COMMONWEALTH OF PENNSYLVANIA

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January 20, 2011

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

RE: Joint Application of West Penn Power Company doing business as Allegheny Power Company, Trans-Allegheny Interstate Line Company and FirstEnergy Corporation 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 the Reply Exceptions on behalf of the Office of Consumer Advocate, in the above-referenced proceeding.

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

Respectfully Submitted,

Darryl Lawrence
Assistant Consumer Advocate
PA Attorney I.D. # 93682

Enclosures
cc: Honorable Wayne L. Weismandel
Honorable Mary D. Long
Office of Special Assistants

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BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Joint Application of West Penn Power Company doing business as Allegheny Power Company, Trans-Allegheny Interstate Line Company and FirstEnergy Corporation 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

REPLY EXCEPTIONS OF THE OFFICE OF CONSUMER ADVOCATE

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Dated: January 20, 2011

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I. INTRODUCTION

The Office of Consumer Advocate (OCA) files these Reply Exceptions in response to the Exceptions of Direct Energy (DE) and the Retail Energy Supply Association (RESA) to the Initial Decision (I.D.) of Administrative Law Judges Wayne L. Weismandel and Mary D. Long (ALJs) dated December 14, 2010. The DE and RESA arguments contained in their Exceptions are, in large part, similar. Two key arguments are prominent throughout the Exceptions of DE and RESA: (1) the ALJs did not seriously consider or adequately address either the DE Proposal to alter the default service environment in the post-Merger service territories or the additional conditions to be imposed on the merger as recommended by RESA, and (2) the ALJs erred by inordinately focusing on the non-unanimous settlement (Settlement) to the detriment of the non-settling parties. Neither of these allegations is borne out by the extensive record in this matter, or by a review of the thorough and well-reasoned Initial Decision. The arguments of DE and RESA are wholly without merit and must be dismissed.

As the ALJs correctly found in their Initial Decision, the DE Proposal to radically alter the default service structure in all of the post-Merger FirstEnergy electric distribution companies' (EDCs) service territories is both illegal and rife with difficulties. The ALJs concluded that the DE Proposal is inconsistent with numerous provisions of the Public Utility Code, is vague and unsupported and would be harmful to ratepayers. To name but a few of its legal shortcomings, the DE Proposal is inconsistent with the default service requirements of Act 129 and also would violate the Section 2807(d)(1) prohibition against slamming. The ALJs also recognized that, contrary to DE's assertions, the default service model in Pennsylvania is not an "anachronism", but has recently been reviewed and updated by the General Assembly.

Indeed, the structure of the default service model was significantly updated and modified just two years ago when Act 129 was signed into law on October 15, 2008. Act 129 was the culmination of many years of experience in Pennsylvania and other restructured states as to how default service procedures and practices actually work in real-world environments. The ALJs correctly recognized that the DE arguments calling for a radical redesign of the default service model in Pennsylvania were unsupported on the record, and the implementation of such a plan would be in violation of existing Pennsylvania laws and the structure of default service resulting from Act 129. Indeed, DE's Proposal would stand the structure of default service established by Act 129 on its head, since, under DE's Proposal, consumers would have to affirmatively choose to receive default service. If DE wishes to change the fundamental nature of default service in Pennsylvania, it must seek to do so through the General Assembly, not through the Commission and not in this merger proceeding.

As already discussed, RESA's Exceptions are similar to those raised by DE. As to RESA's allegations that its proposed merger conditions were never seriously considered by the ALJs, such arguments find no support in the record. The ALJs thoroughly discussed the legal and policy reasons why the RESA conditions were either unnecessary, cumulative, or harmful to ratepayers. As with DE, the allegations found in RESA's Exceptions are neither grounded in the law nor the facts of this matter. There is one clear distinction between the DE and RESA Exceptions, however. While, as the Initial Decision correctly finds, the additional merger conditions proposed by RESA are either unnecessary, duplicative, or otherwise not in the best interests of customers – the DE Proposal is flatly illegal under the existing laws of Pennsylvania. As such, this Commission has no legal authority to approve the DE Proposal either as a condition to the merger or in any other proceeding under the Public Utility Code.

The ALJs provided a thoughtful and substantial discussion of the myriad of issues surrounding this merger proceeding. Neither DE nor RESA have any foundation for their arguments against the legal and public policy reasoning found therein. Accordingly, the OCA respectfully submits that the Commission should deny all of the DE and RESA Exceptions, and approve the Joint Application as modified by the Settlement. The OCA hereby submits these Reply Exceptions in support of the Initial Decision.

II. REPLY EXCEPTIONS

Reply To Direct Energy Exception 1 And RESA Exception 1, Subpart 3: The ALJs Correctly Found That The Joint Application, As Modified By The Settlement, Is In The Public Interest And Should Be Approved. (I.D. at 39-75; OCA M.B. at 7-8, 44-51; OCA R.B. at 1-13).

In their Exceptions, DE and RESA argue that the ALJs erred by failing to adjudicate the issues on the merits, but rather focused on whether the Settlement was in the public interest. DE and RESA both suggest that the Commission lacks the legal authority to approve a non-unanimous settlement by citing dicta in the ARIPPA case for this proposition. ARIPPA v. Pa. PUC, 792 A.2d 636 (Pa.Cmwlth. 2002) (ARIPPA). These allegations, however, are incorrect, as the well-reasoned Initial Decision demonstrates. As the Initial Decision correctly found, the Commission is being asked to approve the Joint Application, as modified by the additional promises and binding commitments made by the Joint Applicants in the Settlement. The ALJs were clear that this transaction was being reviewed under the appropriate merger standards, and not simply under the "public interest" standard for review of a settlement as DE and RESA allege. I.D. at 37-38. The OCA submits that the ALJs were correct in finding

that the Joint Application, as modified by the Settlement, provides substantial affirmative public benefits and thus meets the requisite legal burdens for its approval.[1]

DE's and RESA's arguments that the ALJs relied on a lesser public interest standard to assess the Settlement rather than adjudicating the facts of this case are without merit. The Initial Decision clearly set out the applicable standards for merger approval under Sections 1102, 1103, and 2811(e) of the Code and the standards set out in the City of York and Popowsky cases. I.D. at 37-39. The ALJs also provided the correct legal standard for Commission review of the Settlement here, as follows:

> Finally, the Commission's standards for reviewing a non-unanimous settlement, as proposed here, are the same as those for deciding a fully contested case. Accordingly, substantial evidence consistent with the statutory requirements must support the proposed settlement.

I.D. at 38. After setting out the legal standards, the ALJs then go on for the next 35 pages of the Initial Decision detailing the Joint Application, how the Joint Application has been modified by the Settlement and analyzing and discussing at length the opposing positions of parties like DE.

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[1] DE and RESA both claim that the Commonwealth Court's 2002 ruling in the ARIPPA case provides persuasive precedent as to the illegality of the Commission approving non-unanimous settlements. ARIPPA. First, the ARIPPA Court did not rule on the issue of whether the Commission could approve a non-unanimous settlement, as the Court stated "[b]ecause that issue was not raised, we will not address the issue of whether the Commission can enter such an order." ARIPPA at 660. The Court went on to comment that "[n]on-unanimous settlements, while not common, are not unique and have been the source of some controversy." ARIPPA at 658. The Court then quoted part of an article written by Professor Krieger on this issue. Id.

A fair reading of the Court's Dicta, however, shows that Professor Krieger was focusing on non-unanimous settlements involving very few parties and commission staff, a situation not present here. As Professor Krieger stated:

> As long as the utility and perhaps one or two other parties reach an agreement with the commission staff, these commissions are willing to approve the agreement and to forgo the requirement of a full evidentiary hearing.

ARIPPA at 658. Professor Krieger's theoretical construct of a non-unanimous settlement with one or two parties and commission staff as quoted in the ARIPPA case is not on point with the facts of this Settlement. According to the Initial Decision, eighteen of the active parties in this case signed the Settlement, and only four parties did not. I.D. at 16. In addition, the Settlement occurred in this case only after the submission of Direct, Rebuttal and Surrebuttal testimony by all parties and after a full slate of evidentiary hearings.

Moreover, it is no overstatement to point out that the DE Proposal practically overshadowed the fact that this case was, in the first instance, about a merger proceeding. The transcript bears out this assertion as some of the lengthiest periods of examination by counsel, and specifically by Judge Weismandel, occurred during those times when the DE witnesses were on the stand. *See* Tr. at 830-853; 1040-1062. In addition, the record demonstrates that, contrary to DE's assertions, all parties and the ALJs took the DE Proposal and all evidence presented in regards to that proposal in the most serious light. To that end, the ALJs provided a lengthy discussion of the DE Proposal, which culminated as follows:

> Direct Energy contends that the Commission has the authority to use its discretion to depart from the mandates of Act 129. We find this argument unconvincing. *As we explain in great detail above*, Direct Energy has not provided any compelling reason, such as the highly unique circumstances presented in Pike County, to depart from the "prudent mix" regime of Act 129. More importantly, Direct Energy provided no convincing evidence that its proposal was in the best interests of consumers.

I.D. at 71-72 (emphasis added). DE's assertions that the ALJs failed to adjudicate the facts on the merits are inaccurate.

In similar fashion, RESA's arguments that the ALJs failed to adjudicate the facts of this matter on the merits are unsupported. The ALJs analyzed, discussed and provided sound reasons for the conclusions reached on RESA's proposed merger conditions. *See e.g.*, I.D. at 56-59. RESA's Exceptions on this issue are not borne out by the facts.

In the Initial Decision, the ALJs were called upon to decide whether the Joint Application met the legal standards for approval of a merger based on the evidence of record. At the decisional stage, the Joint Application had been modified by the additional promises and binding commitments that the Joint Applicants made in the Settlement. In their Initial Decision, the ALJs reviewed the Settlement, the parties' briefs, the statements in support and the record as

a whole and concluded to approve the Joint Application as modified by the Settlement – based on the record as a whole. This approval was based on the substantial affirmative benefits test and the requirements of Section 2811(e). DE's and RESA's arguments that the ALJs abdicated their responsibilities in this matter and failed to perform a searching inquiry under the law are without merit and must be rejected.

Reply To Direct Energy Exception 2: The ALJs Considered Direct Energy's Proposals And Rejected Them In A Fair And Non-Biased Manner. (I.D. at 60-72; OCA M.B. at 7-43; OCA R.B. at 3-19).

In its Exceptions, DE alleges that the ALJs erred by never seriously considering the DE Proposal. According to DE, the reason behind this error was that the ALJs "were undoubtedly reluctant to reject any portion of the Non-Unanimous Settlement or to add or modify any of its terms for fear of nullifying the entire agreement." DE Exc. at 13. The OCA submits that DE's implication that the ALJs' review was "tainted by a desire" to approve the Settlement is wholly without merit and must be rejected. DE Exc. at 12.

First, DE is incorrect that any change or modification to the Settlement would automatically "nullify" it. The clause in question allows the parties to the Settlement the right to withdraw if changes are made. A change or a modification, contrary to DE's assertions, does not automatically nullify the agreement. In addition, there is no indication anywhere in the record or the Initial Decision that the ALJs were concerned at all with "nullifying" the Settlement. On the contrary, it is clear that the ALJs concerns were directed at reviewing the facts and the Settlement against the applicable legal standards.

The Initial Decision is well reasoned, thorough, and shows no trace of the alleged bias or "personal desires" of the ALJs to "bless the Settlement" as DE claims. DE Exc. at 12-15. For example, the Initial Decision provides the following:

> Direct Energy and others opposed the Joint Applicants' conclusion that the merger will not have an adverse effect on retail competition. Direct Energy argues first, that the burden on the Joint Applicants is to demonstrate more than that the merger will have no adverse impact. According to Direct Energy, the Joint Applicants must demonstrate that the merger will produce a substantial benefit to competition. Direct Energy further contends that the best way to produce an affirmative benefit to competition is to divest the Joint Applicants of their role as default service providers and put in place complicated auction procedures whereby customers would be auctioned off to alternate suppliers for default service. We reject both of these claims.

I.D. at 64 (footnotes omitted). In response to one of the many DE arguments, the ALJs clearly describe this particular DE argument. The ALJs then provide a substantial discussion as to the lack of evidence to support the DE position, the countervailing weight of the evidence from those opposed to the DE position, and, ultimately, reach a conclusion. *See* I.D. at 64-66. Accordingly, the OCA submits that the Commission must view this Exception for what it is – allegations founded on nothing more than hyperbole – and to reject such accusations in the most direct manner.

Reply To Direct Energy Exceptions No. 3 And 8, And RESA Exception No. 1, Subparts 1 And 2, And RESA Exception No. 2: The ALJs Carefully Weighed The Evidence, And Then Correctly Applied The Law In Finding That The Joint Application, As Modified By The Settlement, Meets The Requirements Of Section 2811(e) Of The Code. (I.D. at 37-39, 60-67; OCA R.B. at 4-13).

The DE and RESA Exceptions here are merely a continuation of their failed legal argument that the Merger must "affirmatively promote competition in some substantial way" in order to pass legal muster. DE M.B. at 16. RESA also alleges that the ALJs failed to analyze the evidence of post-merger harm to the markets and that the ALJs' "conclusions are not based on any reasoned analysis of the evidence." RESA Exc. at 15. The OCA submits that the ALJs

performed a searching inquiry into the law, and the evidence, contrary to DE's and RESA's allegations. The Commission must deny these exceptions.

The Initial Decision addressed the issue of what is required by Section 2811(e) of the Code, in relevant part as follows:

> Direct Energy relies on the Pennsylvania Supreme Court's 2007 *Popowsky* decision for its position that the Joint Applicants must demonstrate that the merger will produce "net affirmative and substantial competitive benefits." However, neither the decision nor the language of Section 2811(e) supports this view.
>
> In discussing the net benefits test, the *Popowsky* Court provided the following:
>
> > 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. Thus, in the present case, it is clear that the Commission's satisfaction that competition will not be impaired was a legitimate and significant factor in the overall certification inquiry.
>
> The holding in *Popowsky* stands for the proposition that competitive impacts must be viewed as an integral part of the weighing of benefits against detriments. The Commission has engaged in an evaluation of positives and negatives, a weighing of benefits against detriments, or some version of a net benefits test in every merger that has come before it. The *Popowsky* court's focus on the relevance of competitive impacts is not the revelation in the law that Direct Energy suggests, nor does it provide any support for the legal interpretation that Direct Energy proposes here.

> Indeed, the relevant statutory provisions support the view that the relevant inquiry is whether the merger will have an adverse impact upon retail markets. Section 2811(e)(1), requires the Commission to consider whether the merger or consolidation "is likely to result in" anticompetitive conduct which would prevent customers from obtaining the benefit of a properly functioning retail market. Subsection (e)(2) requires the Commission to preserve the competitive nature of the markets *after* it concludes that the merger will result in anticompetitive or discriminatory conduct. Section 2811 clearly does *not* require merger applicants to *improve* competitive markets or affirmatively demonstrate benefits to competitors.

I.D. at 64-66 (emphasis in original) (footnotes omitted). It should be clear that the Commission, the Supreme Court of Pennsylvania and also the Commonwealth Court do not view the mandates of Section 2811(e) as requiring an affirmative competitive benefit from a merger. What is required is a showing of overall affirmative public benefits, and no adverse or negative impact on the competitive market, as the following discusses.

In the same ARIPPA case as discussed earlier in these Reply Exceptions, several parties specifically cited and argued the provisions of Section 2811 (e) (1), (2) to the Commonwealth Court. ARIPPA v. Pa. PUC, 792 A.2d 636 (Pa.Cmwlth. 2002) (ARIPPA). The ARIPPA Court held as follows:

> GPU Energy and FirstEnergy provided testimony that the proposed merger would not *prevent* retail customers from obtaining the benefits of a properly functioning and workable competitive retail electricity market because it would result in the loss of only one retail market participant among a field of over 50 electricity retailers licensed by the Commission. Relying on that evidence, the Commission did not find that any evidence was presented to indicate an *adverse impact* on either the wholesale or retail markets resulting from the merger. It found that there was no evidence regarding a *negative impact* on the retail markets because GPU Energy is not in the retail market now, and competition would come from other electric retailers without any *adverse effect.* Moreover, the FERC had found that the merger would not have any anti-competitive effects. *See* FERC Order Authorizing Merger, FERC Docket No. EC01-22-000, Order (Issued March 15, 2001).

> Because there is no evidence that retail competition *will suffer*, the Commission did not err in approving the merger, and the Commission's May 24, 2001 order approving the merger is affirmed.

ARIPPA at 658 (emphasis in original). The OCA submits that the requirements of Section 2811(e) as to merger approval in Pennsylvania is well-settled at this point, and the arguments of DE and RESA on this issue must be summarily dismissed. Moreover, RESA's arguments that the ALJs failed to seriously consider the evidence of harm to the post-merger markets finds no support in the record or in the Initial Decision.

In the Initial Decision, the ALJs provided the following as to the scope of merger review regarding competitive 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.

I.D. at 60 (footnotes omitted). The ALJs then proceeded to discuss the evidence on all sides of the issue, at length,[2] and concluded as follows:

> First, Direct Energy has not put forth any convincing evidence which rebuts the analysis of Dr. Hieronymus. Direct Energy argues that the removal of AE Supply as a competitor is a detriment to the market based on speculation that but for the acquisition by FirstEnergy, it would have become a more significant competitor in the market, but little else. Nor does Direct Energy (or any other party) convince us that screen failures identified by Dr. Hieronymus cause any competitive concerns. The failures that he identified occur in very narrow circumstances and we credit his testimony that those circumstances are unlikely

[2] *See* I.D. at 60-67.

> to provide any real incentive for the Joint Applicants to engage in discriminatory conduct in the market.
>
> Second, while it is clear that FES intends to be an aggressive marketer of retail electricity products, such intent does not translate into discriminatory conduct. Direct Energy, RESA and OSBA rely heavily on FirstEnergy's desire to pursue municipal aggregation as evidence of threatened unlawful market power. As we discuss more fully below, the legality and policy implications of municipal aggregation is far from settled in Pennsylvania, therefore any concerns relative to FirstEnergy's intent are both speculative and not related to whether the merger should be permitted or not. Moreover, we cannot say FirstEnergy's marketing strategies are per se anticompetitive. There is no question that these factors create challenges to rival suppliers, but these challenges do not necessarily rise to the level of discrimination or unlawful market power.

I.D. at 67. Contrary to RESA' allegations, the ALJs performed a thorough review of the record evidence in these areas. The Commission must deny these Exceptions.

Reply To Direct Energy Exception No. 4: The ALJs Correctly Found That The Joint Application, As Modified By The Settlement, Meets The Requirements Of Sections 1102(a) And 1103(a) Of The Code. (I.D. at 32-75; OCA R.B. at 4-13).

In its Exceptions, DE argues that the ALJs erred in finding that the Settlement meets the "affirmative public benefit" standard as required by Section 1102 of the Code. As a review of the Initial Decision provides, however, DE's assertions on this issue are incorrect. The ALJs, in referencing Sections 1102 and 1103 of the Code, provided the following discussion in the Initial Decision:

> The Agreement and Plan of Merger (Merger Agreement) requires the approval of the Commission as evidenced by its issuance of a certificate of public convenience. Before the Commission may issue a certificate of public convenience it must find that the granting of such certificate is necessary or proper for the service, accommodation, convenience, or safety of the public. Even where the Commission finds sufficient public benefit to find that the granting of a certificate of public convenience is necessary or proper for the service, accommodation, convenience, or safety

> of the public without imposing any conditions, the Commission nevertheless has discretion to impose conditions which it deems to be just and reasonable.

I.D. at 37 (footnotes omitted). Here, the ALJs clearly describe that it is the Joint Application that is being reviewed, and the possibility exists that conditions may need to be imposed in order for the Joint Application to satisfy the statutory standards. The ALJs then go on to explain that:

> The burden of proof in this proceeding is upon the Joint Applicants. As the parties bearing the burden of proof, the Joint Applicants must prove by a preponderance of the evidence that the Commission's issuance of a certificate of public convenience approving the Merger Agreement *as modified by the Joint Petition* is in the public interest because it will affirmatively promote the service, accommodation, convenience, or safety of the public in some substantial way. However, the Commission is not required to secure legally binding commitments or to quantify benefits where this may be impractical, burdensome, or impossible in determining if the proposed merger will affirmatively promote the service, accommodation, convenience, or safety of the public in some substantial way. Instead, the Commission "applies a preponderance of the evidence standard to make factually-based determinations (including predictive ones informed by expert judgment) concerning certification matters."

I.D. at 38 (footnotes omitted) (emphasis added). Here is the critical concept that DE fails to acknowledge – it is the Joint Application, as modified by the additional promises and binding commitments found in the Settlement that must, taken as a whole, meet the "substantial affirmative public benefits" test. It is not, as DE argues, the Settlement standing on its own that is being scrutinized here.

In the Initial Decision, the ALJs made this point clear, while also, once more, recognizing the voices of the opposition, as follows:

> It is true, as Direct Energy, RESA and others point out, that not every consequence of the proposed merger is necessarily positive or a benefit. 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 each and every interest of each and every party to be accommodated in a settlement. In *Middletown Township v. Pa. P.U.C.*, the Commonwealth Court stated that "when the 'public interest' is considered, it is contemplated that the benefits and detriments of the acquisition be measured as they impact on all affected parties, and not merely on one particular group or geographic subdivision as might have occurred in this case." Accordingly, we conclude that in its totality, the benefits of the proposed merger, as modified by the settlement agreement, outweigh the negative impacts and we will approve the requested certificate of public convenience.

I.D. at 75 (footnotes omitted). And, as the OCA provided in its Main Brief:

> The signatory parties to that Settlement addressed and proposed a number of key benefits within the Settlement document, including the preservation of Pennsylvania jobs, the affirmative sharing of merger savings with ratepayers, additional funding for renewable energy programs, increased commitments to customer service and reliability, provisions to enhance the competitive markets for electricity and increased funding for low-income programs. The Settlement also provides key financial protections to insulate the regulated operations from the unregulated operations of FirstEnergy.

OCA M.B. at 1; *See also* OCA Statement in Support. The OCA submits that the Joint Application, as modified by the Settlement provides the requisite level of substantial affirmative public benefits required for approval, as the Initial Decision correctly found.

As the Initial Decision provides, the ALJs viewed all of the evidence and weighed the benefits and possible detriments of the merger in reaching their decision. Accordingly, the OCA submits that the DE Exceptions on this issue must be denied.

Reply To Direct Energy Exception No. 5: The ALJs Correctly Held That Direct Energy's Proposed Default Service Modifications Should Not Be Adopted. (I.D. at 60-75; OCA M.B. at 7-43, 50; OCA R.B. at 4-13).

In its Exceptions, DE argues that the ALJs were in error by finding that DE's Proposal to radically change the default service model had no nexus to the Merger. On the contrary, the ALJs correctly recognized that DE's main thrust in this case was not about remedying any perceived negative competitive consequences from the merger, but rather was an attack on the current default service structure in Pennsylvania as a whole. It is clear from the record evidence throughout this proceeding that DE's criticisms and complaints are not directly related to this merger; rather, they are directed at the *current* default service structure in Pennsylvania as a whole.

The DE Proposal rests on the initial premise that the current retail electric markets in Pennsylvania are not competitive. DE's witness, Dr. Morey, makes it perfectly clear that, in his opinion, the entire default service model in Pennsylvania is an "anachronism" and is discriminatory and anticompetitive. DE St. 1 at 11, 12. This, despite the fact that most of the current default service programs in Pennsylvania have been implemented under Act 129 that was just signed into law by Governor Rendell in October, 2008.

In the Initial Decision, the ALJs appropriately recognized DE's underlying purpose in this case, and provided the following analysis:

> Next, Direct Energy's argument that the default service regime in Pennsylvania is fundamentally flawed has no real nexus to the merger of the Joint Applicants. Direct Energy's allegations exist completely independent of the merger, and would remain unchanged even if this merger was abandoned tomorrow.
>
> ...
>
> These assertions relate to the *current* state of the market in Pennsylvania. Thus, Direct Energy's real issue in this matter is the basic structure of the default service market in Pennsylvania. This

> is an issue that is more appropriately addressed by the General Assembly, not by the Commission in a merger proceeding. Indeed, Direct Energy is not arguing that the Commission should not grant the certificate of public convenience to the Joint Applicants. Nor does Direct Energy make any substantial argument that the post-merger FirstEnergy EDCs are unfit to provide default service due to any infirmity in their "financial fitness to serve retail customers, and [their] ability to provide default service under reasonable rates and conditions." Rather, Direct Energy wants to use the merger proceedings as a vehicle to put in place an unprecedented departure from default service which would apply only to the FirstEnergy distribution companies, but offers no analysis of the implication of treating these EDCs differently from the other EDCs within the Commonwealth which presumably operate in the same fatally flawed competitive market. Clearly, these proceedings are not the appropriate venue for Direct Energy's proposal for a radical departure from the current default service regime.

I.D. at 68-69 (footnote omitted).

The ALJs hit the nail squarely on the head. Contrary to DE's assertions, the Initial Decision does not portray a rejection of evidence put on by DE, but rather contains a critical inspection of the evidence that ultimately leads to the rejection of its underlying purpose. The Commission should accept the conclusions of the ALJs on this issue, and deny the DE Exceptions.

Reply To Direct Energy Exception No. 6: The ALJs Correctly Found That The Direct Energy Proposal Is Not In Accord With Act 129 And Various Provisions Of The Public Utility Code. (I.D. at 69-72; OCA M.B. at 7-29; OCA R.B. at 4-13).

In its Exceptions, DE argues that the ALJs erred by finding that the DE Proposal was inconsistent with Act 129. DE also alleges that the ALJs failed to review or discuss the DE Proposal in coming to the conclusion that it was not in accord with Act 129. DE is wrong on both counts.

The DE Proposal does not contain the necessary attributes that Act 129, the Commission's Regulations or the Policy Statement require for default service procurement plans – a Commission-approved procurement plan that contains a prudent mix of spot, short-term and long-term contracts designed to provide service at the least cost over time. Nor does the DE Proposal allow default service to be for customers who decide not to choose an alternative supplier as Section 2807(e)(3.1) provides. 66 Pa.C.S. § 2807(e)(3.1). Rather, under the DE Proposal, a customer must affirmatively choose default service, standing the whole structure of Act 129 on its head.

As FirstEnergy witness Schnitzer explained:

> Direct Energy's proposal is a radical departure from the default service model that the Commission has adopted for major Pennsylvania utilities over the past decade and more recently to meet the requirements of Act 129. Direct Energy is proposing to turn default service on its head.
>
> If default service is defined to mean the service received by customers who choose not to choose, then under Direct Energy's proposal, the actual default service for such customers is to be involuntarily assigned to an EGS. The rate charged to the customer would be established by a consultant hired by the Commission "to determine just and reasonable retail market prices" for two consecutive six month periods tied to a market index. But after that time, the supplier of the "choose not to choose" customer could set prices without Commission oversight.
> For Mass Market customers, what Direct Energy calls default service would actually be a new "opt-in" service option offered by a third party that customers must affirmatively choose. But this new "opt-in" service would be a totally unhedged spot price product - not the type of product that is generally preferred by Mass Market customers.
>
> Thus, the actual effect of Direct Energy's proposal is 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.

Joint Applicants St. 9-R at 7-8; See also OCA M.B. at 11-20. The requirements of Act 129 are clear, default service customers have specific protections: (1) the right not to choose an EGS and thus remain with the DSP; (2) the right to have the DSP supply power in the event of an EGS default; (3) the right to be served by the DSP via a prudent mix of resources, and (4) the right to be served by the DSP at the least cost over time.[3]

The DE Proposal directly violates the laws of Pennsylvania as to those current default service customers who do not opt out of the auction and are therefore transferred to an EGS charging unregulated prices. Section 2807 of the Public Utility Code provides, in relevant part:

> The 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 customers of record *or written evidence* of the customers consent to a change of supplier.

66 Pa. C.S. § 2807(d)(1) (emphasis added). The Commission promulgated regulations in order to establish protocols and procedures consistent with the mandate of Section 2807(d)(1). *See* 52 Pa. Code §§ 57.171 – 57.179. The Commission's regulations on this issue do not provide for a

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[3] As Act 129 specifically provides, a customer who does not choose an alternative supplier will receive default service. 66 Pa.C.S. § 2807(e)(3.1). *See also*, Webster's definition of "default", "An option that is selected automatically unless an alternative is specified." Available at: http://www.websters-online-dictionary.org/definitions/default?cx=partner-pub-0939450753529744%3Av0qd01-tdlq&cof=FORID%3A9&ie=UTF-8&q=default&sa=Search#922

customer's electricity supplier to be changed based on the fact that the customer did not opt out. Changing a customer's electric supplier to an EGS charging unregulated prices without the customer's consent is slamming and is illegal. The DE Proposal as to its "opt-out" feature is inconsistent with the statute and the regulations.

The Initial Decision included language from the Preamble of Act 129, to dispel any doubt as to what the General Assembly intended as a "prudent mix of resources", as follows:

> In addition, as the Preamble sets forth, "price stability" is listed as a beneficial attribute of electric service under the Act. These provisions provide important protections for consumers, including
>
> - The obligation of EDCs to acquire DS supplies at "prevailing market prices" is eliminated.
> - Power supply must be acquired through competitive processes.
> - Power supply shall include a prudent mix of spot market, short-term, and long-term (i.e., up to 20 years) bilateral contracts designed to ensure reliable service at least cost over time.
> - Long-term contracts may constitute up to 25% of the DS obligation.

I.D. at 71.

Interestingly, and as the Initial Decision accurately details, DE argued that the Commission had the authority to depart from these statutory requirements.[4] The ALJs directly addressed this point, as follows:

> Direct Energy contends that the Commission has the authority to use its discretion to depart from the mandates of Act 129. We find this argument unconvincing. As we explain in great detail above, Direct Energy has not provided any compelling reason, such as the highly unique circumstances presented in Pike County, to depart from the "prudent mix" regime of Act 129. More importantly,

[4] This argument below was part of DE's ongoing efforts to liken the current default service markets in Western Pennsylvania to the unique situation in Pike County. *See* OCA M.B. at 24-25.

> Direct Energy provided no convincing evidence that its proposal was in the best interests of consumers.

I.D. at 71-72.

The ALJs provided a thorough discussion as to the mandates of Act 129, and why the DE Proposal was not in accord with those statutory requirements. In relevant part, the Initial Decision provided:

> Finally, Direct Energy's proposal, which appears to rely solely on power purchased at spot market prices appears to run afoul of Act 129, which requires that default service include a "prudent mix" of not only spot market pricing but also short-term and long-term prices. The amendments to Section 2807 brought about by Act 129 do not include language of discretion, but rather contain language of mandate. Of relevance here, default service power is to be procured through "a prudent mix of" spot, short and long-term contracts in order to ensure "the least cost to customers over time."
>
> ...
>
> The default service model in Pennsylvania is hardly an "anachronism," but was enacted by the General Assembly in late 2008 and has been implemented by the Commission in a series of cases decided in 2009 and 2010. The General Assembly and the Commission have put specific requirements in place to afford protections to customers in Pennsylvania who do not shop for an alternative generation supplier or whose alternative generation supplier fails to deliver energy. The default service model proposed by Direct Energy, through the use of a newly-created default service provider, and the auctioning off of customers to EGSs does not even attempt to comply with the mandates set out by Act 129.

I.D. at 69-71.

DE's complaints about the Initial Decision find no support in the facts of this matter. The ALJs correctly recognized that moving all default service (DS) customers to a third-party DS supplier, then auctioning off those customers to EGSs, and finally providing those potentially few default service customers who remained (only the ones who affirmatively opted-

out of the auction) with only spot-market products did not meet the statutory requirements of Act 129. The OCA submits that the Commission must deny DE's Exceptions on this issue.

Reply To Direct Energy Exception No. 7: The ALJs Gave The Direct Energy Proposal, Including all Of Its Parts, Due Consideration. (I.D. at 60-72; OCA M.B. at 7-43; OCA R.B. at 3-19).

In its Exception No. 7, DE alleges that the ALJs failed to consider the possibility of applying the DE Proposal in ways that not even DE had advocated for during the proceeding. This part of the DE Exceptions reads more like a continuation of the testimonial stage of this proceeding, as it raises new issues that make no appearance anywhere else in the record.

For example, DE suggests that perhaps the auction phase of its Proposal could still be implemented, even if the utility was not removed from the default service function. DE Exc. at 34. DE also suggests that perhaps the Commission could phase in different aspects of the DE Proposal, or could potentially create a "pilot" auction for only some subset of the default service customers. DE Exc. at 34-35. The OCA objects to this portion of the DE Exceptions. These new variations and spins on the DE Proposal, as it was thoroughly analyzed, examined and discussed in the case before the ALJs, is wholly improper at this stage of the process.

DE also argues that the ALJs erred by "ignoring" additional conditions that DE had suggested should be imposed on the Merger if approval was otherwise granted. DE Exc. at 35. DE's allegations in this regard are without merit, and directly relate back to its continued misunderstanding of the statutory requirements of Section 2811(e) of the Code. As the Initial Decision succinctly provided:

> Section 2811(e)(1), requires the Commission to consider whether the merger or consolidation "is likely to result in" anticompetitive conduct which would prevent customers from obtaining the benefit of a properly functioning retail market. Subsection (e)(2) requires the Commission to preserve the competitive nature of the markets *after* it concludes that the merger will result in anticompetitive or

> discriminatory conduct. Section 2811 clearly does *not* require merger applicants to *improve* competitive markets or affirmatively demonstrate benefits to competitors.

I.D. at 64-65 (footnotes omitted) (emphasis in original).

This part of the Code requires the Commission to, first, determine whether the merger is likely to create the type of conduct that would harm customers. If the Commission so finds, then it must take actions, such as impose conditions, to preserve the market. This is precisely the type of analysis that the ALJs performed. See I.D. at 60-67. There is no need for the ALJs or the Commission to further consider imposing the additional DE conditions when the evidence fails to support the idea that such conditions are necessary as part of the overall substantial public benefits test.

The OCA submits that the part of DE's Exceptions that contain new matter should not be a part of the Commission's deliberations in this matter. In addition, as just discussed DE's arguments as to the ALJs ignoring their additional conditions have no merit and should be denied.

Reply To RESA Exception No. 3: The ALJs Appropriately Analyzed and Correctly Found That RESA's Proposed Merger Conditions Should Not Be Adopted. (I.D. at 55-59; OCA R.B. at 20-26).

In its last Exception, RESA alleges that the Merger presents competitive market concerns, and that the ALJs "flippantly" dismissed the conditions that RESA sought to have imposed in order to allegedly cure these market deficiencies. RESA Exc. at 17. RESA further contends that the "ALJs presented no legally sufficient or sustainable reason for rejecting RESA's recommendations." RESA Exc. at 18. The OCA submits that RESA is incorrect as to the depth of the ALJs analysis and the legally sufficient reasons behind the Initial Decision.

At several places in the Initial Decision, the ALJs provide that the record evidence does not support the idea that the Merger will lead to the type of competitive issues that Section 2811(e) speaks to. *See* I.D. at 67, 74. In addition, and contrary to RESA's allegations, the ALJs addressed RESA's proposed merger conditions at some length in the Initial Decision.

As to the RESA proposal to implement a comprehensive customer education program, the ALJs reasoned that:

> It is unclear from the RESA proposal where the funding for its suggested education programs should come from, or even how much additional spending would be needed to implement its program, but it would seem unreasonable to ask ratepayers to pay for additional educational spending at this time.

I.D. at 57 (footnote omitted). The ALJs found this proposal to be unsupported, vague and unnecessary. As to RESA's suggestions for a revised purchase of receivables program (POR), the ALJ's found that:

> However, we fail to see that the POR proposed in the Joint Petition is inadequate. The creation of a POR program for West Penn is a reasonable part of the resolution of this matter and could provide certain enhancements to the competitive atmosphere in the West Penn service territory. The Joint Petition provides for a comprehensive POR program that is consistent with the programs in place for Met-Ed and Penelec.

I.D. at 57-58 (footnote omitted). As to RESA's proposal to alter the future default service plans of all of the post-merger FirstEnergy EDCs, the ALJs accepted the testimony of OCA witness Richard Hahn to refute the RESA proposals, in part as follows:

> RESA's suggestion to shorten the length of default service contracts and increase the reliance on spot market purchases is not consistent with the requirement that default service be provided using a prudent, least cost mix of spot purchases, short term contracts and long term contracts. The RESA proposal would eliminate long term contracts from the mix. Additionally, RESA has provided no evidence that such a purchasing strategy will provide the least cost service to customers over time.

I.D. at 58 (footnote omitted). The ALJs further agreed with OCA witness Hahn that load caps, as suggested by RESA, could be harmful to ratepayers and should not be adopted here for use in future default service proceedings as a condition of this merger, as follows:

> The determination of whether there should be load caps, and if so, the appropriate cap, can be very fact and condition specific. Circumstances exist where a load cap, either improperly set or existing at all, can drive up the price of power. Under the load cap, the EDC may not be allowed to meet all of its requirements with the lowest bid if the load cap is reached. By requiring the EDC to also buy power at the next (higher) price, and perhaps even the next (higher) price after that, the overall blended rate charged to customers can increase. Questions regarding the need for, or reasonableness of a load cap should not be made outside of the specific context of the expected procurements. Again, I would note that the RESA proposal has not been shown to be a benefit to customers and may actually introduce harm to customers.

I.D. at 59 (footnote omitted). Similar to RESA's other conditions, the ALJs did not find the need for changes to the operating rules of the FirstEnergy EDCs, as RESA had advocated for. I.D. at 59. The ALJs found that:

> many of the proposals it [RESA] lists are adequately addressed by the Joint Petition. As RESA acknowledges, the Joint Petition provides the opportunity for EGSs to sit down with FirstEnergy's operational personnel to discuss many of the issues that RESA proposes to have incorporated as conditions.

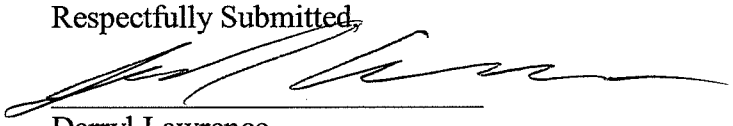
I.D. at 59 (footnote omitted).

RESA's allegations that its additional conditions were not taken seriously by the ALJs does not comport with the record. The OCA submits that for the reasons just discussed, RESA's Exceptions on this issue should be denied.

III. CONCLUSION

WHEREFORE, the Office of Consumer Advocate respectfully requests the Public Utility Commission to deny the Exceptions of Direct Energy and RESA, and to approve the Joint Application, as modified by the Settlement, consistent with the Initial Decision in this matter.

Respectfully Submitted,



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CERTIFICATE OF SERVICE

Joint Application of West Penn Power Company doing business as Allegheny Power Company, Trans-Allegheny Interstate Line Company and FirstEnergy Corporation 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

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

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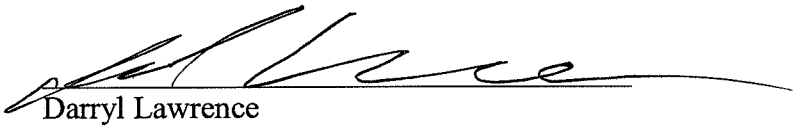

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