COMMONWEALTH OF PENNSYLVANIA

OFFICE OF SMALL BUSINESS ADVOCATE
Suite 1102, Commerce Building
300 North Second Street
Harrisburg, Pennsylvania 17101

William R. Lloyd, Jr.
Small Business Advocate

(717) 783-2525
(717) 783-2831 (FAX)

January 20, 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 Reply Exceptions, on behalf of the Office of Small Business Advocate, in the above-captioned proceedings.

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,

Lauren M. Lepkoski

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

Enclosures

cc: Parties of Record

Robert D. Knecht

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

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

REPLY EXCEPTIONS
ON BEHALF OF THE
OFFICE OF SMALL BUSINESS ADVOCATE

Lauren M. Lepkoski
Assistant Small Business Advocate
Attorney ID # 94800

Daniel G. Asmus
Assistant Small Business Advocate
Attorney ID # 83789

For: William R. Lloyd, Jr.
Small Business Advocate
Attorney ID # 16452

Office of Small Business Advocate
300 North Second Street - Suite 1102
Harrisburg, PA 17101
(717) 783-2525

Dated: January 20, 2011

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases

Statutes

Rules and Regulations

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.[1] 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.[2]

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.[3] TrAILCo is an indirect public utility subsidiary of Allegheny Energy and is certificated by the Commission.[4]

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,

---

[1] Joint Application at 1, ¶ 1.

[2] 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.

[3] Joint Application at 2, ¶ 6.

[4] Joint Application at 2-3, ¶¶ 6 and 8.

Ohio.[5] 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).[6]

Merger Sub is a Maryland Corporation and wholly-owned subsidiary of FirstEnergy formed for the sole purpose of effecting the merger.[7]

If the Joint Application is approved, Allegheny Energy will merge with Merger Sub. As the surviving corporation, Allegheny Energy will become a wholly-owned subsidiary of FirstEnergy.[8] Each Allegheny Energy shareholder will receive 0.667 shares of FirstEnergy common stock for each share of Allegheny Energy common stock held.[9] 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.[10] FirstEnergy will remain the corporate parent of Met-Ed, Penelec, and Penn Power (and its out-of-state subsidiaries) and will become the corporate parent of Allegheny Energy and its subsidiaries, including West Penn and TrAILCo.[11]

---

[5] Joint Application at 2, ¶ 7.

[6] Joint Application at 2-3, ¶ 7.

[7] Joint Application at 4, ¶ 9.

[8] Joint Application at 4, ¶ 10.

[9] *Id.*

[10] *Id.*

[11] Joint Application at 4, ¶ 11.

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, 1010.

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 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.

On January 10, 2010, the OSBA, RESA, Direct Energy, and Citizen Power filed Exceptions to the ALJs' ID.

The OSBA submits these Reply Exceptions in response to certain Exceptions filed by RESA and Direct Energy.

II. REPLY EXCEPTIONS

A. REPLY TO DIRECT ENERGY'S EXCEPTION NO. 5: Direct Energy's Plan would not remedy the harm Direct Energy predicts will result from FirstEnergy's retail marketing strategy. (I.D. at 68, Direct Energy Exception No. 5)

1. Summary of Direct Energy's Plan

In testimony and briefing, Direct Energy proposed numerous conditions on the merger, including a plan ("Direct Energy's Plan") to revise the default service structure in the Met-Ed, Penelec, Penn Power, and West Penn service territories. Specifically, Direct Energy proposed the following changes in default service as merger conditions:

- The Commission would establish a process to select an alternative default service provider, not affiliated with FirstEnergy, that would provide default service to those customers choosing not to participate in a retail customer auction. That default service would be priced on a quarterly adjusted, spot market basis.
- A retail auction would be conducted in which residential and small commercial customers (with peak loads of less than 300 kW) would be assigned to electric generation suppliers ("EGSs") in return for an acquisition payment from the EGSs to participating customers.
- FirstEnergy would be required to create a separate, affiliated billing subsidiary to perform all billing and customer care functions with the duty to provide EGS-specific billing to those customers participating in the retail auction.[12]

[12] Direct Energy Exceptions at 28-29.

The ALJs rejected Direct Energy's Plan. However, through its Exceptions, Direct Energy asked the Commission to impose these conditions notwithstanding the ALJs' decision. According to Direct Energy, these conditions are a necessary response to anticompetitive problems likely to be caused by superimposing the merger over Pennsylvania's current default service design.[13]

2. Premature

The ALJs concluded that Direct Energy's Plan has no real nexus to the merger, in that Direct Energy's objection is actually to the design of default service in Pennsylvania.[14] Specifically, the ALJs stated:

> . . . 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.' [footnote omitted] 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

[13] Direct Energy Exceptions at 28.

[14] ID at 68.

> 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.[15]

Direct Energy excepted to the ALJs' conclusion.[16] However, even if the Commission determines that there is a sufficient nexus between Direct Energy's Plan and the merger, the Commission should reject Direct Energy's proposals to conduct an opt-out auction of customers to EGSs and to base default service rates entirely on spot market prices. For at least the following reasons, Direct Energy's Plan would not remedy the harm in both the wholesale and retail market which Direct Energy predicts will result from FirstEnergy's retail marketing strategy.

First, Direct Energy's Plan would not cure the predicted market power problems in the wholesale market. As Direct Energy witness Dr. Mathew Morey testified, ". . . if we have market power problems in the wholesale market, that regardless of whether this default service auction proposal was approved or used as a condition on this merger, whether you had that or not, it's still conceivable that market power problems in the wholesale market could raise prices for wholesale power, and EGS's would be paying higher prices."[17]

Second, Direct Energy's Plan also would not cure the predicted market power problems in the retail market. As Direct Energy witness Mr. Frank Lacey testified, "Direct's proposal will have no impact on the market between January 1, 2011 through May 31, 2013."[18] By May 31, 2013, the dominance of FirstEnergy's affiliated EGS, FirstEnergy Solutions ("FES"), in the retail

[15] *Id.*

[16] Direct Energy Exceptions at 29.

[17] Hearing Transcript at 823.

[18] Hearing Transcript at 1037.

market in the Met-Ed, Penelec, Penn Power, and West Penn service territories would already be established. Direct Energy's Plan would not reverse that dominance.

Penn Power's rate caps expired on December 31, 2006. West Penn, Met-Ed, and Penelec's rate caps expired on December 31, 2010. As Mr. Lacey confirmed, Direct Energy's proposal to base default service rates (for non-shopping customers with peak loads of less than 300 kW) entirely on spot market prices would not apply to default service rates until June 1, 2013.[19] Moreover, Direct Energy's proposal to auction non-shopping customers (with peak loads of less than 300kW) to EGSs would not apply to electric service until June 1, 2013.[20] For 29 months (from January 1, 2011, through May 31, 2013), Direct Energy's Plan would allow FES to solicit customers through direct sales and (possibly) through municipal aggregation.[21] Therefore, if Direct Energy's predictions prove to be accurate, FES will already be the dominant EGS by May 31, 2013.

Furthermore, any of the retail customers that FES has obtained (through direct sales and municipal aggregation) by June 1, 2013, would be retained by FES and would not be auctioned off to other EGSs.[22] Therefore, Direct Energy's Plan would not deprive FES of whatever market position it holds on May 31, 2013.

Therefore, as OSBA witness Mr. Robert Knecht testified, there is no need for the Commission to make a decision regarding Direct Energy's proposed redesign of default service until the proceedings to establish default service plans for the period beginning June 1, 2013.[23]

---

[19] Hearing Transcript at 1030.

[20] *Id.*

[21] *Id.*

[22] *Id.*

[23] OSBA Statement No. 3 at 6-7.

B. REPLY TO DIRECT ENERGY'S EXCEPTION NOS. 5 and 6: Direct Energy's Plan would violate the Public Utility Code and would be inconsistent with the Commission's default service regulations. (I.D. at 60-72, *Direct Energy Exception Nos. 5 and 6)*

1. Summary of Direct Energy's Exceptions

The ALJs concluded that Direct Energy's Plan is inconsistent with the Public Utility Code.[24] In that regard, the ALJs correctly concluded that Direct Energy's opt-out auction proposal would violate the rules regarding the service a ratepayer gets if the ratepayer does not affirmatively choose service from an EGS.[25] They also correctly concluded that Direct Energy's opt-out auction proposal would violate the rule against "slamming."[26]

Direct Energy excepted to these conclusions.[27] The Commission should deny Exception Nos. 5 and 6 because the opt-out nature of Direct Energy's auction proposal would be unlawful.

Furthermore, in its defense of Exception No. 5, Direct Energy argued that the Commission has the authority to order remedies in a merger case that it may lack the authority to order in a non-merger case.[28] However, it is unnecessary for the Commission to reach that question. Even assuming *arguendo* that Direct Energy is correct that the Commission has broader authority in merger cases than in non-merger cases, the Commission lacks the authority to impose a condition, *i.e.*, the opt-out auction advocated by Direct Energy, when that condition would conflict with specific language of the Public Utility Code. The General Assembly has

---

[24] ID at 60-72.

[25] ID at 78, Conclusion of Law No. 16.

[26] ID at 78, Conclusion of Law No. 18.

[27] Direct Energy Exceptions at 28-33

[28] Direct Energy Exceptions at 30.

provided in the Statutory Construction Act that if two statutes conflict, the one which is more specific governs the one which is more general.[29]

Direct Energy's opt-out auction proposal conflicts with Sections 2803, 2807(e)(3.1), and 2807(d)(1) of the Public Utility Code, 66 Pa. C.S.§§2803, 2807(e)(3.1), and 2807(d)(1). Therefore, the Commission lacks the legal authority to approve that proposal.

2. Sections 2803 and 2807(e)(3.1)

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 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)

[29] 1 Pa. C.S. §1933.

As Sections 2803 and 2807(e)(3.1) recognize, customers who take no action are to receive default service, not service from an EGS. In contrast, Direct Energy proposes that customers who do not affirmatively choose an alternative supplier be auctioned off to an EGS. Under Direct Energy's proposal, the only customers who would be eligible for default service would be those customers who affirmatively choose default service. Therefore, the Commission must reject the opt-out auction element of Direct Energy's proposal because it is inconsistent with the plain language of the statute.

3. Section 2807(d)(1)

The ALJs concluded that Direct Energy's opt-out proposal would violate the anti-slamming rule under Section 2807(d)(1).[30] In addition to addressing this conclusion through Exception No. 6, Direct Energy also explicitly excepted to the ALJs' conclusion regarding slamming as part of its discussion of Direct Energy Exception No. 3.[31]

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 Direct Energy's opt-out auction, the alternative default service provider would be changing a customer from default service to EGS service, without direct oral confirmation from that customer or written evidence of the customer's consent to the change.

[30] ID at 78, Conclusion of Law No. 18.

[31] Direct Energy Exceptions at 21, fn. 55.

4. Previous Decisions Regarding Opt-Out Aggregation

a. Pike

Direct Energy argued that the Commission's decision to approve an opt-out aggregation program for Pike County Light and Power Company ("Pike") in 2006 is precedent for the proposition that opt-out aggregation is not unlawful.[32] However, Direct Energy's argument ignores the unique factual situation in the 2006 Pike proceeding. Pike had had the misfortune of conducting an auction for two years' worth of default service electricity in the fall of 2005 shortly after Hurricane Katrina had caused a spike in prices in the wholesale electricity market. That spike in market prices was passed on directly to Pike's customers in default service rates. Consequently, Pike's rates increased by more than 70% on a total-bill basis and by 129% on a generation-only basis.[33] In response to public outcry, the Commission approved an aggregation program. However, the Commission took care to note that "[w]e again emphasize that this action [adopting an opt-out aggregation program] should not be construed as precedent in future proceedings, but as a solution to a unique problem."[34]

At most, the Commission decided that opt-out aggregation is lawful as a temporary remedy to a flawed default service procurement. The Commission did not decide that opt-out aggregation is lawful as part of a permanent redesign of default service.

b. PECO Market Share Threshold

Direct Energy also pointed to the Commission's approval of a settlement providing for a market share threshold ("MST") program in PECO's service territory as legal justification for

---

[32] Direct Energy Exception No. 3, fn. 55.

[33] *Petition of Direct Energy Services, LLC for Emergency Order Approving a Retail Aggregation Bidding Program for Customers in Pike County Light & Power Company's Service Territory*, Docket No. P-00062205 (Order entered April 20, 2006) at 2.

[34] *Id.* at 17.

opt-out.[35] Under PECO's MST program, the parties to a settlement agreed that PECO would begin randomly assigning customers to EGSs only if shopping did not reach a designated level by January 1, 2003. Specifically, the MST was to be implemented only if shopping did not exceed 50% for residential and commercial customers (based on the number of customers for residential and small commercial customers, and based on peak load for large commercial customers). Failure to reach the specified shopping levels by January 1, 2003, was to trigger PECO's duty to make random assignments of customers to EGSs on an opt-out basis.[36]

The Commission did not expressly reach the lawfulness of opt-out in reviewing the settlement. Specifically, the Commission stated, as follows:

> It should be noted that no interested party objected to the use of the opt-out process, and opt-out procedures have been utilized in other electric industry restructuring proceedings as a means of furthering customer choice. *See, Re Procedures Applicable to Electric Distribution Companies and Electric Generation Suppliers During the Transition to Full Retail Choice*, M-00991230, 92 Pa. P.U.C. 400 (Order entered May 18, 1999); *Re PECO Energy Company Competitive Default Service Program Bidding*, A-110550F0147 (Order entered November 29, 2000). Therefore, we are not questioning the use of an opt-out procedure here. Our purpose in discussing it is merely to recognize the effect that the opt-out procedure has on our evaluation of other aspects of the proposal.[37]

PECO's MST program was approved by the Commission before the expiration of PECO's rate caps. Therefore, even if the Commission is deemed to have implicitly reached the question, the Commission decided only that opt-out aggregation was lawful as a tool to jump

---

[35] Direct Energy Exception No. 3, fn. 55, referring generally to cases cited in the Direct Energy Reply Brief at 31-35.

[36] *Petition for Approval of PECO Energy Company's Market Share Threshold Bidding/Assignment Process*, Docket No. P-00021984, and *Petition for Approval of "The Better Choice" Plan to Meet PECO Energy Company's Market Share Threshold Requirements*, Docket No. P-00021992 (Order entered February 6, 2003).

[37] *Id.* at 17-18.

start shopping during the transition period. The Commission neither explicitly nor implicitly decided that opt-out aggregation is lawful as a tool to increase shopping after the expiration of rate caps.

5. Spot as Default Service

As part of their rationale for rejecting Direct Energy's Plan, the ALJs concluded that basing default service rates on spot market prices would expose default service customers to excessive rate instability in violation of Act 129.[38]

In response to the ALJs' conclusion, Direct Energy pointed out that the Commission previously approved a plan to base Pike's default service rates entirely on spot market prices.[39] Furthermore, according to Direct Energy, the percentage of Pike's load served by the spot market has grown from virtually nothing to 40%.[40] In recognition of that growth, Direct Energy asked, "If hourly priced spot market prices were really so unpleasant, how does one explain the Pike County results?"[41]

Although Direct Energy's question presumably was a rhetorical one, one possible answer is that Direct Energy's rates in Pike are so high (relative to market prices) that a significant number of customers are willing to tolerate rate instability in order to obtain rate relief and that they have been unable to obtain that rate relief by switching to another EGS. Unfortunately, Direct Energy's Plan has the potential for a similar result, in that it would include no regulatory procedure to limit what EGSs could charge after the first year to customers assigned through the auction.[42] Therefore, rather than providing a reason to approve Direct Energy's Plan, the growth

---

[38] ID at 69-72.

[39] Direct Energy Exceptions at 31-32.

[40] *Id.* at 33.

[41] *Id.*

[42] Hearing Transcript at 1039.

in the number of Pike customers affirmatively choosing spot-based default service may actually highlight another reason for rejecting Direct Energy's Plan.

6. Ratepayer "Incentive"

In its Exceptions, Direct Energy claimed that its plan would offer a monetary benefit to customers if they did not opt out of the auction.[43] Direct Energy provided a more detailed explanation of the proposal in its Main Brief, as follows:

> In the auction, relevant data for customers in a tranche would be provided to potential bidders. Utilizing this data and with knowledge of the pre-determined price to serve, each EGS would be asked to bid a certain dollar amount to win the right to serve a tranche of customers. The proceeds of the auction would be placed into a pool, and would be returned (less an amount, which Direct Energy estimates to be not more than 5% for education and administrative costs) to the residential and small commercial customers who participated in the account auction, by way of a check to each customer. The record shows that the acquisition offers would likely be somewhere between $150 and $500 per account. This means that, in total, the auctions could generate between $300 million and $1 billion in revenue. The net revenue would be distributed equally to the auction participants. [44]

Unfortunately, Direct Energy failed to acknowledge that EGSs would almost certainly attempt to recover the "acquisition offers" over time. As explained by Direct Energy in its Main Brief, an acquisition offer is the amount an EGS would bid to win customers through the auction. Those acquisition offers would be paid by the EGSs and distributed to the customers participating in the auction. However, nothing in Direct Energy's proposal would prohibit an

[43] Direct Energy Exceptions at 4.

[44] Direct Energy Main Brief at 47.

EGS from seeking to recover some or all of the acquisition offer through higher generation prices in the future. In that regard, Direct Energy witness Mr. Frank Lacey testified as follows:

> Direct Energy would amortize the cost of that investment over the useful life of that investment and earn a return on the investment over time.[45]

When Mr. Lacey was questioned on cross-examination with regard to this testimony, he acknowledged that Direct Energy would attempt to recover a return on its investment in acquisition offers through the prices that Direct Energy would charge its customers.[46] Therefore, Direct Energy's proposal is a case of bait and switch, *i.e.*, offer customers a financial incentive to participate in the auction but then eventually recover that incentive through higher rates.

C. REPLY TO DIRECT ENERGY'S EXCEPTION NO. 7: Direct Energy's Plan should be adjudicated on the basis of the existing record evidence. (I.D. at 60-72, Direct Energy Exception No. 7)

Direct Energy excepted to the ALJs' alleged failure to consider each element of Direct Energy's plan separately.[47] In defending that exception, Direct Energy proposed alternatives not spelled out in testimony, *e.g.*, that the opt-out auction could be implemented on a pilot basis for fewer than all four EDCs or for a limited subset of customers of each EDC.[48]

There is no record evidence of the details of any of the alternatives Direct Energy proposed in Exception No. 7. Furthermore, other parties have been deprived of the opportunity to conduct discovery or cross-examination regarding any of these alternatives or to respond to the alternatives with testimony. Therefore, Commission approval of any of these alternatives would violate the due process rights of other parties.

---

[45] Direct Energy Statement No. 3-SR at 17.

[46] Hearing Transcript at 1015.

[47] Direct Energy Exceptions at 33-36.

[48] Direct Energy Exceptions at 35.

D. REPLY TO RESA'S EXCEPTION NO. 3: The Commission should reject RESA's proposed changes in default service. (I.D. at 55-59, RESA Exception No. 3)

1. S ummary of RESA's Exception

In its Main Brief, RESA proposed numerous conditions intended to enhance retail competition. Among those conditions were the following changes to the next default service plans of Met-Ed, Penelec, Penn Power, and West Penn:

- A reduction in the commercial and industrial ("C&I") customer threshold for hourly priced service;
- Incorporation of a larger percentage of spot market supply in the default service procurement mix and introduction of shorter term three-month contracts; and
- A reduction in the amount of supply that can be served by any single wholesale supplier to one-third.[49]

The ALJs rejected all of RESA's proposed merger conditions. Specifically, the ALJs stated:

> . . . many of the proposals it [RESA] lists are adequately addressed by the Joint Petition. [footnote omitted] 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.[50]

RESA excepted to the ALJs' rejection of its proposed conditions, including the ones specifically related to the design of default service. However, in Subsection (e) of Exception No. 3, RESA explicitly excepted to the rejection of only two of the aforementioned conditions to change the next default service plans. Those two conditions are:

---

[49] RESA Main Brief at 30.

[50] ID at 59.

- Met-Ed, Penelec, Penn Power, and West Penn should be required to implement hourly-priced service for all customers with peak demand greater than 100 kW; and
- Met-Ed, Penelec, Penn Power, and West Penn should be required to lower the amount of supply that can be served by any single wholesale supplier to 33 1/3%.[51]

RESA did not explicitly challenge the ALJs' refusal to require that Met-Ed, Penelec, Penn Power, and West Penn incorporate a larger percentage of spot market supply and shorter term three-month contracts in their next default service plans.[52] Therefore, RESA has waived those conditions.

The ALJs were correct to deny RESA's proposed changes in default service. The proposals are simply another manifestation of RESA's strategy to make default service rates more volatile in order to increase the number of shopping customers. However, even if those proposals were relevant to this merger proceeding, OSBA witness Mr. Robert Knecht explained why it would be premature for the Commission to approve them. Specifically, Mr. Knecht testified as follows:

> Moreover, locking in DS [default service] procurement rules now would reduce the flexibility that the Commission would otherwise have when the current DS Procurement Plans come up for renewal. Many changes may occur in electric markets over

[51] RESA Exceptions at 25.

[52] Even if RESA's Exceptions had challenged the ALJs' refusal to impose a condition that required the next default service plans to incorporate more spot market purchases and shorter term contracts, those issues should be litigated in the FirstEnergy EDCs' default service proceedings rather than in the instant merger proceeding. For example, RESA made a similar proposal (for shorter-term contracts) in West Penn's default service proceeding for the period ending May 31, 2013. The Commission rejected that proposal. *See Petition of the West Penn Power Company d/b/a Allegheny Power for Approval of its Retail Electric Default Service Program and Competitive Procurement Plan for Service at the Conclusion of the Restructuring Transition Period*, Docket No. P-00072342 (Order entered July 25, 2008), at 31. In view of the fact that RESA proposed shorter-term contracts several years prior to the merger filing, there is no basis for concluding that RESA's proposal in the instant proceeding was actually prompted by some unique alleged problem caused by the merger.

> the next two years, and the Commission will have significantly more information regarding market competition at that time. For example, because rate caps are still in place for Penelec, Met-Ed, and West Penn Power, the Commission has little relevant information regarding shopping in those EDCs' service territories. However, by the time their DS procurement plans are up for renewal, much more relevant information will be available. By locking in changes in DS procurement now, the Commission may preempt options that look more attractive two years from now.[53]

2. Hourly Pricing

RESA's proposal to place Small C&I customers with maximum peak demand over 100 kW on hourly pricing is inconsistent with the Commission's default service regulations and Default Service Policy Statement.

Specifically, both Section 54.187(h)-(i) of the regulations, 52 Pa. Code §54.187(h)-(i), and Section 69.1805 of the Policy Statement, 52 Pa. Code §69.1805, set forth the preferred grouping of customers for procurement purposes and recommend hourly pricing for only those C&I customers with maximum peak loads of 500 kW and above. Although Section 69.1805 states that default service providers "may propose alternative divisions of customers by registered peak load to preserve existing customer classes," default service providers must present a persuasive rationale for the change.

As Mr. Knecht observed, there is no persuasive rationale for adopting RESA's proposal to lower the threshold for hourly pricing. Specifically, Mr. Knecht testified as follows:

> First, [RESA witness] Mr. [Richard] Hudson presents no evidence that there is any lack of competition among EGSs to supply C&I customers over 100 kW at those EDCs whose rate caps have expired. Second, if Mr. Hudson's proposal is intended as a response to reduced competition resulting from the merger, it is not clear why his remedy should be targeted only at the C&I customers over 100 kW. Third, Mr. Hudson provides no assessment of the

[53] OSBA Statement No. 3 at 9-10.

> magnitude of the impact his proposal could be expected to have on the number of shopping customers or affected load. Fourth, Mr. Hudson's proposal would be better addressed in each EDC's next DS [default service] proceeding, when the Commission will know how much retail shopping has occurred simply because rates caps have expired.[54]

3. Load Caps

RESA's proposal to set the maximum share of any particular default service procurement that a single supplier may win, *i.e.*, the load cap, at 33 1/3% is not reasonable for this proceeding. As Mr. Knecht testified:

> It could be argued that Mr. Hudson's proposed load cap will increase competition in wholesale procurements by spreading market share around more evenly. However, to the extent it has any effect at all, Mr. Hudson's proposal will increase rates paid by DS customers. It is difficult to understand the logic of trying to protect DS ratepayers from anti-competitive practices by increasing their rates. In prior DS proceedings, the issue of how much DS supply may reasonably be provided by a single supplier required a balancing of interests. Setting the maximum limit higher will generally result in lower rates for DS ratepayers, because fewer 'in the money' bids will be excluded. However, setting the maximum limit higher will expose DS to greater risk of an individual supplier being unable to meet its obligations under the contract. In considering this issue in the past, the Commission has generally decided that Mr. Hudson's proposal sets the maximum limit too low.[55]

Significantly, the Commission rejected RESA's proposal for a 33 1/3% load cap in the proceeding to approve the current default service plans for Met-Ed and Penelec.[56]

---

[54] OSBA Statement No. 3 at 10.

[55] OSBA Statement No. 3 at 10-11.

[56] *Joint Petition of Metropolitan Edison Company and Pennsylvania Electric Company for Approval of Their Default Service Programs*, Docket Nos. P-2009-2093053 and P-2009-2093054 (Order entered November 6, 2009) at 18.

4. Recommendation

In view of the foregoing, the Commission should reject RESA's proposed changes to the next default service plans of Met-Ed, Penelec, Penn Power, and West Penn. Such rejection would not prejudice RESA, because RESA could make the same, or similar, proposals in the next default service proceedings.

III. CONCLUSION

A. Summary

FirstEnergy's opt-out municipal aggregation plan and Direct Energy's Plan are structured somewhat differently, but each would have the same effect, *i.e.*, the destruction of default service as designed by the General Assembly and the Commission. There is no compelling need for the Commission to approve either one of them in this merger proceeding.

Direct Energy's Plan (and the default service design changes advocated by RESA) would not take effect until the default service period beginning June 1, 2013.[57] Therefore, the changes advocated by Direct Energy and RESA can be deferred to the proceedings in which the Commission reviews the default service plans of Met-Ed, Penelec, Penn Power, and West Penn for that default service period.[58]

As explained in the OSBA's Exceptions and in these Reply Exceptions, opt-out is unlawful, whether it is an element of FirstEnergy's municipal aggregation plan or an element of Direct Energy's Plan. Both plans would violate Sections 2803 and 2807(e)(3.1) of the Public Utility Code, in that ratepayers would have to affirmatively choose service from their default service provider. Furthermore, both opt-out municipal aggregation and Direct Energy's Plan

[57] *Id.*

[58] *Id.* at 5-11.

would violate Section 2807(d)(1), in that both proposals fail to require a customer's affirmative consent in order to switch that customer's electric provider.[59]

If the Commission were to impose the OSBA's proposed conditions relating to municipal aggregation, FES would not be permitted to engage in municipal aggregation until the default service period beginning June 1, 2013, assuming that the General Assembly ultimately provides statutory authorization.[60]

The OSBA is proposing similar treatment for Direct Energy. Specifically, if the Commission were to reject Direct Energy's proposal to auction off non-shopping customers to EGSs on an opt-out basis, Direct Energy would be able to pursue its proposal in one or more of the FirstEnergy EDCs' default service proceedings for the period beginning June 1, 2013.

Finally, if the Commission were to reject RESA's proposed changes in default service design, RESA would not be prejudiced because it (or any of its individual EGS members) would be able to pursue these changes in one or more of the FirstEnergy EDCs' default service proceedings for the period beginning June 1, 2013.

In view of the foregoing, the Commission should reject Direct Energy's Plan and RESA's proposed changes in default service design. The Commission should then approve the Settlement, subject to the conditions on municipal aggregation proposed by the OSBA.

B. Relief Requested

For the reasons stated herein, the OSBA respectfully requests that the Commission deny Direct Energy's Exceptions regarding an opt-out auction of the non-shopping customers of Met-Ed, Penelec, Penn Power, and West Penn to EGSs and regarding the setting of the default service rates of Met-Ed, Penelec, Penn Power, and West Penn entirely on the basis of spot market prices.

[59] *See* OSBA Exceptions at 10-12.

[60] *See* OSBA Exceptions at 18-19.

The OSBA also respectfully requests that the Commission deny RESA's Exception regarding changes in the design of default service for Met-Ed, Penelec, Penn Power, and West Penn to subject C&I customers with peak loads above 100 kW to hourly pricing and regarding a 33 1/3% load cap.

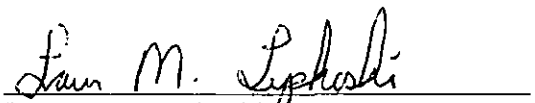
Furthermore, for the reasons set forth in its Exceptions, the OSBA respectfully requests that the Commission grant the OSBA's Exceptions and impose the following conditions:

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 the aforementioned conditions proposed by the OSBA, the OSBA respectfully requests that the Commission reject the merger.

Respectfully submitted,



Lauren M. Lepkoski
Assistant Small Business Advocate
Attorney I.D. No. 94800

Daniel G. Asmus
Assistant Small Business Advocate
Attorney ID No. 83789

For:
William R. Lloyd, Jr.
Small Business Advocate
Attorney I.D. No. 16452

Office of Small Business Advocate
300 North Second Street, Suite 1102
Harrisburg, PA 17101
(717) 783-2525

Dated: January 20, 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 Convenience Under Section 1102(a)(3) of the Public Utility Code Approving a Change of Control of West Penn Power Company and Trans- Allegheny Interstate Line Company	:	**Docket Nos. A-2010-2176520 A-2010-2176732**

CERTIFICATE OF SERVICE

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

Hon. Wayne L. Weismandel
Administrative Law Judge
Pennsylvania Public Utility Commission
P. O. Box 3265
Harrisburg, PA 17105-3265
(717) 787-1191
(717) 787-0481 (fax)
wweismande@state.pa.us
(E-mail and Hand Delivery)

Hon. Mary D. Long
Administrative Law Judge
Pennsylvania Public Utility Commission
301 Fifth Avenue - #220
Pittsburgh, PA 15222
(412) 565-3550
(412) 565-5692 (fax)
malong@state.pa.us

Bradley A. Bingaman, Esquire
FirstEnergy Service Company
2800 Pottsville Pike
P. O. Box 16001
Reading, PA 19612-6001
(610) 921-6203
(610) 939-8655 (fax)
bbingaman@firstenergycorp.com

Allison C. Kaster, Esquire
Carrie B. Wright, Esquire
Office of Trial Staff
Pennsylvania Public Utility Commission
P. O. Box 3265
Harrisburg, PA 17105-3265
(717) 787-1976
(717) 772-2677
akaster@state.pa.us
carwright@state.pa.us
(E-mail and Hand Delivery)

Darryl Lawrence, Esquire
Tanya J. McCloskey, Esquire
Aron J. Beatty, Esquire
Jessica Horner
Office of Consumer Advocate
555 Walnut Street - 5th Floor
Harrisburg, PA 17101-1023
(717) 783-5048
(717) 783-7152 (fax)
tmccloskey@paoca.org
dlawrence@paoca.org
abeatty@paoca.org
jhorner@paoca.org
(E-mail and Hand Delivery)

Robert M. Strickler, Esquire
Griffith Strickler Lerman Solymos & Calkins
110 S. Northern Way
York, PA 17402-3737
(717) 757-7602
(717) 757-3783 (fax)
rstrickler@gslsc.com

David J. Dulick, Esquire
Pennsylvania Rural Electric Association
P. O. Box 1266
Harrisburg, PA 17108-1266
(717) 901-4432
(717) 233-5679 (fax)
david_dulick@prea.com

Charles E. Thomas, Jr., Esquire
Thomas T. Niesen, Esquire
Jennifer M. Sultzaberger, Esquire
Regina L. Matz, Esquire
Thomas Long Niesen & Kennard
P. O. Box 9500
Harrisburg, PA 17108-9500
(717) 255-7600
(717) 236-8278 (fax)
cthomasjr@thomaslonglaw.com
tniesen@thomaslonglaw.com
jms@thomaslonglaw.com
rmatz@thomaslonglaw.com

Derrick Price Williamson, Esquire
Spilman Thomas & Battle, PLLC
1100 Bent Creek Blvd. - #101
Mechanicsburg, PA 17050
(717) 795-2741
(717) 795-2743 (fax)
dwilliamson@spilmanlaw.com

Barbara Alexander
barbalex@ctel.net
(E-mail Only)

Randall B. Palmer
rpalmer@alleghenypower.com
(E-Mail Only)

Thomas P. Gadsden, Esquire
Kenneth M. Kulak, Esquire
Morgan Lewis & Bockius, LLP
1701 Market Street
Philadelphia, PA 19103-2921
(215) 963-5234
(215) 963-5001 (fax)
tgadsden@morganlewis.com
kkulak@morganlewis.com

Benjamin L. Willey, Esquire
Sally Patton
7272 Wisconsin Avenue - #300
Bethesda, MD 20814
(301) 941-1972
(240) 235-7775 (fax)
blw@bwilleylaw.com
ssp@bwilleylaw.com

Richard Hahn
rhahn@lacapra.com
(E-mail Only)

Daniel Clearfield, Esquire
Deanne M. O'Dell, Esquire
Carl R. Shultz, Esquire
Eckert Seamans Cherin & Mellott, LLC
213 Market Street - 8th Floor
P. O. Box 1248
Harrisburg, PA 17101
(717) 255-3744
(717) 237-6019 (fax)
dclearfield@eckertseamans.com
dodell@eckertseamans.com
cshultz@eckertseamans.com

Stephen H. Jordan, Esquire
Rothman Gordon, PC
310 Grant Street - Third Floor
Pittsburgh, PA 15219
(412) 338-1100
(First-class Mail Only)

Thomas J. Sniscak, Esquire
Todd S. Stewart, Esquire
William E. Lehman, Esquire
Hawke McKeon & Sniscak, LLP
100 North Tenth Street
P. O. Box 1778
Harrisburg, PA 17105
(717) 236-1300
(717) 236-4841 (fax)
tjsniscak@hmslegal.com
tsstewart@hmslegal.com
welehman@hmslegal.com

Scott H. Strauss, Esquire
Katharine M. Mapes, Esquire
Spiegel & McDiarmid, LLP
1333 New Hampshire Avenue, NW
Washington, DC 20036
(202) 879-4000
(First-class Mail Only)

Kurt E. Klapkowski, Esquire
Jason E. Oyler, Esquire
Department of Environmental Protection
P. O. Box 8464
Harrisburg, PA 17105-8464
(717) 787-7060
(717) 783-7911 (fax)
kklapkowsk@state.pa.us
joyler@state.pa.us

Alan Michael Seltzer, Esquire
Ryan Russell Ogden & Seltzer, PC
1150 Berkshire Boulevard - #210
Wyomissing, PA 19610-1208
(First-class Mail Only)

Barry A. Naum, Esquire
Spilman Thomas & Battle, PLLC
1100 Bent Creek Blvd. - #101
Mechanicsburg, PA 17050
(717) 795-2742
(717) 795-2743 (fax)
bnaum@spilmanlaw.com

John K. Baillie, Esquire
Charles McPhedran, Esquire
Citizens for Pennsylvania's Future
425 Sixth Avenue - #2770
Pittsburgh, PA 15219
(412) 258-6684
(412) 258-6685 (fax)
baillie@pennfuture.org
mcphedran@pennfuture.org

Susan E. Bruce, Esquire
Vasiliki Karandrikas, Esquire
Carl J. Zwick, Esquire
Charis Mincavage, Esquire
McNees Wallace & Nurick, LLC
P. O. Box 1166
Harrisburg, PA 17108-1166
(717) 232-8000
(717) 237-5300 (fax)
sbruce@mwn.com
vkarandrikas@mwn.com
czwick@mwn.com
cmincavage@mwn.com

Scott J. Rubin, Esquire
333 Oak Lane
Bloomsburg, PA 17815
(First-class Mail Only)

Michael D. Fiorentino, Esquire
42 East Second Street - #200
Media, PA 19063
(610) 566-2166
(610) 566-0362 (fax)
mdfiorentino@gmail.com

Divesh Gupta, Esquire
Constellation Energy
111 Market Place - #500
Baltimore, MD 21202
(First-class Mail Only)

Theodore S. Robinson, Esquire
Citizen Power
2121 Murray Avenue
Pittsburgh, PA 15217
(412) 421) 7029
(412) 421- 6162 (fax)
robinson@citizenpower.com

Eric Cheung, Esquire
Clean Air Council
135 S. 19th Street - #300
Philadelphia, PA 19103
(215) 567-4004
(215) 567-5791 (fax)
echeung@cleanair.org

Clifford M. Naeve, Esquire
Matthew W. S. Estes, Esquire
Skadden Arps Slate Meagher & Flom LLP
1440 New York Avenue, N.W.
Washington, DC 20005
(202) 371-7000
(First-class Mail Only)

Date: January 20, 2011

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