

COMMONWEALTH OF PENNSYLVANIA



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January 10, 2011

**HAND DELIVERY**

Rosemary Chiavetta, Secretary  
Pennsylvania Public Utility Commission  
Commonwealth Keystone Building  
400 North Street  
Harrisburg, PA 17120

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

Dear Secretary Chiavetta:

Enclosed for filing are the original and ten (10) copies of the Exceptions, in both Proprietary and Non-Proprietary versions, on behalf of the Office of Small Business Advocate, in the above-captioned proceedings. Only Parties who have signed a Protective Agreement with the Joint Applicants are being served with the Proprietary version. Parties who were not served with a Proprietary version and who can offer proof of the Protective Agreement may contact this Office, to be served as necessary.

As evidenced by the enclosed certificate of service, two copies have been served on all active parties in this case. If you have any questions, please do not hesitate to contact me.

Sincerely,

A handwritten signature in black ink that reads "Lauren M. Lepkoski".

Lauren M. Lepkoski  
Assistant Small Business Advocate  
Attorney ID No. 94800

Enclosures

cc: Parties of Record

Robert D. Knecht

SECRETARY'S BUREAU  
PA PUC

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**BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

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

PA PUBLIC UTILITY COMMISSION  
REGISTRARS BUREAU

JAN 10 2011

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**EXCEPTIONS  
ON BEHALF OF THE  
OFFICE OF SMALL BUSINESS ADVOCATE**

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**RECEIVED**

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**Dated: January 10, 2011**

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## **I. INTRODUCTION/PROCEDURAL HISTORY**

On May 14, 2010, a Joint Application was filed by West Penn Power Company (“West Penn”) d/b/a Allegheny Power, Trans-Allegheny Interstate Line Company (“TrAILCo”), and FirstEnergy Corporation (“FirstEnergy”) (collectively, the “Joint Applicants”), seeking approval by the Pennsylvania Public Utility Commission (“Commission”) of the merger of Allegheny Energy, Inc. (“Allegheny Energy”) with FirstEnergy under Section 1102 of the Public Utility Code, 66 Pa. C.S. §1102, and Section 69.901 of the Commission’s Rules of Practice and Procedure, 52 Pa. Code §69.901.<sup>1</sup> The Joint Application included extensive testimony by witnesses for the Joint Applicants.

West Penn is a Commission-certificated public utility and electric distribution company (“EDC”) which currently operates as a subsidiary of Allegheny Energy and provides service to all classes of customers in western Pennsylvania. Allegheny Energy is a public utility holding company based in Greensburg, Pennsylvania.<sup>2</sup>

TrAILCo is a corporation organized and existing under the laws of the state of Maryland and the Commonwealth of Virginia that is engaged in the business of transmitting electricity in interstate commerce.<sup>3</sup> TrAILCo is an indirect public utility subsidiary of Allegheny Energy and is certificated by the Commission.<sup>4</sup>

FirstEnergy is a corporation organized and existing under the laws of the state of Ohio and is a Commission-certificated energy services holding company headquartered in Akron,

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<sup>1</sup> Joint Application at 1, ¶ 1.

<sup>2</sup> Joint Application at 2-3, ¶¶ 5 and 8. Allegheny Energy has three public utility subsidiaries that conduct business as Allegheny Power: West Penn, in Pennsylvania; Monongahela Power Company in West Virginia; and Potomac Edison Company in Maryland, West Virginia, and Virginia.

<sup>3</sup> Joint Application at 2, ¶ 6.

<sup>4</sup> Joint Application at 2-3, ¶¶ 6 and 8.

Ohio.<sup>5</sup> FirstEnergy owns, directly or indirectly, all of the outstanding common stock in the following Pennsylvania EDCs: Metropolitan Edison Company (“Met-Ed”), Pennsylvania Electric Company (“Penelec”), and Pennsylvania Power Company (“Penn Power”).

FirstEnergy owns the following additional EDC subsidiaries: the Waverly Electric Light and Power Company (New York), the Ohio Edison Company (Ohio), the Cleveland Electric Illuminating Company (Ohio), the Toledo Edison Company (Ohio), and the Jersey Central Power and Light Company (New Jersey).<sup>6</sup>

Merger Sub is a Maryland Corporation and wholly-owned subsidiary of FirstEnergy formed for the sole purpose of effecting the merger.<sup>7</sup>

If the Joint Application is approved (and other necessary approvals are obtained), Allegheny Energy will merge with Merger Sub. As the surviving corporation, Allegheny Energy will become a wholly-owned subsidiary of FirstEnergy.<sup>8</sup> Each Allegheny Energy shareholder will receive 0.667 shares of FirstEnergy common stock for each share of Allegheny Energy common stock held.<sup>9</sup> Upon completion of the merger, existing shareholders of FirstEnergy will own approximately 73% of the combined company while former Allegheny Energy shareholders will own approximately 27% of the combined company.<sup>10</sup> FirstEnergy will remain the corporate parent of Met-Ed, Penelec, and Penn Power (and its out-of-state

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<sup>5</sup> Joint Application at 2, ¶ 7.

<sup>6</sup> Joint Application at 2-3, ¶ 7.

<sup>7</sup> Joint Application at 4, ¶ 9.

<sup>8</sup> Joint Application at 4, ¶ 10.

<sup>9</sup> *Id.*

<sup>10</sup> *Id.*



subsidiaries) and will become the corporate parent of Allegheny Energy and its subsidiaries, including West Penn and TrAILCo.<sup>11</sup>

On May 24, 2010, Administrative Law Judges (“ALJs”) Wayne L. Weismandel and Mary D. Long, assigned as the presiding officers in the proceeding, issued an order scheduling a Prehearing Conference for June 22, 2010.

On June 3, 2010, the Commission issued a Secretarial Letter to all parties identifying twelve issues and areas of concern that the Commission wished the parties to address.

On June 14, 2010, the Office of Small Business Advocate (“OSBA”) filed a Notice of Intervention and Protest with respect to the Joint Application. The OSBA filed and served its Prehearing Memorandum on June 15, 2010.

Other active parties were the Commission’s Office of Trial Staff (“OTS”); the Office of Consumer Advocate (“OCA”); the Pennsylvania Department of Environmental Protection (“DEP”); the International Brotherhood of Electrical Workers (“IBEW”); the Utility Workers Union of America (“UWUA”) and UWUA Local 102 (“Local 102”) (collectively, “UWUA Intervenors”); the Pennsylvania State University (“PSU”); the Met-Ed Industrial Users Group (“MEIUG”) and the Penelec Industrial Customer Alliance (“PICA”) (collectively, “MEIUG/PICA”); the West Penn Power Industrial Intervenors (“WPPII”); the Pennsylvania Rural Electric Association (“PREA”); the Pennsylvania Mountains Healthcare Alliance (“PMHA”); the West Penn Power Sustainable Energy Fund (“WPPSEF”); the York County Solid Waste and Refuse Authority (“YCSWRA”); ARIPPA; the Clean Air Council (“CAC”); Citizens for Pennsylvania’s Future (“PennFuture”); Constellation New Energy, Inc. and Constellation Energy Commodities Group, Inc. (collectively, “Constellation”); Direct Energy

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<sup>11</sup>Joint Application at 4, ¶ 11.

Services LLC (“Direct”); the Retail Energy Supply Association (“RESA”); and Citizen Power, Inc. (“Citizen Power”).

The Prehearing Conference took place on June 22, 2010, at which a litigation schedule was established.

On July 15, 2010, the Joint Applicants submitted Supplemental Direct Testimony.

The OSBA submitted OSBA Statement No. 1, the Direct Testimony of its witness, Dr. John Wilson, on August 17, 2010. OSBA Statement No. 2, the Rebuttal Testimony of Dr. Wilson, and OSBA Statement No. 3, the Rebuttal Testimony of additional OSBA witness Robert D. Knecht, were submitted on September 13, 2010. OSBA Statement No. 4, the Surrebuttal Testimony of Dr. Wilson, was submitted on October 1, 2010.

Evidentiary hearings were held on October 12-15, 2010.

*During the course of this proceeding, the parties engaged in numerous settlement discussions, which resulted in a non-unanimous settlement. A Joint Petition for Partial Settlement (“Settlement”) was filed with the Commission on October 25, 2010. The Settlement requests approval of the merger with only those modifications spelled out in the Settlement. The OSBA is not a signatory to the Settlement.*

On November 3, 2010, the Joint Applicants, the OSBA, the OCA, Citizen Power, RESA, and Direct Energy filed Main Briefs. The Energy Association of Pennsylvania (“EAP”) filed an *amicus curiae* brief.

Reply Briefs were filed on November 15, 2010, by the Joint Applicants, the OSBA, the OCA, Citizen Power, RESA, and Direct Energy.

The Commission issued the ALJs’ Initial Decision (“ID”) on December 20, 2010.

The OSBA submits these Exceptions to the ALJ’s ID.

## II. SUMMARY OF THE ARGUMENT

Through its Exceptions, the OSBA requests that the Commission reject the proposed transfer of control of Allegheny Energy to FirstEnergy, unless the Commission imposes conditions to protect default service ratepayers and retail competition from the negative impact of FirstEnergy's opt-out municipal aggregation strategy. These requested conditions are as follows:

- a. FirstEnergy and its affiliates shall not engage in municipal aggregation in the Met-Ed, Penelec, Penn Power, and West Penn service territories prior to the enactment and implementation of authorizing legislation or June 1, 2013, *whichever is later*; and
- b. First Energy shall administratively locate the generating assets of FirstEnergy and Allegheny Energy in separate subsidiaries that shall not coordinate whether to bid in a particular default service procurement and regarding what price to bid.<sup>12</sup>

The ALJs rejected the OSBA's additional conditions on the theory that municipal aggregation is both speculative and not related to the merger. Specifically, the ALJs stated the following:

Clearly, the concept of municipal aggregation is nascent in Pennsylvania and subject to considerable debate before both the Commission and in the General Assembly. Indeed, in the aftermath of the announcement of FirstEnergy's municipal aggregation agreement with Meadville, [footnote omitted] on October 28, 2010, RESA sought to initiate such a generic proceeding by filing its *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 Authority*, at Docket No. P-2010-2207062. On October 29,

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<sup>12</sup> OSBA Main Brief at 67.

2010, Dominion Retail, Inc., joined in the effort to initiate a generic proceeding by filing its *Petition of Dominion Retail, Inc. for Order Declaring that Opt-out Municipal Aggregation Programs are Illegal for Home Rule and Other Municipalities in the Absence of Legislation Authorizing Such Programs*, at Docket No. P-2010-2207953. FirstEnergy joined the effort to initiate a generic proceeding on November 9, 2010, when its affiliate, FirstEnergy Solutions Corporation, filed its *Petition of FirstEnergy Solutions Corp. for Approval to Participate in Opt-Out Municipal Energy Aggregation Programs of the Optional Third Class Charter City of Meadville, the Home Rule Borough of Edinboro, the Home Rule City of Warren and the Home Rule City of Farrell*, at Docket No. P-2010-2209253. By Secretarial Letter issued on November 10, 2010, the Commission consolidated the three aforementioned petitions and set a deadline for interested parties to file answers. The Commission directs each EDC not to switch any customer to an EGS pursuant to an 'opt-out' municipal aggregation contract and each EGS not to switch any customer from default service (or the customer's existing EGS) pursuant to an 'opt-out' municipal aggregation contract until these legal issues are addressed and resolved by the Commission.

Thus, the future of municipal aggregation in the Commonwealth, and whether FirstEnergy will be able to achieve its retail aspirations are far from assured. While we believe that the OSBA raises legitimate concerns which should be thoroughly investigated by the Commission and the General Assembly, any threat posed by municipal aggregation is too speculative and not sufficiently related to the proposed merger. The unique circumstances of these merger proceedings are not an appropriate vehicle from which to launch broader policy goals that may have an effect on the electricity markets across the Commonwealth, and not just in the territories of the Joint Applicants. While the acquisition of Allegheny Energy's generating assets by FirstEnergy may provide it with some competitive advantage, the OSBA has not presented any evidence related to the other aspects of FirstEnergy's retail marketing goals which would permit the conclusion that the advantage is necessarily unfair or rises to the level of being anticompetitive. In short, it is inappropriate to place

restrictions upon the Joint Applicants based on speculation and intent, and we decline to do so.<sup>13</sup>

The ALJs failed to recognize that the principal reason for this merger is to enable FirstEnergy to obtain Allegheny Energy's "**LOW-COST GENERATION.**" FirstEnergy has acknowledged that it needs the low-cost generation to achieve its retail business goals, which explicitly include municipal aggregation in Pennsylvania. Therefore, the ALJs' conclusion that municipal aggregation is not related to this merger is incorrect.

Consistent with the ALJs' own conclusions regarding Direct Energy's opt-out aggregation program, opt-out municipal aggregation is presently unlawful. Furthermore, even if the General Assembly enacts legislation authorizing opt-out municipal aggregation, the evidence in this proceeding shows that opt-out municipal aggregation will have a negative impact on default service rates if it is implemented before the expiration of Met-Ed, Penelec, Penn Power, and West Penn's default service periods, *i.e.*, on May 31, 2013.

At the same time they rejected the OSBA's proposed conditions, the ALJs adopted the non-unanimous Settlement.<sup>14</sup> According to the ALJs, the non-unanimous Settlement "provides sufficient benefits to a sufficient spectrum of stakeholders to be in the public interest."<sup>15</sup> The ALJs also concluded that the non-unanimous Settlement is not invalid because some parties did not receive what they wanted. Specifically, the ALJs stated:

Nor do the modifications addressed by the petition for settlement address every concern raised by either the Settling Parties or the non-settling parties. However, neither the Code nor applicable legal precedent requires

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<sup>13</sup> ID at 73-74.

<sup>14</sup> ID at 75.

<sup>15</sup> ID at 39.

each and every interest of each and every party to be accommodated in a settlement.<sup>16</sup>

This is a classic case of political logrolling, in which the non-settling parties are left out and face an almost insurmountable burden to have the non-unanimous Settlement rejected or modified.

The Commonwealth Court commented on the use of non-unanimous settlements when it reviewed the merger of FirstEnergy and GPU Energy.<sup>17</sup> The Court observed that “[n]on-unanimous settlements, while not common, are not unique and have been the source of some controversy.”<sup>18</sup> After making that observation, the Court cited to an article by Professor Stefan H. Krieger regarding the dangers of non-unanimous settlements. Of particular relevance, the Court quoted Professor Krieger as follows:

The danger of such an approach is obvious. Parties with a substantial interest in a utility proceeding can be left out of the decision-making process. Although commissions that permit nonunanimous settlements require review of these settlements to determine their reasonableness, these commissions often defer to the decision of the consenting parties.

\* \* \*

Furthermore, in their zeal to reap the benefits of the nonunanimous settlement process, commissions shift the burden of proof to the nonconsenting parties by forcing them to prove the unreasonableness of the settlement. While both traditional regulatory hearings and the unanimous settlement process provide protection for all parties, the nonunanimous settlement process places some parties at a severe disadvantage.<sup>19</sup>

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<sup>16</sup> ID at 75.

<sup>17</sup> See *ARIPPA v. Pennsylvania Public Utility Commission*, 792 A.2d 636 (Pa. Cmwlth. 2002).

<sup>18</sup> *ARIPPA*, 792 A.2d at 658.

<sup>19</sup> *ARIPPA*, 792 A.2d at 658-659. Compounding the disadvantage before the Commission is the privileged nature of settlement discussions. See 52 Pa. Code §5.231(d). Because of the privilege, non-settling parties are often deprived of their best chance to prove the unreasonableness of the settlement, *i.e.*, by revealing the changes they proposed in the settlement and the position of one or more other parties on those changes.

The OSBA has no objection to the conditions imposed on the merger by the non-unanimous Settlement. However, the ALJs' endorsement of adjudication by political logrolling improperly shifted the burden of proof regarding opt-out municipal aggregation to the OSBA. That is precisely the problem with non-unanimous settlements about which the Commonwealth Court warned in *ARIPPA*.<sup>20</sup>

### III. EXCEPTIONS

**Exception No. 1: The ALJs erred by failing to delay implementation of FirstEnergy's municipal aggregation plan until the enactment of authorizing legislation. (ID at 73-74)**

#### A. Summary

The following is the first condition that the OSBA requested:

*FirstEnergy and its affiliates shall not engage in municipal aggregation in the Met-Ed, Penelec, Penn Power, and West Penn service territories prior to the enactment and implementation of authorizing legislation or June 1, 2013, whichever is later.*<sup>21</sup>

There are two parts to the OSBA's first condition. First, the OSBA requests that the Commission prohibit FirstEnergy from engaging in municipal aggregation until authorizing legislation is passed. Second, the OSBA requests that if legislation is passed allowing municipal aggregation, the Commission prohibit FirstEnergy from providing municipal aggregation until the default service periods of Met-Ed, Penelec, Penn Power, and West Penn expire on May 31, 2013.

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<sup>20</sup> *ARIPPA*, 792 A.2d at 658-659.

<sup>21</sup> OSBA Main Brief at 67.

The ALJs based their rejection of the OSBA's first condition on two grounds: 1.) that municipal aggregation is not relevant to the merger and 2.) that the harm claimed by the OSBA is speculative.<sup>22</sup> The ALJs are incorrect.

## **B. Violation of the Public Utility Code**

### **1. Summary**

As planned by FirstEnergy, residential and small commercial and industrial ("Small C&I") customers in a participating municipality will be included in that municipality's aggregation program unless they affirmatively "opt-out."

Opt-out municipal aggregation violates the meaning of "default service" as laid out in Sections 2803 and 2807(e)(3.1) of the Public Utility Code, 66 Pa. C.S. §§2803 and 2807(e)(3.1), and violates the anti-slamming rule under Section 2807(d)(1) of the Public Utility Code, 66 Pa. C.S. §2807(d)(1). The General Assembly considered legislation in the last session which would have authorized opt-out municipal aggregation, thereby overriding Sections 2803, 2807(e)(3.1), and 2807(d)(1). Because that legislation was not enacted, opt-out municipal aggregation is unlawful. Therefore, the Commission should impose the OSBA's condition that would prohibit FirstEnergy from engaging in opt-out municipal aggregation in the Met-Ed, Penelec, Penn Power, and West Penn service territories until authorizing legislation has been enacted.

### **2. Default Service Provider**

Section 2803 defines the Default Service Provider ("DSP") as follows:

'Default service provider.' An electric distribution company within its certified service territory or an alternative supplier approved by the commission that

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<sup>22</sup> ID at 73-74.



provides generation service to retail electric customers who:

(1) contract for electric power, including energy and capacity, and the chosen electric generation supplier does not supply the service; or

(2) ***do not choose an alternative electric generation supplier.*** (emphasis added)

Section 2807(e)(3.1) states the obligations of a default service provider. In pertinent part,

Section 2807(e)(3.1) provides as follows:

Following the expiration of an electric distribution company's obligation to provide electric generation supply service to retail customers at capped rates, if a customer contracts for electric generation supply service and the chosen electric generation supplier does not provide the service or ***if a customer does not choose an alternative electric generation supplier,*** the default service provider shall provide electric generation supply service to that customer pursuant to a commission-approved competitive procurement plan. (emphasis added)

Interestingly, the Joint Applicants' own witness, Mr. Michael M. Schnitzer, opined that his definition of default service is if a customer does nothing, the customer is on default service.<sup>23</sup> Specifically, Mr. Schnitzer testified as follows:

Well, I mean, in the sense that they are on default service, but the point is that however they got there, by doing nothing, that's where they ended up. And that's my definition of default service, if you do nothing, what happens.<sup>24</sup>

Under its municipal aggregation strategy, FirstEnergy's electric generation supplier, FirstEnergy Solutions ("FES"), will essentially take over the role of the default service provider.

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<sup>23</sup> Hearing Transcript at 938.

<sup>24</sup> Hearing Transcript at 938.

For example, FES Vice President Mr. Tony Banks explained to the House Consumer Affairs Committee, as follows:

Municipal aggregation is not much different than the structure already in place today in Pennsylvania. Today, if customers take no action to shop for electric generation service, they automatically receive default service from their local electric utility. Similarly, under opt-out municipal aggregation, *customers who take no action will automatically default to the generation supplier* with whom their municipality has negotiated a price, presumably lower than the utility default service price.<sup>25</sup> (emphasis added)

Changing the nature of default service, as proposed by Mr. Banks, requires the enactment of legislation.

### **3. Slamming**

Section 2807(d)(1) provides that “[t]he Commission shall establish regulations to ensure that an electric distribution company does not change a customer’s electricity supplier without direct oral confirmation from the customer of record or written evidence of the customer’s consent to a change of supplier.” Under FirstEnergy’s municipal aggregation, FirstEnergy’s affiliated EDC will be changing a customer to FirstEnergy’s affiliated EGS without direct oral confirmation from the customer or written evidence of the customer’s consent to the change.

Allowing FirstEnergy to engage in slamming requires the enactment of legislation.

### **4. Direct Energy’s Opt-Out Proposal**

In the ID, the ALJs adopted conclusions of law that Direct Energy’s opt-out aggregation proposal violates the meaning of default service as laid out in Sections 2803 and 2807(e)(3.1) and violates the anti-slamming rule under Section 2807(d)(1). Specifically, the ALJs adopted the following conclusions of law:

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<sup>25</sup>Direct Energy Cross-Examination Exhibit No. 9.

16. A customer who does not affirmatively choose service from an EGS receives default service.<sup>26</sup>

18. The Direct Energy Proposal is inconsistent with the Code at Section 2807(d)(1) that requires a customer's affirmative consent in order to switch that customer's electric provider.<sup>27</sup>

Since the ALJs concluded that Direct Energy's opt-out proposal is unlawful because it forces customers to take affirmative action to choose default service and it slams customers, the ALJs should also have concluded that FirstEnergy's opt-out municipal aggregation program is unlawful for those same reasons. Therefore, the ALJs erred in not imposing the OSBA's condition that the implementation of FirstEnergy's opt-out municipal aggregation program should be delayed until the enactment of authorizing legislation.

### **C. General Assembly and Consolidated Proceeding**

In their ID, the ALJs stated that "the concept of municipal aggregation is nascent in Pennsylvania and subject to considerable debate before both the Commission and in the General Assembly."<sup>28</sup> The ALJs then referenced the consolidated proceeding that is before the Commission regarding the lawfulness of opt-out municipal aggregation in home rule municipalities.<sup>29</sup>

On June 29, 2010, the then-Chairman of the House Consumer Affairs Committee, Representative Joseph Preston, introduced House Bill 2619 in the Pennsylvania House of Representatives. House Bill 2619 would have authorized opt-in and opt-out municipal

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<sup>26</sup> ID at 78. Conclusion of Law No. 16.

<sup>27</sup> ID at 78, Conclusion of Law No. 18.

<sup>28</sup> ID at 73.

<sup>29</sup> ID at 73.

aggregation programs for both home rule and non-home rule municipalities.<sup>30</sup> However, that particular legislation was not considered by the full House or by the Senate prior to adjournment of the 2009-2010 session.

FirstEnergy represented that “FirstEnergy plans to expand its municipal aggregation marketing in other states beyond Ohio, including Pennsylvania, *if state legislation authorizing ‘opt-out’ municipal aggregation is enacted and implemented with provisions that support viable aggregation programs . . .*”<sup>31</sup> However, despite this representation, FES did not wait for legislation to be enacted. Instead, FES solicited an opt-out contract for municipal aggregation with Meadville.<sup>32</sup>

Because FES refused to wait for legislation to be enacted, RESA and Dominion Retail, Inc. (“Dominion”) filed petitions with the Commission challenging the lawfulness of opt-out municipal aggregation programs in the absence of authorizing legislation. FES responded by filing its own petition, seeking a Commission Order upholding opt-out municipal aggregation in home-rule municipalities under current law. By Secretarial Letter issued on November 10, 2010, the Commission consolidated the three petitions and set November 22, 2010, as the deadline for interested parties to file answers.<sup>33</sup> Although answers were filed, the Commission has not yet adopted or entered an Order adjudicating the consolidated proceeding. Therefore, the

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<sup>30</sup> House Bill 2619, Printer’s Number 4406, page 2, lines 1-7; page 3, lines 15-19; and page 7, lines 5-12. The legislation is available on-line at the General Assembly’s web site: <http://www.legis.state.pa.us>

<sup>31</sup> Direct Energy Cross Examination Exhibit No. 9. (emphasis added)

<sup>32</sup> Direct Energy Cross Examination Exhibit No. 5 and Hearing Transcript at 278.

<sup>33</sup> *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 Authority*, at Docket No. P-2010-2207062; *Petition of Dominion Retail, Inc. for Order Declaring that Opt-out Municipal Aggregation Programs are Illegal for Home Rule and Other Municipalities in the Absence of Legislation Authorizing Such Programs*, at Docket No. P-2010-2207953; and *Petition of FirstEnergy Solutions Corp. for Approval to Participate in Opt-Out Municipal Energy Aggregation Programs of the Optional Third Class Charter City of Meadville, the Home Rule Borough of Edinboro, the Home Rule City of Warren and the Home Rule City of Farrell*, at Docket No. P-2010-2209253 (Secretarial Letter issued on November 10, 2010).

lawfulness of opt-out municipal aggregation remains an issue in the instant proceeding because the General Assembly has not enacted legislation authorizing opt-out municipal aggregation and the Commission has not yet adopted or entered an Order concluding the consolidated proceeding.

**D. Non Home-Rule Municipalities**

With regard to the legality of opt-out municipal aggregation, the Joint Applicants' Main Brief divided municipalities into two categories: 1.) "Non Home-Rule Municipalities" and 2.) "Home-Rule Municipalities."<sup>34</sup> The Joint Applicants conceded that legislation must be enacted before Non Home-Rule municipalities are permitted to participate in opt-out municipal aggregation. Furthermore, the Joint Applicants indicated that FirstEnergy has no intention of entering into contracts with Non Home-Rule municipalities for opt-out municipal aggregation until legislation is passed.<sup>35</sup> Therefore, the ALJs should, at least, have imposed a condition prohibiting FirstEnergy from participating in opt-out municipal aggregation in Non Home-Rule municipalities until legislation is enacted.

The Joint Applicants may argue that imposing this condition upon FirstEnergy is unnecessary or unfair. However, FirstEnergy has represented in this proceeding (in an interrogatory response authored by Mr. Banks) that it plans to expand its municipal aggregation marketing from Ohio to Pennsylvania, "*if state legislation authorizing 'opt-out' municipal aggregation is enacted.*"<sup>36</sup> That representation drew no distinction between home rule and non-home rule municipalities. Nevertheless, FES solicited an opt-out contract for municipal aggregation with Meadville before legislation was enacted. Therefore, FirstEnergy's representations about waiting for the enactment of legislation lack credibility.

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<sup>34</sup> Joint Applicants Main Brief at 62-63.

<sup>35</sup> *Id.*

<sup>36</sup> Direct Energy Cross Examination Exhibit No. 9.

### **E. Home-Rule Municipalities**

According to the Joint Applicants, opt-out aggregation is already allowed in home-rule municipalities.<sup>37</sup> Although the Joint Applicants' position is a matter of dispute in the consolidated proceeding, it is unclear if, or when, the Commission will adjudicate the question. Therefore, the Commission should, at a minimum, impose the OSBA's condition on home-rule municipalities until the conclusion of that proceeding.

### **F. Harm to Small Business Ratepayers**

The ALJs stated that any threat posed by opt-out municipal aggregation is too speculative to warrant the imposition of conditions on the merger. However, numerous factual representations that were made in the instant proceeding demonstrate that opt-out municipal aggregation is relevant to the merger and that the harm opt-out municipal aggregation could cause is not speculative.

As Constellation witness David Fein stated in unrebutted testimony, FES has expressed strong support for legislation concerning opt-out municipal aggregation and has been among the primary drivers behind the legislation.<sup>38</sup> In the instant proceeding, FirstEnergy made clear that "it plans to expand its municipal aggregation marketing in other states beyond Ohio, including Pennsylvania, *if state legislation authorizing 'opt-out' municipal aggregation is enacted and implemented with provisions that support viable aggregation programs. . . .*"<sup>39</sup>

As part of its plan to expand municipal aggregation into Pennsylvania, FES Vice President Mr. Banks testified before the House Consumer Affairs Committee in favor of

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<sup>37</sup> Joint Applicants Main Brief at 62.

<sup>38</sup> Constellation Statement No. 1-SR at 10.

<sup>39</sup> Direct Energy Cross Examination Exhibit No. 9. (emphasis added)

municipal aggregation legislation.<sup>40</sup> Significantly, the legislation Mr. Banks supported would have imposed the same rules on both home rule and non-home rule municipalities.<sup>41</sup> Moreover, that legislation would have required the municipality to apply for an EGS license; required the municipality to act as an aggregator of electric generation supply service on behalf of its citizens (once its EGS license was granted); and required the municipality to negotiate with various EGSs and enter into a contract with the EGS which offers the most favorable terms.<sup>42</sup>

Despite FES's support for that legislation and the representation that FES would enter the municipal aggregation market in Pennsylvania if the state legislature authorized it, FES sought to participate in opt-out municipal aggregation without the enactment of legislation, *e.g.*, FES solicited a contract for opt-out municipal aggregation with Meadville.<sup>43</sup>

Moreover, FES intends to participate in opt-out municipal aggregation programs with home rule municipalities without providing the same protections that would have applied if the pending legislation had been enacted, *e.g.*, competitive procurement. In that regard, there is no record evidence that the proposed contract with Meadville was competitively procured.

The Joint Applicants are likely to argue that the lack of competitive procurement will not harm Meadville ratepayers because, as FirstEnergy CEO Mr. Anthony Alexander testified, the Meadville aggregation rate will be a discount off the default service rate.<sup>44</sup> However, that discount will harm Small C&I customers in Meadville. Specifically, Small C&I customers in

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<sup>40</sup> Direct Energy Cross Examination Exhibit No. 9.

<sup>41</sup> House Bill 2619, Printer's Number 4406, page 2, lines 1-7; page 3, lines 15-19; and page 7, lines 5-12. The legislation is available on-line at the General Assembly's web site: <http://www.legis.state.pa.us>

<sup>42</sup> Direct Energy Cross Examination Exhibit No. 9. The final version of that legislation would actually have required competitive procurement. *See* House Bill 2619, Printer's Number 4406, page 11, lines 19-23. The legislation is available on-line at the General Assembly's web site: <http://www.legis.state.pa.us>

<sup>43</sup> Direct Energy Cross Examination Exhibit No. 5 and Hearing Transcript at 278.

<sup>44</sup> Hearing Transcript at 279.

Meadville will receive a 4% discount off the default service rate, but residential customers will receive a 6% discount off the default service rate.<sup>45</sup> Therefore, the Meadville program will allow just the kind of rate discrimination the General Assembly and the Commission have sought to avoid.

In that regard, Section 2807(e)(7) of the Public Utility Code, 66 Pa. C.S. §2807(e)(7), specifies that “[a]ll default service rates shall be reviewed by the commission to ensure that the costs of providing service to each customer class are not subsidized by any other class.” Furthermore, the Commission’s default service regulations and policy statement also require that the service provided to a customer who does not make a choice must be acquired through a competitive procurement process that separately determines the market price for each rate class procurement group in order to eliminate historical interclass subsidies, to avoid creating new interclass subsidies, and to facilitate shopping.<sup>46</sup>

*Therefore, even if the Commission decides in the consolidated proceeding that it is already lawful for FES to enter opt-out aggregation contracts with Meadville and other home rule municipalities, the Commission should impose the OSBA’s condition in order to prevent rate discrimination against Small C&I customers.*

**Exception No. 2: The ALJs erred by failing to delay implementation of FirstEnergy’s municipal aggregation plan until the default service periods of Met-Ed, Penelec, Penn Power, and West Penn expire on May 31, 2013. (ID at 73-74)**

**A. Summary**

Even if legislation authorizing opt-out municipal aggregation is passed in the future, FirstEnergy should be prohibited from engaging in municipal aggregation until the default

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<sup>45</sup> Direct Energy Cross-Examination Exhibit No. 5.

<sup>46</sup> See 52 Pa. Code §§54.186(b) and (c); 54.187(a), (h), (i), and (j); 69.1805; and 69.1807(3).



service periods of Met-Ed, Penelec, Penn Power, and West Penn expire on May 31, 2013. The purpose of this condition is to prevent harm to default service rates and retail competition.

The Joint Applicants have argued that they should not be singled out for a ban on opt-out municipal aggregation.<sup>47</sup> However, FirstEnergy has a merger before this Commission in which it has explicitly indicated that it intends to use generation (obtained as a result of this merger) for its retail business strategy, which includes opt-out municipal aggregation. No other entity has proposed such a merger. Moreover, FES is the only EGS in Pennsylvania which is trying to solicit contracts with municipalities for opt-out aggregation before legislation has been passed. Furthermore, FES is the only EGS in Pennsylvania trying to impose discriminatory rates on Small C&I customers through opt-out municipal aggregation. Therefore, it is appropriate to place conditions on FirstEnergy's participation in opt-out municipal aggregation without waiting for a generic proceeding to impose similar restrictions on all EDCs and EGSs.

## **B. Negative Impact on Default Service Rates**

### **1. Default Service Procurements**

The ALJs concluded that ownership of low-cost generation will not adversely impact FirstEnergy's default service rates.<sup>48</sup> However, the ALJs overlooked Constellation witness Mr. David Fein's *unrebutted* testimony that municipal opt-out aggregation will lead to higher default service rates.<sup>49</sup> For example, Mr. Fein testified as follows:

Wholesale suppliers bidding to serve an EDC's default service supply requirements under such a DSP [default service plan] understand, accept and account for the fact that the EDC's load will change as customers *at their own election* choose to leave Default Service for competitive

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<sup>47</sup> Joint Applicants Main Brief at 25.

<sup>48</sup> ID at 26-27, Findings of Fact 54 and 57.

<sup>49</sup> See OSBA Main Brief at 33-37.

retail supply from an EGS, and that such individual customers may at some point in time *return* to Default Service.

Municipal Opt-Out Aggregation, however, fundamentally changes the patterns and ways in which customers both leave and return to Default Service. If it seems that Municipal Opt-Out Aggregation policies are likely to be implemented in the near term, bidders in procurements under DSPs already approved by the Commission will recognize and account for the significant load variability differences that Municipal Opt-Out Aggregation programs present with respect to serving a portion of an EDC's Default Service supply requirements. In order to address such differences, wholesale suppliers may either limit their participation in Default Service procurements or else account for the increased risk of large-scale declining and returning load under Municipal Opt-Out Aggregation through additional premiums in their bids. Reduced participation and/or additional premiums will lead only to *less* competitive Default Service procurements with *less* competitive Default Service bids, to the *detriment* of utilities' Default Service consumers. Higher Default Service prices will be paid by *all* customers who remain on Default Service, even though all municipalities may not have implemented or do not plan to implement Municipal Opt-Out Aggregation programs.

In summary, the implementation of Municipal Opt-Out Aggregation represents a new 'default' product for *certain* municipalities' customers that will *increase* the costs of EDCs' statutorily-mandated Default Service product for *all* customers. Potential wide and growing disparities between customers, *including* between municipalities, that may result from Municipal Opt-Out Aggregation would be harmful to the Commission's energy future.<sup>50</sup>

Furthermore, OSBA witness Dr. Wilson testified on cross-examination that if FirstEnergy were to proceed the way it has in Ohio, municipal aggregation would essentially destroy default service as it currently exists in Pennsylvania. Specifically, Dr. Wilson testified:

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<sup>50</sup> Constellation Statement No. 1-SR at 10-11. (emphasis in original)

Dr. Wilson: Not merely that, but rather the way in which FirstEnergy has participated. That is to lock up for long periods of time communities within their service territories by making payments to those communities not purely on price-of-electricity basis.

Certainly, if that sort of thing were to occur in Pennsylvania, it would mount a very severe threat to the default service supply programs that are successful and operating now. It would greatly increase the risks of those programs and likely reduce participation of them in the future and be a threat to consumers who are benefiting from those types of default service supply acquisition programs at the present time, particularly those that operate on a full requirements basis.

Mr. DeCusatis: And that is because other EDCs are prohibited for some reason from competing in the same way that FirstEnergy does?

Dr. Wilson: No. It's because if municipal aggregation moves forward on a basis other than opt-in and on a basis other than competitive bidding and prior to the expiration of the default service programs, particularly with the type of conduct and experience that we've had with FirstEnergy in Ohio, it would be something that would imperil, I think, the ability of the state to have an effective default service supply program in competition with that.<sup>51</sup>

If default service rates are driven up because of reduced participation of bidders in default service procurements or because of additional risk premiums to account for municipal aggregation, then FES's customers will be receiving a discount off an inflated default service rate. Therefore, contrary to the Joint Applicants' contention, municipal aggregation customers may not receive a discount at all; instead, they may be paying higher prices for generation than they would have if municipal aggregation had never been implemented.

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<sup>51</sup> Hearing Transcript at 561-562.

As a way to mitigate the negative impact on default service rates, Mr. Fein suggested that FES should be required to determine the amount of load to be served by municipal aggregation before wholesale suppliers submit their default service bids.<sup>52</sup> Consistent with Mr. Fein's logic, such advance notice should result in smaller risk premiums because the bidders will have greater certainty about what the default service load will be.

Mr. Fein also suggested that "this Commission should take steps to ensure that the timing of any newly-created Municipal Opt-Out Aggregation program will not affect existing Commission approved DSPs and/or already executed contracts under the Commission approved DSPs for not only the FirstEnergy EDCs, but also for Allegheny."<sup>53</sup> By waiting to implement municipal opt-out aggregation until the default service periods beginning June 1, 2013, the FirstEnergy EDCs (Met-Ed, Penelec, Penn Power, and West Penn) will be better able to give wholesale bidders advance notice of what the default service load will be, thereby avoiding or mitigating the risk premiums that will otherwise increase default service rates.

The Joint Applicants tried to dismiss Mr. Fein's testimony by arguing that because Constellation signed the Settlement, the weight of Constellation's testimony must be diminished.<sup>54</sup> However, as the ALJs acknowledged in their ID, a settlement is a compromise of the settling parties' positions.<sup>55</sup> When a party signs a settlement, it does not mean that the party no longer considers its witness's testimony to be true or to have weight. If Constellation had been persuaded that Mr. Fein's testimony was not credible, Constellation could have withdrawn the testimony. Constellation's decision *not* to withdraw Mr. Fein's testimony implies that

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<sup>52</sup> Constellation Statement No. 1 at 13-14.

<sup>53</sup> Constellation Statement No. 1 at 13.

<sup>54</sup> Joint Applicants Reply Brief at 31.

<sup>55</sup> ID at 75.

Constellation continues to stand behind the testimony, but was willing to abandon the municipal aggregation issue in order to get other items into the Settlement.

## 2. Diversion of Low-Cost Generation

The testimony of FirstEnergy CEO Mr. Anthony Alexander shows that FirstEnergy's business strategy is to utilize Allegheny Energy's generation fleet to market aggressively through the following three sales channels:

- Direct Sales;
- Municipal Aggregation; and
- Sales into the Provider of Last Resort ("POLR") Auctions.<sup>56</sup>

Mr. Alexander testified that FirstEnergy is already an active "retail" provider in Pennsylvania.<sup>57</sup> Specifically, FirstEnergy's EGS affiliate, FES, already participates in two out of the three targeted sales channels in Pennsylvania under its retail marketing strategy, *i.e.*, direct sales and sales into the POLR Auctions.<sup>58</sup> Mr. Alexander acknowledged that FirstEnergy's retail marketing in Pennsylvania currently is limited because of the shortage of generation, but he predicted that acquiring Allegheny Energy's generation assets will help FirstEnergy overcome that limitation. Specifically, Mr. Alexander summarized the effect of the merger on FirstEnergy's retail strategy as follows:

Having additional generation will expand our opportunities to attract additional retail customers not only in Pennsylvania but elsewhere.

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<sup>56</sup>Hearing Transcript at 261-262. As acknowledged by the ALJs, Mr. Alexander's reference to "direct sales" is to the customer-by-customer solicitations commonly employed by EGSs. His reference to "sales into the Provider of Last Resort Auctions" is to bidding in the Request for Proposal or auction process used by an EDC to acquire electricity for default service customers. Bidding in default service procurements does not constitute "retail competition," as the Commission appears to define "retail competition." ID at 73.

<sup>57</sup>Hearing Transcript at 262.

<sup>58</sup> Direct Energy Cross-Examination Exhibit No. 3.

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It's the addition of generation that allows you to participate more fully in the retail market opportunities that Pennsylvania presents. It's not unlike the 500 megawatts we added to the system. It gave us more capability to participate in retail markets across the area. The Allegheny generation will be similar to that.<sup>59</sup>

As Mr. Alexander testified, FirstEnergy currently follows the same three-pronged retail marketing strategy in Ohio that it plans to pursue in Pennsylvania.<sup>60</sup> Under the retail marketing strategy in Ohio, FES served 79% of what Mr. Alexander defines as retail load, *i.e.*, the combination of FES's direct sales, aggregation sales, and default service sales in its franchise service territories during the six months ending June 30, 2010.<sup>61</sup> In addition, FirstEnergy's 2010 second quarter results show that 25.5% of FES's sales in Ohio are through municipal aggregation.<sup>62</sup> **BEGIN CONFIDENTIAL** [REDACTED]

[REDACTED]  
[REDACTED]  
**END CONFIDENTIAL**

As Mr. Alexander's testimony shows, the principal benefit of this merger to FirstEnergy is the acquisition of Allegheny Energy's low-cost generation so that FirstEnergy can expand its opportunities in Pennsylvania's retail markets.<sup>64</sup> One way FirstEnergy intends to expand those opportunities is through opt-out municipal aggregation.<sup>65</sup> Although municipal aggregation is only one of three prongs of FirstEnergy's business strategy, the fact is that FES will be using

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<sup>59</sup> Hearing Transcript at 262.

<sup>60</sup> Hearing Transcript at 261-262.

<sup>61</sup> Hearing Transcript at 262-264.

<sup>62</sup> Direct Energy Cross Examination Exhibit No. 3.  
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<sup>64</sup> Hearing Transcript at 262.

<sup>65</sup> Joint Application at 17, ¶28 and Joint Applicants Statement No. 1 at 17.

generation obtained through this merger to participate in municipal aggregation. Therefore, contrary to the ALJs' conclusion that municipal aggregation is irrelevant and speculative, the Commission can not approve this merger without first assessing the impact of municipal aggregation.

FirstEnergy's strategy is to promise municipal aggregation customers a discount off the default service rate.<sup>66</sup> As Direct Energy witness Mr. Frank Lacey testified, it is difficult to understand how FES can afford to make such a promise for an extended period of time in view of the uncertainty about the future direction of market prices. Particularly puzzling, according to Mr. Lacey, is FirstEnergy's willingness to make such commitments in Ohio for periods of up to nine years.<sup>67</sup> One possible explanation is that FirstEnergy can make such guarantees because it is willing and able to commit low-cost generation to municipal aggregation rather than to bid that generation into the default service procurements.

Mr. Fein's testimony suggests another logical explanation for FES's being able to provide a percentage discount off the default service rate, *i.e.*, that opt-out municipal aggregation will drive up default service rates because of reduced participation of bidders in default service procurements or because of the additional risk premiums that will be added to default service rates to account for the risk of load loss from municipal aggregation.<sup>68</sup> Therefore, FES's municipal aggregation customers will be receiving a discount off an inflated default service rate and may actually be paying higher prices for generation than they would have if municipal aggregation had never been implemented.

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<sup>66</sup> See testimony of FirstEnergy CEO Mr. Alexander, Hearing Transcript at 280.

<sup>67</sup> Direct Statement No. 3 at 17-18.

<sup>68</sup> Constellation Statement No. 1-SR at 10-11.

If FirstEnergy is willing and able to guarantee municipalities a discount off the default service rate, it is reasonable for the Commission to infer that, without municipal aggregation, at least some of the same generation which serves municipal aggregation customers would be bid into the default service procurements at relatively low prices. Therefore, if FirstEnergy dedicates a significant portion of Allegheny Energy's low-cost generation to retail competition (including municipal aggregation) rather than to default service, the result could very well be higher default service rates.

### **C. Negative Impact on Competition**

#### **1. Legal Standard**

In addition to the statutory provisions applicable to all mergers, there are special statutory requirements applicable to reviewing a merger in the electric industry. Those special statutory requirements concern how a proposed merger will affect competition.

First, Section 2811(a) of the Public Utility Code, 66 Pa. C.S. §2811(a), imposes a general duty on the Commission regarding "anticompetitive" conduct and "the unlawful exercise of market power," as follows:

The commission shall monitor the market for the supply and distribution of electricity to retail customers and take steps as set forth in this section to prevent anticompetitive or discriminatory conduct and the unlawful exercise of market power.

Second, with respect to the specific issue of whether a merger would impede the development of the electric retail market (thereby negatively impacting the retail prices ratepayers must pay for electricity), Section 2811(e)(l) states:

In the exercise of authority the commission otherwise may have to approve the mergers or consolidations by electric utilities or electricity suppliers, or the acquisition or disposition of assets or securities of other public utilities or electricity suppliers, the commission shall consider whether the proposed merger, consolidation, acquisition or disposition is



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

The Supreme Court emphasized in *Popowsky v. Pennsylvania Public Utility Commission*, 594 Pa. 583, 611, 937 A.2d 1040, 1057 (Pa. 2007), that the Commission is required to weigh any anticompetitive effects of a merger, *i.e.*, the detriments, against the merger's advantages, *i.e.*, the affirmative benefits, in order to determine if the merger would produce *net* public benefits.

Specifically, the Supreme Court stated as follows:

We also differ with the OCA's suggestion that the PUC's analysis of the effect of the Verizon /MCI merger on competition is immaterial to its assessment of public benefit. In line with the DOJ and FCC assessments, competitive impact is a substantial component of a rational net public benefits evaluation in the merger context. That the ultimate determination may be that the impact is modest, minimal, or non-existent does not negate the necessity of undertaking the examination in the first instance or remove the factor from the weighing and balancing process. ***Significantly, in terms of the net public benefits arising out of corporate consolidation, anticompetitive effects may offset or negate advantages and result in a denial of regulatory approval.*** Indeed, it is for this very reason that large merger transactions are so highly regulated.<sup>69</sup>

Consistent with the "net" benefits test, the Commission has recognized that a merger transaction has both benefits and detriments which must be balanced as part of the process for determining whether the transaction should be approved. For example, in a recent merger proceeding, the Commission specifically stated:

The proposed transaction, like all transactions that are presented for our approval, has advantages and disadvantages. On balance, we find the advantages outweigh the disadvantages.<sup>70</sup>

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<sup>69</sup> *Popowsky v. Pennsylvania Public Utility Commission*, 594 Pa. at 610-611, 937 A.2d at 1056-1057 (Pa. 2007). (emphasis added)

<sup>70</sup> *Joint Application of The United Telephone Company of Pennsylvania LLC d/b/a Embarq Pennsylvania and Embarq Communications, Inc. for Approval of the Indirect Transfer of Control to CenturyTel, Inc.*, Docket No. A-2008-2076038 (Order entered May 2, 2010) at 22.

Therefore, regardless of the affirmative benefits provided by the non-unanimous Settlement, the Commission may not approve the merger unless those benefits are sufficient to outweigh the negative effect on retail competition.

## 2. Retail Market

The ALJs concluded that the merger will not have a negative impact on the retail market. Specifically, the ALJs stated the following:

- 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 there is no basis to conclude that the proposed Merger would result in reduced competition in default service supply auctions.<sup>71</sup>
- 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.<sup>72</sup>
- . . . while the Joint Applicants will clearly be an aggressive player in retail energy markets, the Joint Applicants are not likely to engage in anticompetitive or discriminatory conduct which will prevent retail customers from obtaining the benefits of a properly functioning retail market.<sup>73</sup>

Unfortunately, the ALJs failed to appreciate the significant advantage that FES will have over other EGSs under its opt-out municipal aggregation strategy.

FirstEnergy CEO Mr. Alexander summarized the benefits of municipal aggregation (vs. one-on-one solicitation of retail customers) as follows:

It's complex marketing when you're going to the mass market. It's a combination of TV, radio, other opportunities, direct mail. What government aggregation does is allow these customers to automatically enroll if they

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<sup>71</sup> ID at 26-27.

<sup>72</sup> ID at 27.

<sup>73</sup> ID at 39.

choose to receive a discount off their price to compare that they would otherwise pay for default service, and in the case of Meadville, be able to choose any other supplier they want without a switching fee.<sup>74</sup>

However, it is precisely this ability to avoid the normal marketing costs in the Met-Ed, Penelec, Penn Power, and West Penn service territories (where FES will have the “home team advantage”) that will negatively impact retail competition. As Direct Energy witness Dr.

Mathew Morey testified:

FE is taking full advantage of a procurement structure that has a consequence very little shopping by residential and small commercial customers. I believe that such a market structure helps FE advance its retail strategy because it would be harder (and more costly) to lure away commercial customers through direct marketing; and a municipal aggregation plan that FE has supported in statements to the legislature would be more difficult (and perhaps impossible) if most customers were already shopping.<sup>75</sup>

FirstEnergy’s business strategy is to use the low-cost generation obtained from Allegheny Energy to facilitate municipal aggregation.<sup>76</sup> Municipal aggregation is likely to be targeted to municipalities in the service territories of FirstEnergy’s own EDCs. As Mr. Alexander testified, part of FirstEnergy’s business model is to market its retail operations actively in states in which FirstEnergy has regulated distribution companies.<sup>77</sup> Consistent with that strategy, Mr. Alexander testified that the majority of FES’s retail sales are in FES-affiliated franchise service territories.<sup>78</sup>

This strategy of targeting its own EDC service territories holds true for government, *i.e.*, municipal, aggregation contracts in Ohio. As Mr. Alexander testified, the vast majority of FES’s

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<sup>74</sup> Hearing Transcript at 279.

<sup>75</sup> Direct Energy Statement 1-SSR at 4.

<sup>76</sup> If the merger is approved, FES will have access to Allegheny Energy’s generating facilities that are not likely to be available to its EGS competitors.

<sup>77</sup> Hearing Transcript at 273.

<sup>78</sup> Hearing Transcript at 274.

government aggregation contracts are in the franchise service territory of FirstEnergy. For example, according to FirstEnergy's 2010 second quarter results, the total of FES's government aggregation in all of Ohio was the same as the total government aggregation in FirstEnergy's franchise service territory.<sup>79</sup>

**BEGIN CONFIDENTIAL** [REDACTED]

[REDACTED]

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Furthermore, Dr. Morey testified, and Mr. Alexander conceded, that FirstEnergy targets areas that are close to where it owns generation.<sup>81</sup> Therefore, if this merger is approved, it is likely that FirstEnergy will target opt-out municipal aggregation in areas close to the location of Allegheny Energy's generating facilities.

Although other EGSs may have the ability to make offers to municipalities in FirstEnergy's service territories, it does not follow that these other EGSs will have the same chance of succeeding as FES does. Specifically, OSBA witness Dr. Wilson explained FES's "home team advantage" as follows:

Mr. DeCusatis: And that's because other EDCs do not have the competitive ability to go out and make the same kinds of offers and compete on the same basis as FirstEnergy?

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<sup>79</sup> Hearing Transcript at 275-276. According to Mr. Alexander, FES has recently entered into government aggregation contracts in Duke Energy's service territory, but he conceded that the vast majority of FES's government aggregation is in FirstEnergy's franchise territory.

<sup>81</sup> Direct Energy Statement No. 1-SSR at 3 and Hearing Transcript at 273-274.

Dr. Wilson: Well, some of them have the ability to make offers, but the ability to make an offer does not necessarily put you in the position of having equal presence in the market.

For example, the community north of Pittsburgh . . . that is considering or going forward, has made a deal with FirstEnergy on municipal aggregation recently, Meadville, I'm sure that if it had been Delmarva Power and Light that went to them and said, 'Here's a deal that we'd like to do with you,' the reception would have been different than FirstEnergy, who they have a long history of knowing, whose brand is something familiar to them, who have advantages in the geographic area in which they are located.

So, others can make offers, but I don't think anybody would have been in the position to successfully carry out that type of an offer other than FirstEnergy at this time, and certainly, probably next in line would be AES if they are known and received in the area.

Mr. DeCusatis: And I apologize. I may have misspoken. I'm getting my acronyms wrong. I said—I believe I said EDC when I meant to say EGS.<sup>82</sup>

In addition, Direct Energy witness Dr. Morey testified that FirstEnergy's own documents show that FES's post-merger marketing strategy will include promoting its "long-term customer relationships" and its "local brand," *i.e.*, customers' relationships with FirstEnergy's EDCs and the "FirstEnergy" brand.<sup>83</sup>

The matter of "equal presence" (as the "home team advantage" was labeled by Dr. Wilson) is of immediate concern because FES is already soliciting opt-out aggregation contracts with municipalities within the FirstEnergy service territory, *e.g.*, Meadville.<sup>84</sup>

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<sup>82</sup> Hearing Transcript at 562.

<sup>83</sup> Direct Energy Statement No. 1-SSR at 3.

<sup>84</sup> Direct Energy Cross-Examination Exhibit No. 5.

To compound the problem, OSBA witness Dr. Wilson related (in unrebutted testimony) that FirstEnergy appears to have offered Ohio municipalities financial “sweeteners” in exchange for locking up the residents and businesses in those municipalities as generation customers of FES.<sup>85</sup> Direct Energy witness Mr. Frank Lacey also testified that “[in Ohio FES] offers municipalities substantial amounts of cash.”<sup>86</sup> More specifically, RESA witness Mr. Richard Hudson stated that FES provides one-time financial grants in annual payments of \$3 to 4 million to Ohio municipalities.<sup>87</sup> Although Mr. Alexander testified that FES offered no such “sweeteners” to Meadville, he gave no indication that such incentives will be “off the table” for other municipalities.<sup>88</sup>

The OSBA’s condition prohibiting FirstEnergy from providing opt-out municipal aggregation until June 1, 2013, would not prevent FES from enjoying a competitive advantage over other EGSs through opt-out aggregation after that date. However, imposition of the condition would at least give other EGSs an opportunity to get a significant foothold in the retail market.

**Exception No. 3: The ALJs erred by failing to order that the FirstEnergy and Allegheny Energy generating assets be administratively located in separate subsidiaries and that there be no coordination regarding whether to bid in a default service procurement and regarding how much to bid. (ID at 73-74)**

The OSBA proposed a condition requiring that the generating assets of FirstEnergy and Allegheny Energy be located in separate subsidiaries.<sup>89</sup> This condition would limit the ability of

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<sup>85</sup> OSBA Statement No. 1 at 18-19.

<sup>86</sup> Direct Energy Statement No. 3 at 17-18.

<sup>87</sup> RESA Statement No. 1 at 9.

<sup>88</sup> Hearing Transcript at 285.

<sup>89</sup> OSBA Main Brief at 67.

FES to divert Allegheny Energy's low-cost generation from default service procurements to opt-out municipal aggregation.

The ALJs rejected the OSBA's condition on the grounds that municipal aggregation is not relevant to the merger proceeding and that the alleged harm caused by municipal aggregation is based on speculation.<sup>90</sup> The ALJs are incorrect.

Opt-out municipal aggregation will have a negative impact on the rates paid by default service customers.<sup>91</sup> As OCA witness Mr. Richard Hahn testified, the merger will consolidate two entities that control a large percentage of the low-cost generating plants in PJM.<sup>92</sup>

According to Mr. Hahn, FirstEnergy currently owns 12% and Allegheny Energy currently owns 8% of the region's low-cost generation.<sup>93</sup> As OSBA witness Dr. John Wilson testified, merging two of the dominant owners of generation in the region means less competition in the default service procurements.<sup>94</sup> Direct Energy witness Dr. Mathew Morey agreed.<sup>95</sup>

FES's strategy is to promise opt-out municipal aggregation customers a discount off the default service rate.<sup>96</sup> As Direct Energy witness Mr. Frank Lacey testified, it is difficult to understand how FES can afford to make such a promise for an extended period of time in view of the uncertainty about the future direction of market prices. Particularly puzzling, according to Mr. Lacey, is FirstEnergy's willingness to make such commitments in Ohio for periods of up to

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<sup>90</sup> ID at 73-74.

<sup>91</sup> See, e.g., Hearing Transcript at 561 (the cross-examination of OSBA witness Dr. Wilson); Constellation Statement No. 1 at 13-14 (the direct testimony of Constellation witness Mr. Fein); and Constellation Statement No. 1-SR at 11 (the surrebuttal testimony of Constellation witness Mr. Fein).

<sup>92</sup> OCA Statement No. 1 at 32.

<sup>93</sup> *Id.*

<sup>94</sup> OSBA Statement No. 1 at 16.

<sup>95</sup> Direct Energy Statement No. 1-SRR at 1-2.

<sup>96</sup> See testimony of FirstEnergy CEO Mr. Alexander, Hearing Transcript at 280.

nine years.<sup>97</sup> One possible explanation is that FES can make such guarantees in Pennsylvania because it is willing and able to commit Allegheny Energy's low-cost generation to municipal aggregation rather than to bid that generation into the default service procurements.

As another possible explanation, Mr. Lacey testified that "FES's willingness to commit cost savings compared to a utility default service price that will change several times during the term of the agreement may indicate that inappropriate communications may even be expected between the regulated company and FES."<sup>98</sup> In that regard, Mr. Lacey argued that the existing code of conduct in Pennsylvania is not sufficient to prevent inappropriate interactions between the regulated company and its EGS affiliate.<sup>99</sup> Therefore, structural measures, *e.g.*, OSBA's proposal to require that the generating assets of Allegheny Energy and FirstEnergy be kept separate and that there be no coordination regarding default service bidding, would address Mr. Lacey's concerns.

Joint Applicants witness Mr. William Hieronymus asserted that there is "no basis" for requiring separate generation subsidiaries.<sup>100</sup> Nevertheless, the Joint Applicants indicated that, at least initially, it was their intent to maintain the FirstEnergy and the Allegheny Energy generating assets in separate subsidiaries.<sup>101</sup> Furthermore, FirstEnergy CEO Mr. Anthony Alexander testified that FirstEnergy has made no decision as to where the generation will reside,

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<sup>97</sup> Direct Energy Statement No. 3 at 17-18.

<sup>98</sup> Direct Energy Statement No. 3 at 18.

<sup>99</sup> Direct Energy Statement No. 3 at 17-19.

<sup>100</sup> Joint Applicants Statement No. 4-R at 32.

<sup>101</sup> Joint Application at Exhibit F-1.



under what subsidiary, and how it will be moved around. According to Mr. Alexander, FirstEnergy will deal with those questions at a later date.<sup>102</sup>

Given Mr. Alexander's testimony, there is no evidence of record as to why keeping the FirstEnergy and the Allegheny Energy generating assets separate would be a major additional burden, other than the vague and unquantified protest by Joint Applicants witness James Pearson that this could separate them "from the financial metrics of the corporate family."<sup>103</sup>

Furthermore, the ALJs failed to acknowledge that they have recommended approval of this merger based on the fact that the generating assets will be kept separate. Specifically, the Joint Applicants indicated in their filing that it was their intent to maintain the FirstEnergy and the Allegheny Energy generating assets in separate subsidiaries.<sup>104</sup> In short, the ALJs have evaluated the instant merger as if FirstEnergy and the Allegheny Energy generation assets will be kept in separate subsidiaries. In the ID, the ALJs pointed to two acceptable organizational structures, both of which would keep the generating assets in separate subsidiaries.<sup>105</sup> Even if the Commission is unwilling to require the indefinite separation of the generating assets, the Commission should not permit FirstEnergy to relocate the generating assets without Commission review. Therefore, if and when FirstEnergy wishes to merge those assets under a single subsidiary, FirstEnergy should be required to seek Commission approval.

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<sup>102</sup> Hearing Transcript at 282.

<sup>103</sup> Joint Applicants Statement No. 2-R at 4.

<sup>104</sup> Joint Application at Exhibit F-1.

<sup>105</sup> ID at 33. *See* Joint Application at Exhibits F1 and F2 for two organization charts on which the ALJs relied. Under both charts, the generating assets would be located in separate subsidiaries.

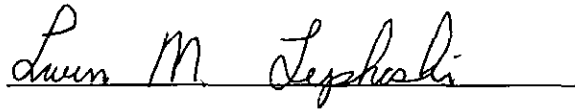
### III. CONCLUSION

For the reasons set forth above, the OSBA respectfully requests that the Commission grant the OSBA's Exceptions and impose the following conditions:

- a. First Energy Corporation and its affiliates shall not engage in municipal aggregation in the Met-Ed, Penelec, Penn Power, and West Penn service territories prior to the enactment and implementation of authorizing legislation or June 1, 2013, whichever is later; and
- b. FirstEnergy shall administratively locate the generating assets of FirstEnergy and Allegheny Energy in separate subsidiaries that shall not coordinate regarding whether to bid in a particular default service procurement and regarding what price to bid.

In the alternative, if the Commission is unwilling to grant the OSBA's Exceptions and impose these conditions, the OSBA respectfully requests that the Commission reject the merger.

Respectfully submitted,



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Dated: January 10, 2011

**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 :**           **Docket Nos. A-2010-2176520**  
**Convenience Under Section 1102(a)(3) of the :**           **A-2010-2176732**  
**Public Utility Code Approving a Change of :**  
**Control of West Penn Power Company and :**  
**Trans- Allegheny Interstate Line Company :**

**CERTIFICATE OF SERVICE**

I certify that I am serving two copies of the Exceptions in both Proprietary and Non-Proprietary versions, on behalf of the Office of Small Business Advocate, by e-mail and first-class mail (unless otherwise noted) upon the persons addressed below:

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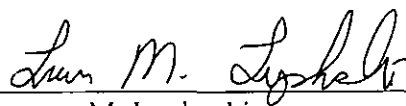
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