, could not be done without the prior issuance of a certificate of public convenience evidencing the Commission's approval. 66 Pa. C.S. § 1102(a)(3). Moreover, Section 1102(a) provides that a certificate may issue only "[u]pon the application of any public utility . . .". Nothing in the Electric Competition Act overrides the protection against involuntary transfers embodied in Section 1102. Consequently, the BillCo concept, even if it were permissible under

the Code – and there is no indication that it is -- 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. None of the FirstEnergy or Allegheny EDCs has agreed to any such divestiture.[21]

e. Direct Energy Is Estopped From Seeking A Further Unbundling Of Met-Ed/Penelec's Distribution Rates

Billing costs currently are recovered by the four EDCs through their base distribution rates. As discussed *supra,* the Direct Energy Plan would unbundle the billing function and, of necessity, require that rates be established for the new BillCo entity. However, as a signatory to the Joint Petition for Settlement that resolved Met-Ed's and Penelec's default service proceedings at Docket Nos. P-2009-2093053 and P-2009-2093054, Direct Energy agreed as follows:

> By reason of the Companies agreeing to unbundle uncollectible accounts-expense and to file a POR [Purchase of Receivables] program on the basis set forth above, the other Joint Petitioners agree not to petition the Commission for the further unbundling of the Companies' distribution rates until such time as the Companies file a distribution base rate case.

Jt. App. Cross Exam. Ex. 3; Tr. 633-634. No such distribution base rate case(s) has been filed and Direct Energy is therefore estopped from seeking a further unbundling of Met-Ed/Penelec's distribution rates in this proceeding.[22]

f. FirstEnergy's First Amendment Rights Would Be Violated If It Were Stripped Of The Use Of Its Name In Marketing Electricity

Direct Energy's proposed ban on FirstEnergy's use of its name in marketing competitive (i.e., non-utility) electricity offers in its four EDCs' service territories violates the First

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[21] *See also* 66 Pa. C.S. § 2804(5): The commission may permit, but shall not require, an electric utility to divest itself of facilities or to reorganize its corporate structure.

[22] RESA was also a signatory to the Joint Petition for Settlement at Docket Nos. P-2009-2093053 and P-2009-2093054.

Amendment. Brand names are not essential facilities and the choice of brand name is a form of commercial speech which is constitutionally protected. *Central Hudson Gas & Elec. Corp. v. Pub. Serv. Comm'n of New York*, 447 U.S. 557, 563 (1980). To restrict FirstEnergy's First Amendment rights, the Commission would have to establish not only that the potential harm addressed is both real and serious, but also that the proposed restrictions appropriately remedy that harm. *Edenfield v. Fane*, 507 U.S. 761, 768-777 (1993). No harm flows from FirstEnergy's use of its name; to the contrary, brand identification aids consumers in differentiating among alternative suppliers. Direct Energy's proposed ban, in contrast, would restrict the flow of accurate and factual information to consumers, thus hindering consumer choice and unfairly advantaging competitors such as Direct.

In addition, neither Direct nor any other party presented evidence even remotely suggesting that FirstEnergy derives any "branding advantage" by marketing power through its competitive retail supplier, FirstEnergy Solutions or "FES." Unlike several of Direct Energy's RESA colleagues which clearly play off the name of an incumbent EDC to promote retail sales (e.g., ConEdison Solutions, PPL EnergyPlus) (RESA St. 1, p. 2, n. 1; Tr. 622-624; Jt. App. Cross Exam. Exs. 1 and 2), there has been no showing that customers in the Met-Ed, Penelec and Penn Power service areas are even aware of the corporate affiliation between FES and their EDC.[23]

Moreover, and as Mr. Graves explained (Jt. App. St. 10-R, pp. 16-17), claims regarding alleged branding advantages are overblown:

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[23] The following exchange during the cross-examination of RESA witness Hudson is instructive:

Q. You don't think there's any improper customer confusion caused by Con-Ed Solutions having Con-Ed as part of its name, do you?

A. I do not.

Q. And that in no way leverages any aspects of Con-Ed's other business, including its utility businesses, right?

A. No.

> These concerns are mostly based on conceptual arguments and speculations rather than any empirical evidence of such advantages. I suspect they are also overstated – as no utility of which I am aware is universally beloved by its customers. It is not hard to find customers who complain their utility is non-responsive, over-charging, not green enough, and so on. Such customers are likely to be averse to the EDC's brand name and affiliates, not attracted to that utility as intervenors claim.
>
> More importantly, I do not think it can be concluded that the merger in a reliable way strengthens brand recognition or retail customer loyalty. There is no evidence, and no good reason to believe, that Allegheny Energy customers will feel a stronger connection with their utility simply because it is affiliates with FirstEnergy, and vice versa for FirstEnergy customers. While some brand loyalty might currently exist, I do not think the merger can be presumed to strengthen brand recognition or customer loyalty. I should also note that the EGS affiliate of Met-Ed, Penelec and Penn Power does business under the brand name of FirstEnergy Solutions or FES, a fact that undercuts the intervenor witness' concerns.

As Mr. Graves further observed (Jt. App. St. 10-R, p. 10), branding is not an issue when it comes to default service auctions as bids are ranked solely on the basis of price and the identity of winning bidders is not disclosed on default service customers' bills.

3. Direct Energy Has Failed To Demonstrate That Adoption Of Its Plan Is Either Necessary Or In The Public Interest

Apart from the various legal obstacles enumerated above, Direct Energy has simply failed to demonstrate why the dismantling of Pennsylvania's current default service model is a good idea. To the contrary, the evidentiary record in this proceeding confirms that competition for retail sales is vibrant and has flourished in those service areas where generation rate caps have expired. Moreover, critical components of the Direct Energy Plan remain largely undefined and/or unsupported.

a. A Workable Competitive Retail Electric Market Exists Today And Will Remain In Place Post-Merger

As candidly acknowledged by its own witnesses, Direct Energy's principal complaint lies not with the proposed Merger, but rather with Pennsylvania's existing default service model.

See, e.g., Direct Energy St. 1, p. 12 ("What I am saying is that the model for DSP service itself . . . results in an anticompetitive and discriminatory market structure"). Indeed, the Merger will not change the manner in which retail customers are served -- Met-Ed will remain the DSP in its service territory, West Penn in its and so forth (Tr. 777-778).[24] And, in each instance, customers will essentially have the same purchase options they have today -- and likely will have even more options when the EDCs' generation rate caps are lifted at the end of 2010.

Dr. Morey's characterization of the current DSP model as "anachronistic," "a vestige of history" and "inherently anticompetitive and discriminatory" (Direct Energy St. 1, pp. 5, 33), just doesn't square with the facts. First, it is important to note that Direct Energy did not submit one shred of evidence suggesting that FirstEnergy or any of its affiliates had engaged in anticompetitive or discriminatory behavior. To the contrary, Dr. Morey went out of his way to make it clear that was **not** his testimony: "No, I am not suggesting that the conduct I have described above has happened or necessarily will happen in FirstEnergy's territory." (Direct Energy St. 1, p. 17; *see also* Tr. 781-782).

Second, the current DSP model does not inhibit competitors from entering the market. As Dr. Hieronymus observed (Jt. App. St. 4, pp. 14-15), there are, by way of example, 21 alternative suppliers licensed to serve commercial and industrial customers in West Penn's service territory and 26 in Penelec's. Notwithstanding Dr. Morey's apparent misgivings (Direct Energy St. 1-SR, p. 7), there is no reason to believe that new entrants will not similarly vie for

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[24] As noted by Direct Energy witness Morey:

> Q. BUT WON'T FIRSTENERGY CONTINUE TO SERVE THESE CUSTOMERS IN THE SAME WAY AS OTHER EDCS IN PENNSYLVANIA, SUCH AS PENNSYLVANIA POWER & LIGHT?
>
> A. Yes it will, and therein lies the problem . . . . . .

Direct Energy St. 1, p. 10.

residential customers once the generation rate caps come off. Again, Dr. Morey's testimony is most telling:

> Retail merchant services are inherently competitive services and, as mentioned above, are handled as competitive services in a number of restructured markets including the U.K. There are several reasons for this market design policy choice. First, entry barriers are comparatively low; merchant suppliers can readily enter and exit from the market without major limitations such as the presence of sunk costs. Viable merchant activities can be readily organized within regional energy markets by both comparatively small entities as well as larger and often more experienced organizations. To a large extent, the key resources of successful merchants within energy markets is human capital and know how in key dimensions, such as management, operational skills in energy marketing, power supply contracting, technical analysis of loads and energy costs, information systems geared to customer contact, and the internal coordination of information flow. The presence of these capabilities is necessary. *However, the merchant function is not confronted with overarching institutional or market barriers that inhibit the organization of and integration of these capabilities to support viable merchant activities by entrants.*

Id. at pp. 37-38 (emphasis added).

Third, Dr. Morey's concerns over the purported lack of "well-capitalized" competitors and absence of "scale economies" (*Id.* at p. 41-42; Tr. 827) have a hollow ring. As to the former, Dr. Morey was reluctant to acknowledge that his client might be "well-capitalized" even though Mr. Lacey volunteered that Direct Energy was part of a $26 billion corporate enterprise (Direct Energy St. 3, p. 2; Tr. 791).[25] And, when questioned on statements he had made on redirect examination regarding the importance of "scale economies," Dr. Morey testified: "I have not studied the economics of retailing to know precisely what level of customers are necessary to achieve scale economies in order to achieve a workably competitive market price outcome" (Tr. 830). Yet, as Mr. Graves demonstrated (Jt. App. St. 10-R, p. 14), Pennsylvania is flush with

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[25] Dr. Morey was similarly reluctant to opine as to whether ConEd Solutions, Constellation, Dominion, Exelon, PPL, Sempra and Sunoco, all licensed EGSs in Pennsylvania, were "well-capitalized" (Tr. 792).

EGSs that are as large as, or larger than, FirstEnergy/Allegheny will be post-Merger and that unquestionably have sufficient scale and experience to compete.[26]

Fourth, it is undeniable that retail competition has flourished, particularly in those areas where generation rate caps have expired. Thus, within six months of the lifting of rate caps in the PPL service territory, approximately 36% of all residential customer load was being served by alternative suppliers (Jt. App. St. 9-R, p. 15, n. 16; Tr. 779-780). Moreover, Dr. Morey observed that customers were enjoying "a wide range of competitive retail options available in other territories in Pennsylvania" (Direct Energy St. 1, p. 33; Tr. 799-800).

Fifth, FirstEnergy's President and CEO, Mr. Alexander, explained that there was nothing improper in the fact that FirstEnergy Solutions controls generation and competes for retail customers while at the same time the FirstEnergy Pennsylvania Utilities also provide default service to non-shopping customers. Jt. App. St. 1-SR, p. 4. These arrangements are common in restructured electric markets in the United States, including other EDC territories in Pennsylvania, and Mr. Alexander emphasized that nothing in the Merger would diminish either FirstEnergy's commitment to the Commission's Code of Conduct applicable to Pennsylvania EDCs and EGSs or the Commission's abilities to enforce its regulations. Mr. Alexander also underscored that FirstEnergy Solutions was in no way relying upon the FirstEnergy Pennsylvania Utilities in competing for retail customers, but had its own "local brand" in Pennsylvania where it currently employs nearly 1,400 people in electric generation and retail marketing operations. Jt. App. St. 1-SR, p. 6.

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[26] Ironically, while complaining about "scale economies," Direct Energy holds itself out as being part of an organization with "over 6 million gas, electric and related services customer relationships" (Direct Energy St. 3, p. 2). In addition, Dominion Resources has been able to accumulate over 300,000 residential customers in Pennsylvania alone (Tr. 886), thereby putting to rest any concern that a determined EGS might be unable to achieve sufficient "scale."

Finally, Dr. Morey's criticisms of the current DSP model cannot be reconciled with the views recently expressed by Mr. Cory Byzewski, Direct Energy's Vice President and General Manager of US North-Residential Business. As set forth in Joint Applicants Cross-Examination Ex. 16, Mr. Byzewski, in announcing Direct Energy's decision to enter the Duquesne Light market, commented as follows: "We think there's a great opportunity there and Pennsylvania has done a great job to make sure that the markets are open and competitive."

b. Critical Components Of Direct Energy's Plan Are Undefined And/Or Unsupported

The Direct Energy Plan, as previously explained, consists of several key elements, including (i) the appointment of one or more new DSPs; (ii) the auctioning off of the four EDCs' default service customers; (iii) the unbundling or the EDCs' billing function and the creation of a separate BillCo; and (iv) the divestiture of some undetermined amount of generation. Unfortunately, substantial confusion persists as to why and/or how each of these measures would be implemented.

The New DSP(s). It is Direct Energy's belief, according to Mr. Lacey and Dr. Morey, that the overwhelming majority of customers will not "opt out" of the proposed auction and, accordingly, that the new DSP will have very few takers for its services (Tr. 1028). If that, in fact, is Direct Energy's expectation, then one must question the need for or wisdom of stripping the four EDCs of their DSP responsibilities. In addition, Direct's perception of the new DSP's diminished role may explain its uncertainty as to how the new DSP would operate:

- Under cross-examination by Judge Weismandel (Tr. 849), Dr. Morey opined that the new DSP would be a public utility. In contrast, when he was questioned (Tr. 1045), Mr. Lacey indicated that the new DSP need not be a public utility.
- According to Mr. Lacey (Tr. 1048), the new DSP would be expected to initially finance the creation of the BillCo. Yet, he also suggested

that it would operate on a non-profit basis (Tr. 1028), raising some doubts about its long-term financial viability and/or ability to deal with contingencies.

- Ms. Brownell insisted that the new DSP would function under the same "confines" as the four EDCs do now (Direct Energy St. 2-SR, p. 4). Mr. Lacey subsequently acknowledged that was not the case and that, in fact, the new DSP would have very few responsibilities (Tr. 1012-1014; *see also* Tr. 786-790).

- After recommending that the four EDCs be forced to relinquish their roles as DSPs and that FirstEnergy Solutions and/or Allegheny Supply be required to change their names in order to engage in "sales activity" and participate in default service auctions in the EDCs' service territories (Direct Energy St. 3, p. 16), Mr. Lacey reversed course and indicated that, in his view, it would be perfectly permissible for Direct Energy affiliates to both assume the DSP role and participate in the auctions (Tr. 1006-1007, 1033-1034).

Auction of Customers. The keystone of the Direct Energy Plan is the auctioning off of customers in tranches ranging from 2,000-10,000 commercial customers to 20,000-100,000 residential customers. Although such customers could choose to opt out of the auction, they could not elect to stay with their current EDC (which would be out of the DSP business) and instead would be assigned to the new DSP and provided unhedged hourly priced service. In addition, those who did not opt out would have no say in terms of the specific EGS to which they would be sold.

As Mr. Schnitzer observed (Jt. App. St. 9-R, p. 6), the colloquial term for what Direct Energy is proposing is "slamming." While some customers will undoubtedly be able to sort through all of this and consciously decide whether or not to enter the auction, others obviously will not. For that reason, Ms. Brownell's attempt to portray auctioned customers as "voluntarily participating" smacks of gamesmanship (Tr. 970):

Q. So just to summarize, it's your testimony that a customer who takes no action today is being forced to default service, and a customer who takes no action under Direct Energy's program is voluntarily participating, is that correct?

A. Yes.

The involuntary assignment of customers to EGSs who successfully bid for their accounts is particularly troublesome in the case of low income customers, which Direct Energy proposes to auction off as a group, i.e., a separate low income tranche (Direct Energy St. 3, p. 11; Tr. 1004). As noted previously, under the Direct Energy Plan, the winning bidders would be free to charge the auctioned customers whatever they pleased after one year. And, if that price were unattractive, customers would have two options – try to identify another EGS with a more favorable offer or accept hourly priced default service. In either case, the customer would have to take affirmative action.

The "carrot" that Direct Energy holds out, of course, is the claim that customers could expect to receive a substantial rebate, estimated by Mr. Lacey as "more than 95% of the total auction revenue," or roughly between $150 and $500 per customer (Direct Energy St. 3, p. 12). The prospect of customers actually receiving anything near those amounts, however, is more illusory than real. Indeed, based on the record in this case, there is every reason to believe that customers would see very little of those funds.

First, and as Mr. Lacey explained in his direct testimony (Direct Energy St. 3, p. 12), the auction proceeds initially will be used "to fund a customer education program and to fund systems changes to enable 'BillCo' to become a fully functioning service company" before any rebates are issued to customers. However, in his surrebuttal testimony (Direct Energy St. 3-SR, p. 29), Mr. Lacey revealed that Direct had not endeavored to quantify the cost of implementing its plan:

> Direct Energy has explicitly acknowledged that there will be costs incurred in developing the BillCo. Direct Energy also explicitly proposed that the costs be paid for out of the auction proceeds. Direct Energy has

> not attempted to quantify the costs as of yet, as that analysis would be premature.
>
> * * *
>
> Direct Energy has explicitly acknowledged that there will be costs incurred in the customer education program. Direct Energy also explicitly suggested that the costs be paid for out of the auction proceeds. Direct Energy has not attempted to quantify the costs as of yet, as that analysis would be premature at this time.

When questioned as to why it was "premature" to get a fix on those costs, Mr. Lacey professed that "we don't know the parameters of the plan" (Tr. 1006). Surely if Direct Energy does not comprehend the "parameters" of its own Plan, it cannot expect the Commission to give its proposals serious consideration.

Second, Dr. Morey's contention, accepted by Mr. Lacey, that EGSs would readily pay between $150 and $500 for the right to serve a customer who could leave the next day is fanciful and totally unsupported. As established during Dr. Morey's cross-examination (Tr. 793-800), his "empirical research" consisted entirely of reading a few internet articles and dividing a reported purchase price by a reported customer count on a hand-held calculator (Jt. App. Cross Exam. Ex. 9). And, upon further scrutiny, it became clear that the transactions on which he had relied in developing his $150-$500 per customer range were in no way comparable to Direct Energy's proposed customer auction. Indeed, in addition to acquiring the right to serve customers, the buyers in Dr. Morey's "illustrative" sample purchased, among other things, "distributable cash", brand names and naming rights, a substantial power supply agreement, customer care and billing systems, a risk management system, accounts receivable and gas inventories (Tr. 798-799; Jt. App. Cross Exam. Ex. 10).

Third, questions remain as to the reasonableness of Direct Energy's plans to distribute the net auction proceeds. According to Mr. Lacey, all of the funds would go into a common pool and be distributed "equally." In other words, no distinctions would be made based on the

different bid prices for individual tranches and, in fact, a commercial customer would get the same dollar rebate as a residential customer (Tr. 1003-1004). Moreover, customers who were already shopping and hence did not go through the auction process would be allocated a share of the auction proceeds nonetheless, while customers who opted out would not (Tr. 1032-1033).

"BillCo". As discussed *supra*, it is the Joint Applicants' position that (i) Direct Energy, as a signatory to the Met-Ed/Penelec DSP Settlement Agreement, is estopped from seeking a further unbundling of distribution rates at this time and (ii) the Commission lacks the authority to require the four EDCs to divest their billing operations. That said, Direct Energy's BillCo proposal is ill-conceived and guaranteed to generate massive customer confusion.

Like the new DSP, Direct Energy's witnesses offered arguably conflicting opinions on whether BillCo would be a regulated public utility -- Dr. Morey said yes (Tr. 793) and Mr. Lacey said maybe (Tr. 1010). Similarly, there seemed to be some disagreement over how BillCo's rates were to be set -- Mr. Lacey assumed that they would continue to be established on a traditional cost of service basis (Tr. 1008) while Ms. Brownell alluded to "several models", including some form of "split savings" (Tr. 983). More troubling, however, was Direct Energy's vision, or lack thereof, of how the billing process was to work.

Not surprisingly, Mr. Lacey was quite adamant that bills issued to his customers would carry Direct Energy's name and logo (Tr. 1049). But, when questioned by the ALJs, he was far less certain as to whom the customer would call if it had a problem with the bill. He first suggested that the bill would carry BillCo's 800 number "because they will have all the billing data." *Id.* He then acknowledged that it might also be appropriate for the bill to include the EGS's number. Then again, the inquiry might relate to regulated wires service, in which case the EDC's 800 number might have to be added as well.

At some point, one is tempted to ask why we want to put customers through all this, particularly in light of Mr. Lacey's admission that the creation of the BillCo was unlikely to yield any savings (Tr. 1010). The answer frequently given by the Direct Energy witnesses is that the unbundling of the billing function will somehow facilitate the development of "value added services". But, alternative generation suppliers, including Direct Energy, have been hawking the benefits of "value added services" for years and neither the proposed Merger nor the current default service model is preventing Direct from delivering on its promises.

Divestiture of Generation. In her direct testimony (Direct Energy St. 2, p. 5), Ms. Brownell reported that it was Direct Energy's position the Joint Applicants should be required to divest some generation "to mitigate the anti-competitive and discriminatory effect of the merger" and that she supported that recommendation. However, when asked what Direct's specific proposal was, Ms. Brownell confessed: "I actually don't know" (Tr. 967). Mr. Lacey also referred to Direct Energy's recommended divestiture, but, like Ms. Brownell, was silent as to details (Jt. App. St. 3, p. 16).

It therefore fell to Dr. Morey to shed light on Direct Energy's divestiture proposal. But, as it turned out, Dr. Morey didn't have a specific recommendation either: ". . . I believe it would be premature to recommend any specific plant divestitures" (Direct Energy St. 3, p. 31). Instead, Dr. Morey proposed "a further analysis of the retail price impacts of the proposed merger to determine the specific generation divestiture plan that is warranted" (*Id.* at p. 32). Thus, two Direct Energy witnesses opined confidently that divestiture was needed, but could not offer any details, while the third concluded that additional study was required.

Similar confusion surrounded the import of the 1997 Allegheny/Duquesne merger proceeding, which both Dr. Morey and Ms. Brownell cited as evidence of the Commission's

alleged preference for "structural measures" to address market power issues. Under cross-examination, Dr. Morey acknowledged that he had never read the Commission's final order in that case (Tr. 785), while Ms. Brownell was under the mistaken impression that the Commission had mandated the divestiture of generation as a condition of merger approval in that proceeding (Tr. 968). It did not. *Re DQE, Inc.*, 186 PUR4th 39, 61 (1998).

All of this talk of divestiture, however, may be moot. At the very conclusion of the evidentiary hearings, Mr. Lacey declared: "I think everyone in the room would tell you that the wholesale markets are competitive" (Tr. 1056). Consequently, even if the Commission had the authority to mandate the divestiture of generation, there would be no reason to do so.[27]

c. The "Zogby Survey"

In a last desperate attempt to resuscitate its proposal, Direct Energy, in mid-September, retained Zogby International to poll the four EDCs' customers. Presumably, the purpose of this exercise was to convince the Commission that people really liked the Direct Energy Plan. However, when viewed in its most favorable light, the Zogby Survey, the results of which were partially summarized in Mr. Lacey's surrebuttal testimony, confirmed nothing more than that customers would be happy if someone handed them a $500 check.

As described by Mr. Lacey (Direct Energy St. 3-SR, pp. 24-25), Zogby conducted 802 telephone interviews over a four day period. The interviews averaged about eight minutes in length, during which the respondents were asked to answer twenty-nine questions (i.e., a question and answer every fifteen seconds) (Tr. 1016). The respondents purportedly were selected on a random basis from telephone lists comprised of residents in the various counties served by the four EDCs.

[27] Moreover, and as discussed *supra*, the proposed Merger does not raise wholesale or retail market power concerns.

At the Joint Applicants' request, Mr. Graves reviewed the survey materials provided by Mr. Lacey to determine whether the results he reported could indeed be construed as an enthusiastic endorsement of the Direct Energy Plan. As Mr. Graves explained (Tr. 881-882), there are broadly two types of problems with the survey. First, the survey implicitly assumes a level of understanding that unlikely exists. For example, it is doubtful that customers have a firm grasp on the current terms and conditions of default service or the competitive options available to them (*see, e.g.,* Direct Energy Ex. FL-4--Question 3's reference to "more choices," Questions 5's reference to "all of the consumer protections that exist today"). Similarly, there is no evidence or, for that matter, reason to believe that the specific details of the Direct Energy Plan were shared with the respondents.

Second, Mr. Graves noted that several of the questions were worded in such a way as to shape the responses. To illustrate his point, Mr. Graves offered the following example (Tr. 883-884):

> The last three or four questions focus on the expectation that Direct Energy has $150 to $500 rebates being possibly forthcoming from their plan. The questions spend a lot of time fostering interest in that $150 to $500 and then asking whether you would support the proposal, and of course they get 85, 90 percent favorable responses, which is not particularly surprising in light of having sort of hung a carrot in front of the respondents before asking them the substantive question about their support for the proposal.

In fact, the bias in the questions posed by Zogby was far more pervasive than described by Mr. Graves. For purposes of his oral rejoinder, Mr. Graves focused on Mr. Lacey's Ex. FL-4, which, for reasons which remain unclear, included only 13 of the 29 questions asked by Zogby. In response to a request for the actual questionnaire or survey script utilized, Direct Energy produced a document that was later entered into the record as Joint Applicants Cross-

Examination Ex. 15. Included among the questions asked, but not reported by Mr. Lacey, were the following:

- "Have you or anyone in your immediate family lost a job due to corporate downsizing within the past year?"
- "Are you or anyone in your immediate family afraid of losing a job within the next year?"
- "Have you or has anyone in your immediate family gone without food for 24 hours in the past month due to a lack of food or money?"

Not surprisingly, after exploiting fears over potential job loss and hunger, Direct Energy could then ask customers whether they would react favorably to a $150 - $500 rebate check and be reasonably confident in the response it would receive.[28]

Other, perhaps less glaring, potential problems with the Zogby Survey relate to the fact that telephone surveys have been shown to be prone to participation bias -- e.g., bias toward certain income strata, bias toward families with two parents working (Tr. 882). For example, and as Mr. Lacey confirmed under questioning by Judge Weismandel (Tr. 1059), cell phone users were not contacted. In addition, while it is known that approximately 800 interviews were conducted, the non-response rate was not provided (Tr. 909).

In short, Direct Energy has failed to demonstrate that the results of the Zogby Survey are either reliable or particularly relevant to the issues presented by this proceeding.

B. The Commission Should Not Attach To Its Approval Of The Merger The Additional Conditions Sought By The OSBA

The OSBA's witness, Dr. John W. Wilson, contends that the Merger should not be approved without attaching certain conditions described by Dr. Wilson (OSBA St. 1).[29] As

[28] Of course, for the reasons explained *supra*, it was somewhat misleading for Direct Energy to suggest that customers might actually receive rebate checks in the amounts quoted.

explained hereafter, five of the OSBA's proposed conditions have been addressed by the Settlement and the remaining conditions are unnecessary, inappropriate and/or pertain to matters that are not implicated by the proposed transaction.

1. Retail Competition

Dr. Wilson expressed concern about the potential for the Merger to adversely affect retail competition if the EGS operations of Allegheny Energy Supply ("AES") and FirstEnergy Solutions ("FES"), respectively, were combined (OSBA St. 1, p. 16). On that basis, Dr. Wilson proposed three conditions, which lack merit and should be rejected.

Maintain AES And FES As "Separate Subsidiaries." Dr. Wilson proposed that the Commission "require FES and AES to be separate subsidiaries of FirstEnergy" and "prohibit the two EGSs from implementing a *de facto* plan not to compete." As previously noted, Dr. Wilson premised this proposal on his assumption that combining AES and FES could adversely affect retail competition. However, his assumption is not supported by – indeed, is contrary to – the record evidence, as the Joint Applicants' witness, Dr. Hieronymus, explained (Jt. App. St. 9-R, pp. 37-38):

> Dr. Wilson points to the obvious fact that if the two retail operations, FirstEnergy Solutions and Allegheny Energy Supply, are merged, then a competitor will be lost. He points specifically to the fact that Allegheny will not compete in the FirstEnergy service areas and FirstEnergy will not compete in the Allegheny service areas.
>
> Dr. Wilson states that I found the effect of the merger on retail competition to be benign on the basis that the two companies do not serve customers in the same service areas. He points out that with the expiration of below market default service rates, competition may become more substantial and that, absent the

[29] Many of Dr. Wilson's arguments simple allude to legal arguments the OSBA intends to present in its Brief. Accordingly, if those arguments are fleshed out in the OSBA's Brief, the Joint Applicants will respond, as necessary, in their Reply Brief.

> merger, there might be more competition between the two. The point, as far as it goes, is reasonable. However, what is true of FirstEnergy and Allegheny is also true of other competitors who will have more substantial competitive opportunities. My conclusion that the merger of the Joint Applicants' retail operations would not harm competition was not due solely or even principally to the fact that the two entities do not compete currently in the same areas. Rather, it was because 1) Allegheny Energy Supply is a small fringe competitor whose loss will have a trivial impact on the market, and 2) the merged company's share of generation after the transaction will not allow it to control the market price of energy that retail suppliers use to meet their retail service obligations.

Not only is Dr. Wilson seeing a problem where none exists, his proposed remedy is likely to impair competition rather than enhance it. Hamstringing the combined company by forcing it to maintain the business infrastructure of two, separate retail marketing arms will simply increase costs and make the "separate" businesses less able to compete vigorously in all areas of the state. Far from benefiting retail customers, Dr. Wilson's prescription would reduce their options.

Limitations On Municipal Aggregation. In his direct testimony, Mr. Alexander noted that FirstEnergy actively supports and promotes retail electric competition in Pennsylvania "as recently evidenced by its support and endorsement of municipal aggregation" (Jt. App. St. 1, p. 17).[30] Based on this lone statement, Dr. Wilson has tried to convert this proceeding into a comprehensive review of how municipal aggregation should be authorized and implemented in Pennsylvania. To that end, Dr. Wilson recommends that the Commission impose three

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[30] Municipal aggregation refers to the process by which a municipality acts as the agent, on behalf of its citizens, to contract, on their behalf, to obtain more favorable terms from EGSs to serve the participating customers' aggregate load than such customers might obtain individually. The EGS deals with the municipality, as the agent acting on behalf of its citizens, in order to offer power to participating customers. Some municipalities in Pennsylvania that have adopted "Home Rule" have concluded that their Home Rule charters already confer authority for them to act as agents on behalf of their citizens to enter into agreements with EGSs to supply power to those citizens. *See* Pa. Constitution, Article IX, Section 2 (A "Home Rule" municipality may "exercise any power or perform any function not denied by [the] Constitution, by its home rule charter or by the General Assembly at any time."); *City of Philadelphia v. Schweiker*, 579 Pa. 591, 605 (2004). On this basis, the Borough of Meadville -- a "Home Rule" municipality -- concluded that it has authority to enact an ordinance to act on behalf of its citizens, as discussed in the cross-examination of Mr. Alexander by Direct Energy (Tr. 277-281).

conditions that would apply with respect to the Joint Applicants – but not to other EGSs that might supply municipal aggregators: (1) any municipality that wishes to participate in municipal aggregation must purchase electricity "through competitive bidding;" (2) any municipality that engages in municipal aggregation must assure that all of its resident participants "affirmatively opt into the program;" and (3) the Joint Applicants and their affiliates "should be prohibited from engaging in municipal aggregation programs in Pennsylvania prior to the expiration of existing default service programs on May 31, 2013" (OSBA St. 1, pp. 19-20).

There is no valid basis to tie municipal aggregation to the issues properly before the Commission in this proceeding as Dr. Wilson has tried to do. As the Commission is aware, state-wide implementation of municipal aggregation must await comprehensive statutory authorization. In fact, legislation to do just that has been introduced and has received active consideration by the Pennsylvania legislature. The imposition of conditions on municipalities' right to contract, which two of Dr. Wilson's proposed conditions would purport to do, is outside the jurisdiction of this Commission and, therefore, could not be implemented other than through legislation enacted by the General Assembly, and certainly not in the context of this Merger. To the extent that municipal aggregation is permitted by certain political subdivisions that already have the statutory authority to contract for electrical service on behalf of their residents, any issues that might be within the Commission's jurisdiction can, and should, be addressed in an appropriate generic proceeding.[31] Certainly, these issues are not specific to the Joint Applicants and are not implicated by the request for approval of the Merger that defines the scope of this

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[31] In fact, other parties have sought to invoke the Commission's jurisdiction to address one or more of the conditions proposed by Dr. Wilson. *See Petition of the Retail Energy Supply Association for Investigation and Issuance of Declaratory Order Regarding the Propriety of the Implementation of Municipal Electric Aggregation Programs Absent Statutory Authorization*, filed October 28, 2010; *Petition of Dominion Retail, Inc. for an Order Declaring that Opt-Out Municipal Aggregation Programs Are Illegal for Home Rule and Other Municipalities in the Absence of Legislation Authorizing Such Programs*, filed October 29, 2010.

proceeding. Therefore, the conditions related to municipal aggregation that the OSBA's witness has proposed should be rejected.

Dr. Wilson tried to shoe-horn issues about municipal aggregation into this case by alleging that the Merger will reduce by one the number of EGSs that will be available to compete to serve municipal aggregators. Yet, inexplicably, he seeks to impose restrictions on one participant in the market (FES), which would further limit the number of available competitors. More specifically, he contends that the Joint Applicants may be able to exert market "dominance" in municipal aggregation in their home service territories. As Mr. Graves explained (Jt. App. St. 10-R, p. 19), Dr. Wilson's speculation is unfounded. The Merger will not provide the Joint Applicants any additional tools to compete for municipal aggregation that are not already available to all the other EGSs that might wish to serve such customers:

> It is my understanding that municipal aggregation has not been statutorily authorized in the case of most Pennsylvania municipalities and that legislative changes would be needed to make it widely possible. The merger has no effect on this possibility. Moreover, even if legislation were passed to make municipal aggregation more widely available, there is no step in municipal aggregation that the Joint Applicants will find easier to do, or other EGSs will find harder to do, following the merger. The other EGSs are just as capable of finding municipal targets and of quantifying and sharing the savings with the aggregated customers.
>
> Dr. Wilson's observation that the number of EGS competitors hypothetically participating in municipal aggregation would fall by one is correct, but there are so many EGSs capable of pursuing municipal aggregation that I see no reason to consider this a problem for competition.

Mr. Graves expanded on this explanation in responding to Dr. Wilson's surrebuttal testimony (Tr. 886-887):

> In my view, what it takes to compete effectively in municipal aggregation is managerial skills, not physical resources. It takes skills in things like forecasting, risk management, contract administration. And there are numerous suppliers [in] the retail space already who have those capabilities. If you're going to participate in default service or you're going to provide service to customers on a one-on-one basis as an EGS, you have to be able to do all those things already.
>
> And, it's not clear that in any way the FirstEnergy companies either before or after the merger have any dominance of the supply of those skills. Again, there's many, many such players and the process that one undertakes in order to gain a municipal client is not affected by the merger.

Additionally, Dr. Hieronymus explained why Dr. Wilson's comments are misguided and pertain to matters that have no valid connection to issues properly before the Commission in this case (Jt. App. St. 4-R, p. 39):

> Currently, there is little if any aggregation of retail load in Pennsylvania. In the event that aggregation proves to be an attractive service, there is nothing distinguishing about the Joint Applicants that warrants restrictions specific to them, and nothing that even vaguely relates to the effects of the merger. Hence, the restrictions on aggregation that Dr. Wilson proposes are not properly in this proceeding and should be considered, if at all, in a docket in which all interested parties can participate.

In short, Dr. Wilson and the OSBA are trying to use this proceeding to litigate issues they believe are important but which have no discernible nexus to this case. Those efforts contravene the principles that the Commonwealth Court established in *ARIPPA v. Pennsylvania Public Utility Comm'n*, 792 A.2d 636, 657 (Pa. Cmwlth. 2002), where the Court held that "[e]very Commission case should not be used to decide issues that are ancillary to the main case, i.e., a

case within a case."[32] Accordingly, the "conditions" the OSBA has proposed are not appropriate for consideration in this case and should be rejected.

2. Wholesale Competition

In a single paragraph (see OSBA St. 1, pp. 21-22), Dr. Wilson alleges that the Merger raises concerns – which Dr. Wilson neither identifies nor supports with any empirical evidence – about "possible anticompetitive conduct or unlawful market power in the wholesale market." Based solely on this assertion, Dr. Wilson opines that the Commission should "require the generation assets of Allegheny and FirstEnergy to be under the control of separate subsidiaries." Dr. Wilson did not explain what "under the control" means in this context or how such a condition, if adopted, would be converted into a set of coherent operational rules that would put participants on notice of what might – or might not – be impermissible conduct. Apart from its inherent lack of clarity and specificity, this proposed condition should be rejected because the record evidence establishes that the Merger will not adversely affect wholesale competition, as explained in Section V.B., *infra*.[33]

3. "Harmonizing" Default Service Supply Procurement

The default service supply plans and associated methods and procedures for competitive procurement of default service supplies differ between West Penn and FirstEnergy's Pennsylvania Utilities. Dr. Wilson testified that "[o]ver time, harmonization of the procurement programs of the FirstEnergy EDCs with the procurement programs of West Penn may not be objectionable" (OSBA St. 1, pp. 22-23). Nonetheless, he proposed as a "condition" that "such

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[32] In *ARIPPA*, *supra*, the Court held that the Commission properly refused to consider various environmental issues that should properly have been addressed in another forum.

[33] Dr. Wilson also stated: "In addition, the Commission should impose conditions aimed at avoiding, detecting, and correcting any anticompetitive conduct that could adversely affect retail default service rates" (OSBA St. 1, p. 22). Dr. Wilson did not describe what such "conditions" would actually entail, how they might be implemented or why they are necessary. There is no basis in law or fact for such ill-defined "conditions," and they should, therefore, be rejected.

harmonization should occur no earlier than with the respective EDC procurement plans for the default service period beginning June 1, 2013." *Id.* Since the Met-Ed, Penelec and Penn Power default service plans approved by the Commission are in place through May 31, 2013, Dr. Wilson's proposed "condition" simply acknowledges existing legal strictures and has been incorporated in the Settlement (Jt. Pet. ¶ 32).

4. Merger Synergies/Energy Efficiency and Conservation Plan Costs

As Mr. Evanson explained (Jt. App. St. 3, pp. 8-9; Tr. 308), the Merger could allow West Penn to avoid up to $100 million in costs by integrating West Penn into the FirstEnergy Pennsylvania Utilities' customer information system. These avoided costs translate into approximately $15-20 million **per year** in future revenue requirement over the anticipated ten-year depreciable life of the avoided investment (Tr. 494). Dr. Wilson implicitly acknowledged that these avoided costs would flow from the Merger, but contended that the savings realized by small commercial and industrial customers would be offset, at least in part, by concomitant revisions that would be made to West Penn's EE&C Plan:

> West Penn has already proposed to alter its SMIP [Smart Meter Implementation Plan] and [Energy Efficiency and Conservation] plans in contemplation of the merger. In theory, these alterations could reduce the cost of West Penn's SMIP through integration of West Penn's Customer Information System ("CIS") and other back office systems with those of FirstEnergy EDCs. However, on balance, these alterations may be detrimental to Small C&I customers.
>
> Specifically, counsel advises that West Penn's proposal to delay the deployment of smart meters is likely to force West Penn to eliminate, modify, or delay numerous residential conservation programs. In order to meet its statutorily-mandated conservation targets, West Penn may, instead, seek to add or expand Small C&I conservation programs. That shift, could, in time, force Small C&I customers to bear more EE&C cost than under the West Penn EE&C Plan already approved by the Commission. If that is the

case, the merger would constitute a detriment, rather than a benefit, to West Penn's Small C&I customers.

In his surrebuttal testimony, Dr. Wilson stated that "the result of slowing down West Penn's deployment of smart meters will be higher EE&C costs for Small C&I customers in the amount of about $6 million" (OSBA St. 4, p. 5). However, as Mr. D'Angelo, FirstEnergy Service Company's Manger, Rates and Regulatory Affairs for Pennsylvania, explained (Tr. 494), the figure of $6.0 million cited by Dr. Wilson is the cumulative amount over the four-year life cycle of the EE&C programs, or about $1.5 million per year. That cost pales in comparison to commercial and industrial customers' share of the $15 to $20 million in **annual** avoided revenue requirement (over a ten-year period) expected from integrating West Penn into FirstEnergy's CIS infrastructure. *Id.* Nonetheless, to avoid any possibility of disparate impact on certain commercial customers, under Paragraph 18 of the Joint Petition, if the Merger is approved, West Penn will provide a credit equal to the increase in EE&C costs (deemed to be $6.19 million) to rate schedules that correspond to the classes Dr. Wilson had identified. Accordingly, the "condition" proposed by Dr. Wilson in this regard (*See* OSBA St. 1, p. 25) has been incorporated in the Joint Petition.

5. Detailed Reporting On Executive Compensation

Dr. Wilson proposed that the Commission condition its approval of the Merger by imposing a requirement that "the merged company . . . file reports of executive compensation" (OSBA St. 1, pp. 26-27). This condition attempts to pre-judge issues that, from this Commission's perspective, are rate-related and, as such, can – and undoubtedly will – be addressed in rate proceedings as part of the parties' and the Commission's detailed review of all compensation claimed for recovery. Accordingly, Dr. Wilson's effort to pull these kinds of issues into this proceeding should be rejected.

Moreover, issues related to executive compensation – apart from their impact on specific rate increase requests – are the subject of comprehensive federal legislation administered by the Securities and Exchange Commission. Extensive reporting requirements already apply and require publicly held companies to report detailed information regarding executive compensation in the annual proxy statement, including significant discussion and disclosure regarding compensation policies and exacting detail regarding each element of the covered executive's compensation. In addition, the Dodd-Frank Wall Street Reform and Consumer Protection Act (15 U.S.C. § 78 n-1) imposes a "say on pay" requirement on public companies, whereby shareholders are given an advisory vote on the compensation of an issuer's executive officers. Existing requirements for compensation disclosures in the annual proxy statement and this recent enactment leave to the appropriate federal agency, specifically, the SEC, the responsibility for assuring full reporting on the issues subject to shareholder vote and, as public information, those reports are available to anyone interested in looking at them. The transparency that OSBA seems to seek is already fully accorded by federal law and regulation, and there is no suggestion that the Companies have not fully complied with all applicable obligations. Accordingly, the OSBA's proposed condition should be rejected.

6. Additional Financial Governance Measures

Dr. Wilson proposed that the Commission condition its approval of the Merger on adoption of various financial governance measures for, in Dr. Wilson's words, "protecting the utility and the consumers of the utility from business activities of financial activities associated with parents and affiliates" (Tr. 571). Dr. Wilson's proposal, as well as a comparable recommendation by OTS witness Amanda Gordon (OTS St. 1), were fully addressed by Mr. James F. Pearson, FirstEnergy's Vice President and Treasurer, who explained that (1) FirstEnergy had important utility financial governance measures already in place, which would

be extended to Allegheny's utilities after the Merger; and (2) the additional financial governance measures recommended by Dr. Wilson and Ms. Gordon are not necessary to safeguard the financial viability or creditworthiness of the regulated utilities after the Merger (Jt. App. St. 2-R). However, within the context of the Settlement, the Joint Applicants have agreed that, upon consummation of the Merger, they will adopt additional financial governance measures including commitments regarding the EDCs' equity-to-total capitalization ratio and associated restrictions on the payment of dividends (Jt. Pet. ¶ 36), as well as six specific measures pertaining to, among other things, the use of money pools; maintenance of individual utility operating company financial statements, credit ratings, and capital structures; and restrictions on property transfers and issuance of debt secured by utility property without prior Commission approval (Jt. Pet. ¶ 35). The provisions of the Joint Petition, while not identical to Dr. Wilson's recommendations, comprise a comprehensive set of financial governance measures that will provide appropriate protection to the combined company's utility subsidiaries, as evidenced by the OTS' full and unqualified support of the Settlement.

7. Customer Service And Reliability

Dr. Wilson offered a general recommendation that:

> [T]he Commission should require the Joint Applicants to compare the SAIDI, CAIDI, and SAIFI scores of each Pennsylvania affiliate of FirstEnergy and Allegheny for the last several years in order to identify those practices that are most likely to improve reliability. The Joint Applicants should be directed, as a merger condition, to implement those practices that are most likely to improve reliability at all of their Pennsylvania affiliates.

As part of the Settlement, the Joint Applicants agreed to meet specific reliability and customer service levels, including specific improvement targets, as set forth in Paragraph 49 of the Joint Petition. Additionally, Paragraph 50 of the Joint Petition provides that FirstEnergy will

take specific steps to identify "best practices" and ways to implement "best practices" and to report on the results of its study.[34] In short, Paragraphs 49 and 50 provide better, clearer and more concrete commitments for enhancing reliability and customer service than the condition proposed by the OSBA, which should, therefore, be rejected.

8. Blending Distribution Rates

Dr. Wilson recommended that the Commission impose a merger condition "requiring that any consolidation of the distribution rates of the four EDCs occur only after the issuance of a certificate of public convenience under Section 1102 to merge the individual EDCs into a single EDCs" (OSBA St. 1, p. 35). This restriction is already incorporated as a term of the Settlement (Jt. Pet. ¶ 30).

C. The Commission Should Not Attach To Its Approval Of The Merger The Additional Conditions Sought By RESA

Throughout its testimony in this proceeding, RESA makes wide-ranging unsupported allegations – usually subtly qualified by the words "may" or "likely" or "could" – that FirstEnergy will act unlawfully and violate the Commission's Code of Conduct by favoring its affiliate, FirstEnergy Solutions, if the Merger is approved. *See, e.g.*, RESA St. 1, pp. 6-7 ("RESA is concerned that the proposed merger *may be predicated* on a business strategy *that will likely* have anticompetitive effects") and pp. 11-12 (suggesting that FirstEnergy EDCs "*could*" provide inferior access to non-affiliated EGSs); RESA St. 1-R, p. 14 ("The combined company *will have the ability* to propose default service plans that provide an advantage for the unregulated affiliate.") (emphasis added). Based on these speculative concerns, RESA proposes that the Commission take extensive action now to: (i) impose conditions on future default service plans of the post-merger FirstEnergy EDCs; (ii) unbundle all default service costs from

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[34] Paragraph 51 outlines specific action that will be taken to enhance service to members of the PREA.

distribution rates for each post-merger FirstEnergy EDC; (iii) develop a different code of conduct for FirstEnergy; (iv) appoint a market monitor for the FirstEnergy post-merger utility service territories; (v) mandate cost allocation audits; and (vi) order a variety of additional programs to aid EGSs in obtaining customers.

The Joint Applicants have already explained why retail markets will not be adversely affected by the Merger and the relationship and activities of FirstEnergy affiliates, *see* Section V.B.2 and VI.3.a., and RESA provides no evidence to the contrary. In fact, RESA's witness Mr. Hudson admitted that **RESA has no evidence that the FirstEnergy Pennsylvania Utilities have ever given <u>any</u> preference to FirstEnergy Solutions.** Tr. 630. Despite months of discovery and extensive hearings, with cross-examination of the Joint Applicants' witnesses, RESA has nothing whatsoever to support its allegations other than suspicion and innuendo.[35] The impropriety of RESA's proposals is further addressed below, and, for the reasons set forth therein, the Commission should reject each of RESA's requested conditions to the Merger.[36]

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[35] The only "evidence" RESA offers to support its claims is a misunderstanding of FirstEnergy's cost allocations between regulated and unregulated subsidiaries, discussed *infra*, its dissatisfaction with the scope of FirstEnergy's purchase of receivables ("POR") programs that RESA supported in the settlement of Met-Ed and Penelec's default service proceeding, FirstEnergy's support of municipal aggregation, provisions of the Met-Ed and Penelec supplier tariffs that RESA is currently litigating before the Commission, "onerous" lead times for implementation of rate ready billing codes (now being reduced to 14 days, *see* Tr. 468), and procurement practices in Ohio approved by the Public Utility Commission of Ohio. See RESA St. 1-R, pp. 6-7. None of this "evidence" justifies the relief RESA seeks.

[36] In its rebuttal testimony, RESA endorsed Direct Energy's proposal to dismantle Pennsylvania's default service model and also expressed support for testimony of other parties relating to municipal aggregation (OSBA), ring-fencing (OCA and OSBA), and long-term contracts for compliance with Pennsylvania's Alternative Energy Portfolio Standard (DEP). See generally RESA St. 1-R. RESA added nothing of substance to the proposals and testimony of the other parties. The illegality and inadequacy of Direct Energy's proposal is addressed in detail by the Joint Applicants in Section VI.A *infra*, and financial governance and municipal aggregation are discussed in Section VI.B. With respect to long-term contracts for AEPS compliance, RESA noted that it agreed with the approach already taken by Met-Ed and Penelec to acquire solar alternative energy credits in a competitively-neutral manner for both the EDC and EGS load in their territories, which the post-Merger FirstEnergy utilities will also do in implementing the provisions of the Settlement to procure 40% of their solar AEPS requirements through 2021. As described by Joint Applicants' witness Fullem, the Joint Applicants do not believe there is any need at this time to conduct long-term procurements of non-solar AEPS "Tier I" credits in light of market conditions. See Jt. App. St. 8-R, pp. 28-30.

1. Default Service Procurement Issues

RESA proposes that the Commission impose conditions on the post-merger FirstEnergy Pennsylvania Utilities: (i) mandating a 33% load cap in future default service procurements; and (ii) requiring the redesign of procurement classes to place all commercial and industrial customers with demands over 100 kW on hourly pricing service and procurement of default service supply for medium commercial customers (25 kW to 100 kW demand) based only on short-term contracts as well as the use of 25% spot, 25% three-month, and 50% contracts of one year or less for residential and small commercial customers. *See* RESA St. 1, pp. 20-22.

The Commission has already expressly considered and rejected RESA's proposal for a 33% load cap for Met-Ed and Penelec. *Joint Petition of Metropolitan Edison Co. & Pennsylvania Elec. Co. for Approval of their Default Serv. Programs*, Docket Nos. P-2009-2093053 & P-2009-2093054 (Order entered November 6, 2009), pp. 16-18 (adopting 75% load cap instead of 33% or 50% load cap advocated by RESA) ("*Met-Ed/Penelec Default Service Order*"). RESA argues that the Commission should nevertheless revisit this issue in this proceeding because RESA believes that the Merger will reduce wholesale competition and also "consolidate further control of Pennsylvania EDCs in the hands of a single corporate entity." RESA St. 1-R, p. 18. As discussed by Dr. Hieronymus (*see* Section V.B.2, *supra*), there is no basis to conclude that there will be any reduction in wholesale or retail competition, and RESA offers no evidence to the contrary. See Section V.B.2, *supra*, and Jt. App. St. 10-R, p. 11 (listing number of bidders and suppliers in default supply auctions).

RESA's proposal to condition the Merger on the imposition of new commercial customer classes and limitations on procurement contract terms for future default service plans for each of the utility operating companies is similarly misplaced. As a procedural matter, these issues previously were – and should continue to be – considered as part of each company's default

service proceeding, when the Commission is able to properly consider all issues associated with default service supply (including the results of the current default service plans). In addition, RESA's proposals are flatly inconsistent with the Commission's decisions in the last year regarding default service procurement plans for the FirstEnergy Pennsylvania Utilities. *See* Jt. App. St. 8-R, p. 13-16; *see also* OSBA St. 1-R, pp. 8-9.

2. Retail Market Changes

RESA also proposes an extensive set of retail market "enhancements" to support retail competition in the service territories of West Penn and the FirstEnergy Pennsylvania Utilities. However, RESA has acknowledged that Met-Ed, Penelec, and Penn Power are *already* implementing a variety of the retail market enhancements it proposes (consistent with settlements previously agreed to by RESA). *See* RESA St. 1, pp. 25-26. Notably, the Settlement extends many of these enhancements to West Penn's service territory, including:

- a purchase of receivables ("POR") program for West Penn's residential and small commercial customers;
- mailings to customers regarding competitive offers;
- updated lists of shopping and non-shopping customers for suppliers, with regular updates;
- provision of interval and non-interval customer data via electronic data interchange ("EDI") and other EDI transactions;
- appointment of a West Penn representative to perform retail ombudsman services;
- provision of flexible billing options for EGSs within West Penn's service territory, including both EDC rate-ready and bill-ready options and programming of new rate ready billing codes; and
- provision of budget billing for an EGS's supply charges if the EGS is utilizing EDC consolidated billing.

Jt. Pet. ¶¶ 38-48.

The Settlement thus addresses many of the supplier issues identified by RESA in a manner consistent with the default service settlements that RESA has previously supported for Met-Ed and Penelec and which retail suppliers Dominion Retail, Direct Energy, Exelon Energy, and Constellation New Energy supported in the most recent default service proceeding for Penn Power. *Met-Ed/Penelec Default Service Order*, pp. 40-42; *Petition of Pennsylvania Power Co. for Approval of Default Serv. Program for Period from January 1, 2011 through May 31, 2013*, Docket No. P-2010-2157862 (Recommended Decision issued September 3, 2010), pp. 70, 72 (recommending approval of Joint Petition for Settlement, including retail market enhancements described at pp. 18-22).

RESA acknowledged that the Commission has not been "sitting back" or inactive with respect to retail markets in Pennsylvania. To the extent that RESA still wants more,[37] the Joint Applicants believe that further retail market enhancements should be considered only after the existing enhancements are implemented (particularly in those territories where rate caps are ending) and the Commission, EDCs, and the retail supplier community have an opportunity to evaluate the results through such Commission initiatives as the Committee Handling Activities for Retail Growth in Electricity ("CHARGE").

[37] The primary additional retail market "enhancements" on which RESA provided surrebuttal testimony that are not addressed entirely, or in large part, by the Settlement are an expanded customer referral program, expansion of POR programs to large commercial and industrial customers, and appointment of a high-level employee for retail coordination. The Joint Applicants oppose these enhancements. RESA never quantified the costs of its proposed customer referral program (Tr. 630) and, as explained by Mr. Fullem, imposing a supplier referral function on EDC call centers will inevitably compromise the primary function of those call centers. Jt. App. St. 8-R, p. 11. In addition, there is no need to expand POR programs to support retail choice for large commercial and industrial customers, who are already mostly shopping. See id., p. 12 (noting that 94.5% of Penn Power's large commercial and industrial customers are served by an EGS). Nor do the Joint Applicants believe that a high-level director needs to be assigned to manage the day-to-day supplier questions in light of the immediate access of the supervisors of supplier support services at the FirstEnergy Pennsylvania Utilities and West Penn to other management personnel. *Id.*, p. 21.

3. Appointment of Cost Allocation Expert

RESA also proposes, as a condition of Merger approval, that FirstEnergy be required to retain an "independent cost allocation expert" to audit the relationship between FirstEnergy's regulated utilities and its unregulated businesses (as well as the relationship between West Penn and Allegheny's unregulated businesses) for the previous three years and for the year following the Merger and provide reports to the Commission. RESA St. 1, pp. 26-27. RESA did not undertake a cost allocation analysis in support of its proposal; instead, RESA asserted that FirstEnergy "may already be" misallocating expenses of unregulated subsidiaries to utility operating companies based on RESA's understanding of information FirstEnergy produced in discovery about the allocation of costs incurred by its regulated and unregulated subsidiaries. *See id.*, p. 27 and RESA St. 1-R, pp. 4-5.[38]

As Mr. D'Angelo made clear, RESA's claim that FirstEnergy "may be" misallocating costs was based upon a consistent failure to understand that many of the costs incurred for services to unregulated subsidiaries are **directly billed** to those subsidiaries and not allocated among regulated subsidiaries and unregulated subsidiaries. Tr. 492; *see also* Jt. App. St. 7-R, pp. 25-26 (explaining that FirstEnergy directly bills its subsidiaries for costs and performs cost allocations consistent with the requirements of the Commission and the Federal Energy Regulatory Commission). For example, while Mr. Hudson asserts that FirstEnergy is not allocating costs of its government relations function that are incurred on behalf of FES, FirstEnergy is in fact allocating over 83% of government relations costs to its unregulated operations. Tr. 493.

[38] Mr. Hudson claimed that his analysis was limited because he was prevented from reviewing highly sensitive material produced by FirstEnergy under the Protective Order in this proceeding. RESA St. 1-R, p. 4. However, after Mr. Hudson was permitted access to this material, he offered no additional testimony. Tr. 195, 621.

The FirstEnergy Pennsylvania Utilities and West Penn are regularly audited by the Commission's Bureau of Audits and the Commission has broad statutory powers to conduct audits, request information, and supervise affiliate relations (including disallowance of unreasonable expenses charged to regulated utilities by their affiliates). *See* 66 Pa. C.S. §§ 505, 516, & 2101 *et seq*. RESA provides nothing more than conjecture to support its requested cost allocation audit, and the Commission should reject RESA's proposal.

4. Imposition of Alternative Code of Conduct

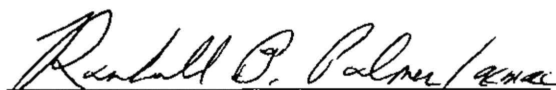
RESA also proposes that the Commission impose an "enhanced" code of conduct for FirstEnergy and mandate the unbundling of all default service costs from distribution rates to address "misallocat[ed] costs" that RESA believes the Commission can otherwise not adequately address through its powers over affiliates. *See* RESA St. 1, p. 13 and St. 1-R, pp. 7-8. However, as discussed *supra*, RESA has provided no evidence of *any* improper conduct of the FirstEnergy Pennsylvania Utilities, nor any evidence to rebut the Joint Applicants' demonstration that there will be no adverse effects on retail markets in Pennsylvania. Furthermore, RESA has failed to support its theory that FirstEnergy Solutions will be relying on the "local brand" of its EDCs. *See* Jt. App. St. 1-SR, pp. 6 (explaining that FES relies on its own brand derived from employment of almost 1,400 people in Pennsylvania); Section IV.A.2.f (noting that FirstEnergy Solutions does not do business under the local brand names of its EDC affiliates Met-Ed, Penelec, or Penn Power). Notably, when RESA witness Hudson was asked about his own employer, retail marketer ConEd Solutions – a subsidiary of Consolidated Edison, Inc., which owns electric utilities in New York – he denied that there was any "improper customer confusion" and that ConEd Solutions in no way leveraged its affiliated utility businesses when it markets services in the territory of its affiliated utilities. Tr. 623-24. *See* Section VI.2.f, *supra*.

There is thus no basis for the Commission to impose a different code of conduct on FirstEnergy than that which other companies in the Commonwealth are not required to observe. *See* Jt. App. St. 8-R, p. 7 (noting additionally that the Commission already has an on-going proceeding at Docket No. L-2010-2160942 relating to code of conduct issues that are a more suitable forum if any revisions to the Code of Conduct are required); Tr. 630 (acknowledging that RESA does not believe the Commission has been lax in enforcing its Code of Conduct). Furthermore, RESA should not be permitted to seek any unbundling of default service costs from distribution rates in light of its commitment in the most recent default service proceeding for Met-Ed and Penelec not to do so until each of those companies next files a distribution rate case. See Jt. App. Cross Exam. Ex. 3, p. 74; *see also* Section VI.A.3.e, *supra*.

CONCLUSION

WHEREFORE, for the reasons set forth above, the Joint Applicants request that the Administrative Law Judges approve the Joint Petition For Partial Settlement, filed October 25, 2010, without modification and deny the relief sought by the non-signatory parties.

Respectfully submitted,



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APPENDIX A

QUESTIONS POSED IN THE COMMISSION'S JUNE 3, 2010 SECRETARIAL LETTER WERE APPROPRIATELY ADDRESSED ON THE RECORD

1. How will the merger impact employment levels in Pennsylvania, particularly, but not limited to, those employees not covered by collective bargaining agreements? What will the impact be on Allegheny Energy's corporate headquarters in Greensburg, PA, as well as the operating companies' offices?

As part of the Joint Application, FirstEnergy committed to have no net reductions due to involuntary attrition, for a period of two years after consummation of the Merger, as a result of the Merger integration process, in either the employment levels of the FirstEnergy Utilities or in the employment levels of employees of Allegheny Energy Service Company who are assigned to positions in the Allegheny Power Utilities comparable to their counterparts who are employed by the FirstEnergy Utilities. It also committed to keep the regional headquarters of West Penn in Greensburg. *See* Jt. App. St. 1-S, p. 5 (citing Jt. App. St. 1, pp. 6, 13-15; Jt. App. St. 3, pp 6-7).

In addition, under the Settlement, specific net employment level commitments have been made for employees of FirstEnergy and its affiliates in Greensburg and Westmoreland County. *See* Jt. Pet. ¶ 14. Career transition services will be provided for those Greensburg employees whose jobs are negatively impacted by the Merger. *Id.* Further, the corporate headquarters of Allegheny Energy in Greensburg will become the regional headquarters of West Penn and the regional headquarters of Met-Ed and Penelec will remain in Reading and Erie, respectively, for a period of at least five years. *Id.* ¶¶ 14-15.

2. How will the merger affect the customer service and system reliability of West Penn Power and the FirstEnergy Pennsylvania utilities? How will the merger affect West Penn Power and the FirstEnergy Pennsylvania utilities ability to respond to outages and other emergencies?

FirstEnergy and Allegheny share a strong commitment to enhancing customer service and reliability. In the Joint Application, a commitment was made by FirstEnergy and Allegheny

to conduct a review of their existing procedures and policies as part of the Merger integration process to determine "best practices" in these areas and how to implement them. *See* Jt. App. St. 1-S, p. 6; Jt. App. St. 3, pp. 9-13. Under the Settlement, the Joint Applicants commit to achieving specific levels in the Commission's Customer Average Interruption Duration Index ("CAIDI") and System Average Interruption Duration Index ("SAIDI") for West Penn, as well as West Penn's average speed of answering customer calls. In addition, the Joint Applicants commit to continued reliability investments for rural electric cooperatives and to establish a Joint Utility-Industrial Customer Committee to identify, discuss and address local power and service quality issues for industrial customers. (Jt. Pet. ¶¶ 49-52).

3. Review the impact of the initially proposed corporate structure of the merger versus the alternately proposed corporate structure. Which corporate structure will better protect the public interest?

The public interest will be equally protected under either corporate structure. The Commission's jurisdiction and oversight with respect to West Penn and the FirstEnergy Pennsylvania utilities remains the same under either corporate structure. The Joint Applicants anticipate that, in the future, the alternative structure will be desirable for consistency with FirstEnergy's existing internal corporate arrangements and procedures once the companies are combined. *See* Jt. App. St. 1-S, pp. 2-3.

4. What, if any, ring-fencing mechanisms are presently in place, or proposed as part of this transaction, to protect West Penn Power, Met-Ed, Penn Power, and Penelec from the business and financial risk of the parent and other non-regulated affiliates? Are any changes or additions necessary to better protect the public interest and make the regulated electric distribution subsidiaries bankruptcy remote?

Under the Settlement, FirstEnergy has committed to a robust suite of financial governance measures (consistent with its current practice) to maintain appropriate separation

between its regulated operations and its unregulated operations. Jt. Pet. ¶¶ 35-36. For example, for a period of five years, if any post-merger FirstEnergy EDC's equity-to-total capitalization ratio falls below 40% from a financial covenant standpoint, then that company will provide the Commission with a 12 month plan for bringing its equity-to-total capitalization ratio to at least 40%; if after that period the equity-to- total capitalization ratio remains below 40%, then such company shall not pay a dividend to its parent until the equity-to-total capitalization ratio is 40% or greater. (Jt. Pet., ¶ 36). These financial governance measures are discussed in Sections V.A. and VI.B. of Joint Applicant's Brief.

5. How will the merger impact the Act 129 smart meter and energy efficiency implementation plans of West Penn Power and First Energy's regulated utilities, Met- Ed, Penelec and Penn Power?

The Merger will have a positive impact because the adjoining service territories will facilitate integrating and implementing the Act 129 energy efficiency measures and smart meter programs of each utility:

- The combined company should be better able to invest in and deploy new processes and technologies, and, in the case of West Penn, potentially avoid over $100 million in technology infrastructure costs. *See* Jt. App. St. 1, p. 9; Jt. App. St. 3, pp. 8-9.
- Under the Settlement, the smart meter plans for Met-Ed, Penelec, Penn Power and West Penn will include preparing a cost/benefit analysis for deployment of smart meters to at least 90% of the EDCs' customers no later than December 31, 2018. *See* Jt. Pet. ¶ 23.
- Met-Ed, Penelec, Penn Power and West Penn will have voluntary time of use rates available to residential customers who have smart meters installed, and voluntary real time rates available for any commercial or industrial customers that have smart meters installed so long as the EDCs remain the default service suppliers. *Id.* ¶ 24.

6. How will the merger affect the capital structure of FirstEnergy Corporation? Will the merger create a more leveraged organization? How will the proposed merger impact the credit rating of FirstEnergy?

The Merger will not create a more leveraged organization; in fact, debt as a percentage of total capitalization for FirstEnergy will be reduced and therefore improve for FirstEnergy. *See* Jt. App. St. 1-S, p. 6. The Merger and the resulting stronger balance sheet and cash flow, along with the Settlement financial governance measures discussed above, are expected to positively affect the credit rating of FirstEnergy over time. *See* Jt. App. St. 1-S, pp. 6-7 (citing Jt. App. St. 2 (Pearson), pp. 3-12).

7. Will West Penn Power and the other Allegheny Energy subsidiaries that currently issue their own debt maintain their own external borrowing authority and separate bond rating?

Yes. FirstEnergy will ensure: (1) that each FirstEnergy Pennsylvania utility operating company issues its own debt after obtaining appropriate regulatory authorization; (2) that each FirstEnergy Pennsylvania utility operating company maintains its own credit rating so long as it has debt outstanding and credit rating agencies are willing to provide such rating; and (3) that no individual FirstEnergy Pennsylvania utility operating company will assume debt issued by the holding company without Commission approval. *See* Jt. Pet. ¶ 35. In addition, no FirstEnergy Pennsylvania utility operating company shall issue debt secured by utility assets for purposes other those approved by the Commission. *Id.*

8. Will West Penn Power participate in the FirstEnergy Utility money pool? If, yes, please provide an updated agreement.

FirstEnergy intends to request the necessary approvals for both West Penn and TrAILCo to participate in the existing FirstEnergy utility money pool under its terms and in a manner consistent with participation by other FirstEnergy Pennsylvania subsidiaries. An updated agreement, providing for West Penn's and TrAILCo's participation, will be filed shortly after the Merger is consummated. In the meantime, West Penn and TrAILCo will not participate in the

existing FirstEnergy money pool until the necessary approvals are granted by the Commission. *See* Jt. App. St. 2-S, p. 6. In addition, under the Settlement, FirstEnergy has committed to maintain separate money pools for regulated and unregulated operations. *See* Jt. Pet. ¶ 35.

9. How will the proposed merger savings benefit Pennsylvania ratepayers? Will cost savings benefit ratepayers or only shareholders?

As a general matter, over time merger savings should, at least in part, offset the increasing cost of providing regulated retail utility service. These reductions in cost would accordingly delay or reduce the size of future rate increase requests and thereby benefit customers. *See* Jt. App. St. 1-S, p. 7.

Under the Settlement, commitments were made to provide specific savings to customers:

- Met-Ed, Penelec and Penn Power have committed to not increase their distribution base rates until October 1, 2012, and, during the period of the stay-out, if any company's net distribution investment earns a return on equity that exceeds 10.1%, then the company will credit its excess earnings over the following 12 months to the customers of that company. *See* Jt. Pet. ¶ 16.

- Certain merger savings will be shared with West Penn residential customers and the Tariff 37 customer in the form of significant rate credits beginning 60 days after consummation of the Merger.

- A credit of $3.57 million per year for three years will be applied to residential customers' distribution rates and a credit of $15,000 per year for three years will be applied to Tariff 37 customer's distribution rates. *Id.* ¶ 17.

- West Penn will provide a credit equal to the increase in EE&C costs (deemed to be $6.19 million) to Rate Schedules 20, 22, 30 Small and 30 Large and Rate Tariff 37 resulting from West Penn's revised EE&C Plan. *Id.* ¶ 18.

- West Penn has committed to expanded universal services for its customers and to increase funding for West Penn's Low-Income Usage Reduction Program ("LIURP"). The commitments for these programs include funding towards a 55% penetration rate for West Penn's Customers Assistance Program and significant additional LIURP expenditures during the five-year period following the Merger. *Id.* ¶¶ 20, 22.

10. Are the proposed affiliated interest agreements and cost allocation proposals reasonable and consistent with the public interest under Section 2102(b) of the Public Utility Code?

Yes. The Joint Applicants are only seeking approval to add certain Allegheny companies to existing agreements previously approved by or currently pending before the Commission and are not seeking to make any other changes in the protections in place with respect to affiliated interests and cost allocation. *See* Jt. App. St. 1-S, p. 7; Jt. App. St. 2, pp. 12-13. Further, as part of the Settlement, the Joint Petitioners specifically request that the Commission approve the revised FirstEnergy Service Company Agreement, Mutual Assistance Agreement, and Intercompany Income Tax Allocation Agreement, to become effective upon close of the merger. *See* Jt. Pet. ¶ 57.

11. Investigate the impact the proposed merger may have on the potential for anticompetitive behavior per 66 Pa. C.S. § 2811(e)(1). How will the merger affect wholesale and retail competition for power/electric generation and transmission?

The Merger will not negatively affect wholesale or retail competition for electric generation and transmission. *See generally* Jt. App. St. 4 and Ex. WHH-1 (testimony of Dr. William Hieronymus before the Federal Energy Regulatory Commission). While FirstEnergy has already been very active in supporting and promoting electric competition in Pennsylvania, specific additional commitments were made in the Settlement to further support competitive wholesale and retail markets. Retail market enhancements include: a standard Price-to Compare structure and new customer electric choice materials for each post-merger FirstEnergy EDC; and, for West Penn, EGS offer mailings, provision of customer information and interval consumption to EGSs, appointment of a retail choice ombudsman, and a revised purchase of receivables program. *See* Jt. Pet. ¶¶ 38-48. Regarding wholesale markets, the post-merger FirstEnergy EDCs will provide to OTS, OSBA and OCA detailed information regarding the

processes and results of procuring Default Service power supplies occurring after June 1, 2013 and for a period of three years thereafter, subject to the appropriate confidentiality agreements. In addition, the EDCs will file with the Commission annually from 2011- 2015 a report addressing wholesale market prices and price trends in the PJM markets in which it participates. *See* Jt. Pet. ¶¶ 53-55.

12. How will transmission projects in te western part of the state be affected by the merger?

The Joint Applicants have no plans to alter any existing transmission projects undertaken by TrAILCo or West Penn, nor do they anticipate any changes to the schedules for such projects. *See* Jt. App. St. 1-S, p. 4.

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APPENDIX B

JOINT APPLICANTS' PROPOSED FINDINGS OF FACT, CONCLUSIONS OF LAW AND ORDERING PARAGRAPHS

I. PROPOSED FINDINGS OF FACT

1. On May 14, 2010, West Penn Power Company ("West Penn"), doing business as Allegheny Power, Trans-Allegheny Interstate Line Company ("TrAILCo") and FirstEnergy Corp. ("FirstEnergy") (collectively "Joint Applicants") filed a Joint Application to obtain the approval of the Pennsylvania Public Utility Commission ("PUC" or the "Commission") under Chapters 11 and 28 of the Public Utility Code for a change in control of West Penn and TrAILCo to be effected by the merger of Allegheny Energy, Inc. ("Allegheny") with Element Merger Sub., Inc. ("Merger Sub"), a wholly-owned subsidiary of FirstEnergy (the "Merger").

2. The Joint Applicants also asked for the Commission's approval under Chapter 21 of the Public Utility Code to revise certain affiliated interest arrangements in order to facilitate sharing services between the Allegheny and FirstEnergy systems.

3. Along with the Joint Application and its attachments, the Joint Applicants submitted Statement Nos. 1-5 and accompanying exhibits.

4. FirstEnergy[1], Allegheny[2] and Merger Sub[3] are parties to an Agreement and Plan of Merger (the "Merger Agreement") (Exhibit E to Jt. App. Ex. 1). Under the terms of the

[1] FirstEnergy owns, directly or indirectly, all of the outstanding common stock of seven electric utility operating subsidiaries in four states: Metropolitan Edison Company ("Met-Ed"), Pennsylvania Electric Company ("Penelec"), and Pennsylvania Power Company ("Penn Power"), in Pennsylvania and, in the case of Penelec, The Waverly Electric Light and Power Company, in New York; Ohio Edison Company, The Cleveland Electric Illuminating Company and The Toledo Edison Company, in Ohio; and Jersey Central Power & Light Company ("JCP&L"), in New Jersey (collectively, the "FirstEnergy Utilities"). The FirstEnergy Utilities comprise the nation's fifth largest investor-owned electric system based on customers served, with 4.5 million customers in Ohio, Pennsylvania, New Jersey and New York. In addition, FirstEnergy subsidiaries and affiliates are involved in the generation and transmission of electricity, energy management and other energy-related services. Through its subsidiaries, FirstEnergy owns electric generation totaling more than 14,000 MW of capacity. *See* Jt. App. Ex. 1 (pp. 2-3)

Merger Agreement, Allegheny will merge with Merger Sub and, as the surviving corporation, Allegheny will become a wholly-owned subsidiary of FirstEnergy. The shareholders of FirstEnergy and Allegheny approved the Merger (Tr. 202).

5. FirstEnergy will remain the ultimate corporate parent of Met-Ed, Penelec, Penn Power, (the "FirstEnergy Pennsylvania Utilities") and all other FirstEnergy subsidiaries and will become the ultimate corporate parent of Allegheny and all of the Allegheny subsidiaries, including West Penn and TrAILCo. *See* Ex. F-1 to Jt. App. Ex. 1. Met-Ed, Penelec, Penn Power, West Penn and TrAILCo will continue to operate as Pennsylvania electric public utilities.

6. Petitions to Intervene, Protests or Notices of Appearance in this proceeding were filed by the following twenty-one parties:

1. The Commission's Office of Trial Staff ("OTS")
2. The Pennsylvania Office of Consumer Advocate ("OCA")
3. The Pennsylvania Office of Small Business Advocate ("OSBA")
4. The Pennsylvania Department of Environmental Protection ("DEP")
5. The International Brotherhood of Electrical Workers ("IBEW")
6. The Utility Workers of America, AFL-CIO ("UWUA") and UWUA System Local No. 102 ("Local 102") (collectively, "UWUA Intervenors")
7. The Pennsylvania State University ("PSU")
8. The Met-Ed Industrial Users Group ("MEIUG") and the Penelec Industrial Customer Alliance ("PICA") (collectively, "MEIUG/PICA")
9. The West Penn Power Industrial Intervenors ("WWPII")
10. The Pennsylvania Rural Electric Association ("PREA")
11. The Pennsylvania Mountains Healthcare Alliance ("PMHA")
12. The West Penn Power Sustainable Energy Fund ("WPPSEF")
13. The York County Solid Waste and Refuse Authority ("YCSWA")
14. The Anthracite Region Independent Power Producers Association ("ARIPPA")

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[2] Allegheny is a public utility holding company and has three direct public utility subsidiaries that conduct business as Allegheny Power: West Penn, in Pennsylvania; Monongahela Power Company ("Mon Power"), in West Virginia; and The Potomac Edison Company ("Potomac Edison"), in Maryland, West Virginia, and Virginia (collectively, the "Allegheny Power Utilities"). The Allegheny Power Utilities serve 1.6 million customers in four states. In addition, TrAILCo is an indirect public utility subsidiary of Allegheny. *See* Jt. App. Ex. 1, pp. 2-3.

[3] Merger Sub is a wholly owned subsidiary of FirstEnergy that was formed for the sole purpose of effecting the Merger. When the Merger is completed, Merger Sub will be subsumed, by operation of law, into Allegheny and cease to exist as a separate corporate entity.

15. The Clean Air Council ("CAC")
16. Citizens for Pennsylvania's Future ("PennFuture")
17. Citizen Power, Inc. ("Citizen Power")
18. Constellation NewEnergy, Inc. and Constellation Energy Commodities Group, Inc. ("Constellation")
19. The Retail Energy Supply Association ("RESA")
20. Direct Energy Services, LLC ("Direct Energy")
21. Duquesne Light Company ("Duquesne")

7. On October 25, 2010, the settling parties filed and served a Joint Petition For Partial Settlement ("Joint Petition"). Statements in Support of the Joint Petition were filed on or about October 29, 2010. The following parties are signatories to the Joint Petition: Joint Applicants, OTS, OCA, DEP, IBEW, UWUA Intervenors, PSU, MEIUG/PICA, WPPII, PREA, PMHA, WPPSEF, YCSWA, ARIPPA, CAC, PennFuture, and Constellation. The OSBA, Citizen Power, RESA and Direct Energy are not parties to the Joint Petition.

8. The Merger will affirmatively benefit the public in the following substantial ways (Jt. App. St. 1, pp. 8-12):

A. ***Increased Scale and Scope; Diversification***. There are many benefits that should be derived from the increased scale, scope and diversification of the combined company, including improved service, reliability and operational flexibility, and increased financial stability for West Penn, TrAILCo, Met-Ed, Penelec, Penn Power, and all other FirstEnergy and Allegheny public utility subsidiaries.

B. ***Increased Financial Strength and Flexibility***. The increased scale and scope is ultimately expected to strengthen the balance sheet of the combined company, creating a larger, financially stronger parent company that is better positioned to compete for and attract capital on reasonable terms for its public utility subsidiaries. In addition, the diversification of

the energy delivery and generation portfolios of the combined company should result in a more stable cash flow. The all-stock transaction is expected to improve financial metrics of the combined company.

C. ***Enhanced Expertise in Competitive Energy Markets, Energy Technologies, and Regional Issues.*** The combined company is expected to be able to draw upon the intellectual capital, technical expertise and experience of a deeper and more diverse workforce, with particular skills in managing distribution companies in competitive energy markets. The Merger is a natural alliance of companies with adjoining service territories and interconnected transmission systems, which should be beneficial in the integration and management of the combined company. The combined company should also be better able to invest in and deploy new processes and technologies, including innovations anticipated as part of the Act 129 Energy Efficiency and Conservation plans being implemented by West Penn, Met-Ed, Penelec, and Penn Power.

D. ***Enhanced Customer Service and Reliability.*** FirstEnergy and Allegheny share a strong commitment to enhancing customer service and reliability. The Merger will facilitate and build upon the combined companies' areas of expertise, allowing the deployment of "best practices" derived from ten electric utilities and additional, experienced resources when needed to meet emergencies, storm outages or other similar circumstances. As part of the Merger integration process, FirstEnergy and Allegheny intend to conduct a review of their existing procedures and policies to determine "best practices" and how to implement them. The combined company will work to maintain the current levels of reliability of West Penn, as measured and determined using West Penn's current methodology for measuring reliability, and will conduct a study to determine if opportunities exist to improve reliability. The combined

company's commitment to streamlining operations, reducing overall complexity and reliance upon a regional focus will ensure a continued high level of management attention on distribution system reliability and overall customer service.

E. ***Synergies, Efficiencies and Cost Savings.*** The Joint Applicants are confident that the Merger will generate synergies and result in overall aggregate cost saving opportunities for the combined company. The synergies that will accrue to the Pennsylvania utilities over time should, at least in part, offset the increasing cost of providing regulated retail utility service and, thereby, may reduce the size of future rate increase requests.

9. The Settlement is supported by a broad and diverse stakeholder coalition that includes the Commonwealth of Pennsylvania, representatives of the residential and industrial customer classes, organized labor, and environmental and sustainable energy groups. The Settlement ensures that there will be affirmative benefits in the immediate future and over time in addition to those described in the Joint Application. These further benefits include:

A. ***Expanded Employment Commitments to Employees.*** Under the Settlement, in addition to the commitments made in the Joint Application, specific net employment level commitments have been made for employees of FirstEnergy and its affiliates in Greensburg and Westmoreland County. *See* Jt. Pet. ¶ 14. The corporate headquarters of Allegheny Energy in Greensburg will become the regional headquarters of West Penn; the regional headquarters of Met-Ed will remain in Reading; and the regional headquarters of Penelec will remain in Erie for a period of at least five years. *Id.* ¶¶ 14-15.

B. ***Immediate and Continuing Rate Relief for FirstEnergy and West Penn Customers.*** Upon consummation of the Merger, West Penn's residential customers will receive

distribution rate credits of $3.57 million per year for three years. Additional rate credits will be provided to customers receiving service under existing West Penn Tariff 37. (Jt. Pet. ¶ 17) Also, the FirstEnergy Pennsylvania Utilities will not seek any distribution rate increases to be effective before October 1, 2012 (except for extraordinary storm expense or changes by the Federal Energy Regulatory Commission in facilities included in transmission rates). (Jt. Pet. ¶ 16) In addition, a credit of $6.19 million will be provided to commercial customers under specified rate schedule to address increases in Energy Efficiency & Conservation ("EE&C") costs under West Penn's revised EE&C Plan.

C. ***Reliability and Customer Service Improvements.*** The Joint Applicants commit to achieving specific levels in the Commission's Customer Average Interruption Duration Index ("CAIDI") and System Average Interruption Duration Index ("SAIDI") for West Penn, as well as West Penn's average speed of answering customer calls. In addition, the Joint Applicants commit to continued reliability investments for rural electric cooperatives and to establish a Joint Utility-Industrial Customer Committee to identify, discuss and address local power and service quality issues for industrial customers. (Jt. Pet. ¶¶ 49, 50-52)

D. ***Increased Universal Service.*** The Joint Applicants commit to attaining a 55% penetration level for West Penn's Customer Assistance Program over a five-year period (based upon additional spending of $750,000 per year) as well as an increase in funding for West Penn's Low-Income Usage Reduction Program (rising to an additional $1.8 million in the fifth year after the Merger). (Jt. Pet. ¶¶ 20 & 22) In addition, FirstEnergy will review methods used by West Penn in raising money for its Hardship Fund and adopt any "best practices" to achieve additional fundraising success for the hardship programs of the FirstEnergy Pennsylvania Utilities. (Jt. Pet. ¶ 21)

E. ***More Renewable Energy.*** West Penn and the FirstEnergy Pennsylvania Utilities will procure 40% of their solar requirements under Pennsylvania's Alternative Energy Portfolio Standards Act through 2021 using long-term contracts. (Jt. Pet. ¶¶ 25-26) In addition, FirstEnergy will contribute $1 million to the Pennsylvania Sunshine Program to support solar energy and $1 million to the Keystone Home Energy Loan Program, as well as provide additional support to the West Penn Sustainable Energy Fund. (Jt. Pet. ¶¶ 27-29).

F. ***New Retail Market Enhancements in West Penn's Service Territory.*** Consistent with programs offered to support competitive retail electric supply in the service territories of the FirstEnergy Pennsylvania Utilities, West Penn will modify its proposed purchase of receivables program, appoint a representative to perform retail ombudsman services, and introduce expanded billing options and access for suppliers to interval and non-interval consumption information via Electronic Data Interchange ("EDI") as well as submit several additional EDI change requests. (Jt. Pet. ¶¶ 38-48)

G. ***More Financial Protection for Customers.*** FirstEnergy will ensure that utility customers are financially protected in a variety of ways, including: (i) ensuring that each FirstEnergy Pennsylvania Utility operating company issues its own debt after obtaining appropriate regulatory authorization; (ii) ensuring that each FirstEnergy Pennsylvania Utility operating company maintains its own credit rating so long as it has debt outstanding and credit rating agencies are willing to provide such rating; (iii) ensuring that no individual FirstEnergy Pennsylvania Utility operating company will assume debt issued by the holding company without Commission approval; and (iv) maintaining separate financial statements reflecting each FirstEnergy Pennsylvania Utility's own assets and liabilities; and 6) ensure that each FirstEnergy

Pennsylvania Utility operating company has its own capital structure, which is a function of its own debt and equity. (Jt. Pet. ¶¶ 35-36)

H. ***Additional Information and Analysis of Wholesale Electricity Markets.*** West Penn and the FirstEnergy Pennsylvania Utilities will provide detailed information about default supply procurements to the OCA, OTS and OSBA and also prepare annual reports through 2015 addressing wholesale market prices and trends in the PJM markets. (Jt. Pet. ¶ 54)

I. ***Sharing of Earnings.*** As part of the Settlement, each of the FirstEnergy Pennsylvania Utilities will credit customers to the extent the utility earns a return on equity that exceeds 10.1% (subject to adjustments for pension normalization) between the consummation of the Merger and October 1, 2012. (Jt. Pet. ¶ 16)

10. To examine the impacts of the Merger on the wholesale electric markets, Dr. William H. Hieronymus, on behalf of the Joint Applicants, presented an analysis of the Merger that conformed to FERC's regulations and merger precedents to determine whether the merger applicants will have the ability to exercise market power, which is defined as the ability to increase market prices for a sustained period of time. (Jt. App. St. 4, Exh. WHH-1, Exh. J-1 at 23-29)

11. Dr. Hieronymus focused his analysis on the PJM market that will exist after June 1, 2011, when generation and transmission assets in the American Transmission Systems, Inc. ("ATSI")[4] footprint (including generation assets not owned by FirstEnergy) are integrated into PJM. He also analyzed alternative geographic markets to give the Commission further assurance

[4] ATSI is a wholly owned subsidiary of FirstEnergy and owns transmission assets which operate as part of the Midwest Independent System Operator ("MISO"). Those transmission assets will be integrated into PJM in 2011.

that the Transaction will not have an adverse impact on competition. (Jt. App. St. 4, Ex. WHH-1, Ex. J-1 at 4)

12. Dr. Hieronymus found that, even after the transaction, the markets he analyzed are almost entirely large, unconcentrated markets. (Jt. App. St. 4, Ex. WHH-1, Exh. J-1 at 46-47) On average, the post-transaction testing index levels (Herfindahl-Hirschman Index) are below the current threshold for defining an unconcentrated market, and, in only three off-peak seasonal periods do levels slightly exceed the threshold. *Id.*

13. Dr. Hieronymus testified that the combined company's share of electric generation after the transaction will not allow it to control the market price of energy that retail electric suppliers use to meet their retail service obligations, and the loss of Allegheny Energy Supply as a competitor will have only a trivial impact on the market due to its small size. (Jt. App. St. 4, pp. 12-16; Jt. App. St. 4-R, p. 38.)

14. Joint Applicants' witness Michael Schnitzer emphasized that the Merger would not have any adverse impact on either the provision of default service or the ability of EGSs to serve retail mass market customers. In default service supply solicitations, many suppliers compete to provide supply on the basis of lowest price to customers and the timing and definitions of products procured are established through a Commission proceeding; the combined company will have no ability to unilaterally alter those decisions. (Jt. App. St. 9-R, p. 12) Similarly, EGSs that want to serve default service customers must now compete against other EGSs and the default service approved by the Commission; after the Merger, the situation is unchanged. *See id.*, p. 14.

15. Joint Applicants' witness Frank Graves testified that the ownership of low-cost generation resources by a wholesale supplier does not provide it with an unfair pricing advantage

in retail electricity markets, and that there was no basis to conclude that the proposed Merger would result in reduced competition in default service supply auctions. Jt. App. St. 10-R, p. 6-12. He also underscored that the Merger would not in any way affect the barriers to entering or exiting the Pennsylvania retail electricity market, and concluded that with the ending of rate caps, there will be a sufficient number of EGSs active in Pennsylvania to support a workably competitive market in retail electricity after the Merger. *See id.*, p. 16.

16. The record evidence establishes that the Merger will not result in anticompetitive or discriminatory conduct, including the unlawful exercise of market power, which will prevent retail electricity customers in this Commonwealth from obtaining the benefits of a properly functioning and workable competitive retail market.

17. Direct Energy recommended that the proposed Merger be conditioned on a fundamental restructuring of Pennsylvania's default service provider ("DSP") model (at least as applied to the Joint Applicants). The principal components of the Direct Energy Plan are as follows (Jt. App. St. 9-R. pp. 3-7):

A. Require the merged entity's four EDCs to exit the DSP business and have the Commission appoint one or more alternative DSPs to take over that role in the Met-Ed, Penelec, Penn Power and West Penn service territories;

B. Have the new DSP(s) auction off existing residential and small business ("Mass Market") default service customers to EGSs, unless such customers affirmatively "opt out." After an initial one-year period, the EGSs, at their discretion, would be free to charge the assigned customers whatever prices they wished;

C. Mandate that the only DSP product to be offered the "opt out" Mass Market customers be a completely unhedged, 100% hourly spot priced service;

D. Require the merged entity to unbundle its billing function and distribution rates through the creation of a separate "BillCo"; and

E. Require the merged entity to divest an undefined amount of generation.

18. Mr. Schnitzer testified that the potential implications of Direct Energy's Plan are dramatic: "Mass Market customers who today choose not to choose default to a largely fixed price service, which is competitively procured in the wholesale market under the oversight of this Commission. Under Direct Energy's proposal, the actual default service is involuntary assignment. Those same choose not to choose customers would be involuntarily assigned to an EGS whose pricing, after an initial one year period, would not be subject to Commission oversight. Customers wishing to avoid such involuntary assignment and receive a Commission sanctioned default service would have to affirmatively elect such service, but they would not be able to obtain the stable pricing to which they are accustomed. The only service offering under the Commission's jurisdiction would be a completely unhedged and volatile spot price offering." (Jt. App. St. 9-R, p. 8)

19. Direct Energy's proposals are allegedly designed to address what its own witnesses describe as generic flaws in the structure of the competitive retail market in Pennsylvania arising from the way the Commission has implemented the Electric Competition Act for all Pennsylvania EDCs, not just West Penn and FirstEnergy's Pennsylvania Utility subsidiaries. (Direct Energy St. 1, p. 12 ("What I am saying is that the model for DSP service itself . . . results in an anticompetitive and discriminatory market structure")).

20. The Merger will not change the manner in which retail customers are served – the FirstEnergy Pennsylvania Utilities will remain the DSPs in their service territories and West Penn will remain the DSP in its service territory. (Tr. 777-778).

21. Direct Energy did not file a petition to have either Met-Ed, Penelec, Penn Power, or West Penn relieved of its DSP obligation.

22. Direct Energy has not alleged that Met-Ed, Penelec, Penn Power or West Penn lacks the operational and financial fitness to continue to serve as a DSP in its service area, nor have they claimed that those companies have lost the ability to provide default service under reasonable rates and conditions.

23. At the conclusion of DSP proceedings, in which Direct participated, the Commission found that Met-Ed, Penelec, Penn Power and West Penn were fit to perform the duties of a DSP and that their respective DSP programs satisfied the requirements of 66 Pa. C.S. § 2807(e) for competitive procurement of generation supplies for default service customers. The DSP programs of Met-Ed and Penelec were approved in November 2009;[5] Penn Power's most recent DSP program was resolved by a Joint Petition for Settlement filed on July 23, 2010, to which Direct Energy was a signatory;[6] and West Penn's DSP program was approved by the Commission in a fully litigated 2008 proceeding.[7]

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[5] *Joint Petition Of Metropolitan Edison Company And Pennsylvania Electric Company For Approval Of Their Default Service Plans*, Docket Nos. P-2009-2093053 and P-2009-2093054 (November 6, 2009).

[6] Joint Petition for Settlement submitted July 23, 2010 at Docket No. P-2010-2157862.

[7] *Petition of the West Penn Power Company d/b/a Allegheny Power for Approval of its retail Electric Default Service Program and Competitive Procurement Plan for Service at the Conclusion of the Restructuring Transition Period,* Docket No. P-00072342, 2008 Pa. PUC LEXIS 30 (July 25, 2008).

24. Direct Energy did not submit evidence suggesting that FirstEnergy or any of its affiliates had engaged in anticompetitive or discriminatory behavior. Direct Energy's witness, Dr. Morey stated: "No, I am not suggesting that the conduct I have described above has happened or necessarily will happen in FirstEnergy's territory." (Direct Energy St., p. 17; see also Tr. 781-782).

25. There are many alternative suppliers licensed to serve commercial and industrial customers in the service territories of West Penn and the FirstEnergy Pennsylvania Utilities. (Jt. App. St. 4, pp. 14-15).

26. Pennsylvania has a number of EGSs that are as large as, or larger than, FirstEnergy/Allegheny will be post-Merger and that have sufficient scale and experience to compete. (Jt. App. St. 10-R, p. 14).

27. Dr. Morey testified that customers were enjoying "a wide range of competitive retail options available in other territories in Pennsylvania" (Direct Energy St. 1, p. 33; Tr. 799-800).

28. Mr. Cory Byzewski, Direct Energy's Vice President and General Manager of US North-Residential Business, in announcing Direct Energy's decision to enter the Duquesne Light market, stated as follows: "We think there's a great opportunity there and Pennsylvania has done a great job to make sure that the markets are open and competitive." *See* Jt. App. Cross-Examination Ex. 16.

29. Billing costs currently are recovered by Met-Ed, Penelec, Penn Power and West Penn through their base distribution rates. The Direct Energy Plan would unbundle the billing function and, of necessity, require that rates be established for the new BillCo entity.

30. As a signatory to the Joint Petition for Settlement that resolved Met-Ed's and Penelec's default service proceedings at Docket Nos. P-2009-2093053 and P-2009-2093054, Direct Energy agreed as follows: "By reason of the Companies agreeing to unbundle uncollectible accounts-expense and to file a POR [Purchase of Receivables] program on the basis set forth above, the other Joint Petitioners agree not to petition the Commission for the further unbundling of the Companies' distribution rates until such time as the Companies file a distribution base rate case." (Jt. App. Cross-Examination Ex. 3; Tr. 633-634)

31. There has been no showing that customers in the Met-Ed, Penelec and Penn Power service areas are aware of the corporate affiliation between FES and their EDC.

32. Direct Energy does not anticipate that very many customers will affirmatively choose to take service from the new DSP under its proposal. Tr. 1028.

33. Dr. Morey's research to support his contention that EGSs would readily pay between $150 and $500 for the right to serve a customer consisted entirely of reading a few internet articles and dividing a reported purchase price by a reported customer count on a hand-held calculator. (Jt. App. Cross-Examination Ex. 9; Tr. 793-800)

34. Direct Energy did not quantify the costs of implementing its proposal. Direct Energy St. 3-SR, p. 29.

35. Direct Energy's proposal is not necessary to remedy any alleged adverse impact of the Merger on retail or wholesale competition.

36. Direct Energy's proposal would not enhance retail competition.

37. Direct Energy's proposal is likely to increase costs to customers, reduce customers' competitive options, generate needless customer confusion, and, generally, harm efforts to promote retail competition in the Commonwealth.

38. Direct Energy's proposal is based on assumptions that are not supported by record evidence. Specifically, there is no evidence that Direct Energy's proposal would produce any discernable benefits to customers.

39. The OSBA's witness, Dr. John W. Wilson, recommended that the Commission attach various conditions to its approval of the Merger.

40. Five of the OSBA's proposed conditions, dealing with Merger synergies/EE&C Plan costs, financial governance measures, customer service and reliability, "blending" of distribution rates and "harmonizing" default service procurement methods following the Merger have been adequately addressed in the Settlement (Jt. Pet.¶¶ 18, 30, 32, 35-37, 49-52).

41. The OSBA's remaining proposed conditions are unwarranted and should be rejected.

42. Dr. Wilson's proposed condition that AES and FES be maintained as "separate subsidiaries" is based on the erroneous premise that combining those entities would adversely affect retail competition. The evidence shows that the combination of AES and FES would not adversely affect retail competition. To the contrary, the evidence shows that Dr. Wilson's proposed condition, if adopted, would likely impede competition and reduce the options available to customers. (Jt. App. St. 4-R, pp. 36-37)

43. Dr. Wilson's proposal to impose restrictions on the Joint Applicants – but not other EGSs – with respect to participating in municipal aggregation relates to matters that are

outside the scope of this proceeding. (Jt. App. St. 4-R, p. 39; Jt. App. St. 10-R, p. 19). Additionally, Dr. Wilson's contention that the Merger would give the Joint Applicants an unfair advantage in competing for municipal aggregation customers is contradicted by the evidence. No changes effected by the Merger will make it easier for the Joint Applicants to compete for municipal aggregation customers or harder for any other EGS to do so. *Id.*; Tr. 886-887.

44. Dr. Wilson's allegation that the Merger raises wholesale market power concerns that warrant conditioning the Merger on "[requiring] the generation assets of Allegheny and FirstEnergy . . . under the control of separate subsidiaries" is contrary to the substantial evidence – including a detailed empirical analysis by the Joint Applicants' expert witness, Dr. Hieronymus – that thoroughly refutes Dr. Wilson's unsubstantiated contentions. (Jt. App. Sts. 4 and 4-R; Jt. App. Ex. WHH-1)

45. Dr. Wilson's proposal to require detailed reporting on executive compensation is misplaced, unwarranted and duplicative. Issues concerning the cost impact of executive compensation are properly addressed in future rate proceedings, not in merger approval proceedings. Moreover, extensive reporting requirements already apply and require publicly held companies such as FirstEnergy to report detailed information regarding executive compensation in annual proxy statements, which are publicly accessible. Additionally, the Dodd-Frank Wall Street Reform and Consumer Protection Act imposes a "say on pay" requirement on public companies that requires an advisory shareholder vote on compensation for executive officers of the reporting companies.

46. RESA has presented no evidence that the FirstEnergy Pennsylvania Utilities have ever given any preference to FirstEnergy Solutions. (Tr. 630)

47. Met-Ed, Penelec, and Penn Power are currently implementing a variety of the retail market enhancements RESA proposes in this proceeding. *See* RESA St. 1, pp. 25-26. The Settlement extends many of these enhancements to West Penn's service territory, including: (1) revisions to West Penn's proposed purchase of receivables ("POR") program for residential and small commercial customers; (2) mailings to customers regarding competitive offers and promotion of shopping opportunities; (3) updated lists of shopping and non-shopping customers for suppliers, with regular updates; (4) provision of interval and non-interval customer data via electronic data interchange ("EDI") and other EDI transactions; (5) appointment of a West Penn representative to perform retail ombudsman services; (6) provision of flexible billing options for EGSs within West Penn's service territory, including both EDC rate-ready and bill-ready options and programming of new rate ready billing codes; and (7) provision of budget billing for customers for an EGS's supply charges if the EGS is utilizing EDC consolidated billing. (Joint Petition, ¶¶ 38-48)

48. RESA did not quantify the costs of its proposed customer referral program (Tr. 630) and, as explained by Joint Applicants witness Fullem, imposing a supplier referral function on EDC call centers will compromise the primary function of those call centers. (Jt. App. St. 8-R, p. 11)

49. An expansion of POR programs is not necessary to support retail choice for large commercial and industrial customers, who are already mostly shopping. *See id.*, p. 12. A high-level director need not be assigned to manage day-to-day supplier questions, as RESA proposes, in light of the immediate access of the supervisors of supplier support services at the FirstEnergy Pennsylvania Utilities and West Penn to other management personnel. *Id.*, p. 21.

50. RESA proposes, as a condition of Merger approval, that FirstEnergy be required to retain an "independent cost allocation expert" to audit the relationship between FirstEnergy's regulated utilities and its unregulated businesses (as well as the relationship between West Penn and Allegheny's unregulated businesses) for the previous three years and for the year following the Merger and provide reports to the Commission. RESA St. 1, pp. 26-27. RESA did not undertake a cost allocation analysis in support of its proposal.

51. Many of the costs incurred for services to unregulated subsidiaries are directly billed to those subsidiaries and not allocated among regulated subsidiaries and unregulated subsidiaries. (Tr. 492; *see also* Jt. App. St. 7-R, pp. 25-26 (explaining that FirstEnergy directly bills its subsidiaries for costs and performs cost allocations consistent with the requirements of the Commission and the Federal Energy Regulatory Commission))

52. The FirstEnergy Pennsylvania Utilities and West Penn are regularly audited by the Commission's Bureau of Audits and the Commission has broad statutory powers to conduct audits, request information, and supervise affiliate relations (including disallowance of unreasonable expenses charged to regulated utilities by their affiliates).

53. FES relies on its own brand derived from employment of almost 1,400 people in Pennsylvania. (Jt. App. St. 1-SR, pp. 6)

54. When RESA witness Hudson was asked about his own employer, retail marketer ConEd Solutions – a subsidiary of Consolidated Edison, Inc., which owns electric utilities in New York – he denied that there was any "improper customer confusion" and that ConEd Solutions in no way leveraged its affiliated utility businesses when it markets services in the territory of its affiliated utilities. (Tr. 623-24)

II. PROPOSED CONCLUSIONS OF LAW

1. The Commission has the jurisdiction and authority to consider and approve the Joint Application and the Joint Petition for Partial Settlement.

2. The Joint Applicants have established by a preponderance of substantial evidence that the Merger, implemented in accordance with the terms and conditions of the Joint Application as supplemented by the Joint Petition, satisfies the requirements of Section 1102(a) of the Public Utility Code.

3. The Joint Applicants have established by a preponderance of substantial evidence that the Merger, implemented in accordance with the terms and conditions of the Joint Application as supplemented by the Joint Petition, satisfies the requirements of Section 2811(e) of the Public Utility Code.

4. The Joint Applicants have established by a preponderance of substantial evidence that the proposed revisions to the FirstEnergy Service Agreement, the Mutual Assistance Agreement and the Intercompany Tax Allocation Agreement should be approved under Section 2102 of the Public Utility Code.

5. No further approval from the Commission is required to consummate the Merger as described in the Merger Agreement and the Joint Application and as supplemented by the Joint Petition.

6. Direct Energy's proposal is outside the scope of action authorized by Section 2811(e) of the Code, and Section 2811(e) does not provide authority for the Commission to adopt Direct Energy's proposal in this case.

7. Direct Energy, in making its proposal in this case, has not complied with the procedural and substantive requirements imposed by the Commission's default service regulations at 52 Pa. Code § 54.183. Direct Energy did not file a Petition, as the regulations require. Direct Energy did not address, or present evidence that would support, the findings Section 54.183(c) requires before the Commission can reassign the default service obligation.

8. Direct Energy is estopped from making its proposal in this case by reason of its participation in the DSP proceedings of the FirstEnergy Pennsylvania Utilities and West Penn.

9. Direct Energy's hourly pricing proposal for default service customers violates Section 2807(e)(3.1), (3.2), (3.4) and (3.7) of the Code because it fails to consider the "least cost to customers over time," "price stability" and a "prudent mix" of "long-term, short-term and spot market" sources, as the law requires.

10. Direct Energy's proposal also violates the law because: (a) the Code does not authorize the forced divestiture of an EDC's billing function; (b) Direct Energy is estopped from seeking further unbundling of Met-Ed's and Penelec's distribution rates in this case by reason of prior settlements to which it was a party; and (c) Direct Energy's proposal would violate FirstEnergy's First Amendment rights to use its name in competitive marketing.

11. RESA is estopped from seeking further unbundling of Met-Ed and Penelec's distribution rates in this case by reason of prior settlements to which it was a party.

III. PROPOSED ORDERING PARAGRAPHS

1. The Joint Application of West Penn Power Company doing business as 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 is hereby granted and approved.

2. The Joint Applicants proposed revisions to the FirstEnergy Service Agreement, the Mutual Assistance Agreement and the Intercompany Tax Allocation Agreement are approved.

3. The Joint Petition for Partial Settlement is hereby granted and approved.

4. Certificates of Public Convenience evidencing approval of the Merger are hereby granted under 66 Pa. C.S. §1103(a).

5. The proceedings at Docket Nos. A-2010-2176520, A-2010-2176732 are concluded and the docket shall be marked closed.

6. The Joint Applicants shall file with the Commission written notice of the Merger within 30 days of the consummation of that transaction.

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BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

JOINT APPLICATION OF WEST PENN POWER COMPANY *doing business as* 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 A-2010-2176732**

CERTIFICATE OF SERVICE

I hereby certify and affirm that I have this day served a copy of the **Initial Brief Of Joint Applicants West Penn Power Company, Trans-Allegheny Interstate Line Company, And FirstEnergy Corp.** on the following persons in the matter specified in accordance with the requirements of 52 Pa. Code § 1.54:

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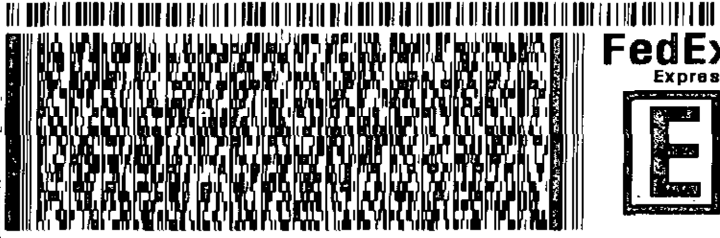

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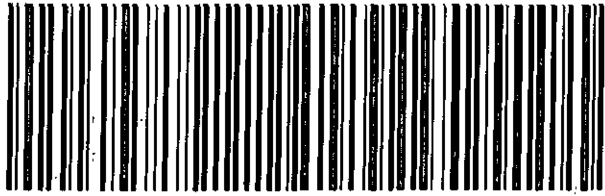

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