

**IN THE
COMMONWEALTH COURT OF PENNSYLVANIA**

ARIPPA,	:	
	:	
Petitioner	:	No. 1462 CD 2001
	:	
	:	
Mid-Atlantic Power Supply Association,	:	
	:	
Petitioner	:	No. 1564 CD 2001
	:	
	:	
York County Solid Waste and Refuse Authority,	:	
	:	
Petitioner	:	No. 1635 CD 2001
	:	
	:	
Clean Air Council and Citizen Power, Inc.,	:	
	:	
Petitioners,	:	No. 1674 C.D. 2001
	:	
v.	:	
	:	
Pennsylvania Public Utility Commission,	:	
	:	
Respondent.	:	

**ADVANCED TEXT BRIEF
OF THE JOINT PETITIONERS
CLEAN AIR COUNCIL AND CITIZEN POWER, INC.**

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I. STATEMENT OF JURISDICTION

The Commonwealth Court obtains jurisdiction over this Joint Petition for Review pursuant to Section 763(a)(1) of the Judicial Code, 42 Pa.C.S. §763(a)(1), which provides for judicial review of final orders of the Pennsylvania Public Utility Commission, and also pursuant to §702 of the Administrative Agency Law, 2 Pa.C.S. §702.

II. SCOPE OF REVIEW, STANDARD OF REVIEW

The scope of review which the Commonwealth Court may apply in proceedings appealing decisions of the Pennsylvania Public Utility Commission is limited to determinations of whether Constitutional rights have been violated, an error of law has been committed, or the Commission's findings and conclusions are not supported by substantial evidence. 2 Pa. C.S. 704, Barasch v. PUC, 507 Pa. 561, 493 A.2d 653 (1985), Popowsky v. PUC, 653 A.2d 1385 (Pa. Cmwlth. 1995), *appeal denied*, 544 Pa. 650, 664 A.2d 977 (1995).

III. ORDERS IN QUESTION

The Orders of the Commission in question were entered June 20, 2001, at PUC Docket Nos. A-110300F0095, A-110400F0040, P-00001860 and P-00001861. In the Order on the “P” Docket cases, the Commission resolved issues under GPU, Inc.’s Petition for Rate Cap Exception through adoption of a Settlement Stipulation between several parties.

In the Order on the “A” Docket cases, the Commission adopted the Recommended Decision of Administrative Law Judge Larry Gesoff, as modified, rejected or granted Exceptions of the various Parties, and approved the proposed merger of GPU, Inc. and FirstEnergy with conditions.

The Ordering Paragraphs provide as follows:

MAY 24, 2001 ORDER (“Merger Order”)

THEREFORE; IT IS ORDERED:

1. That the Exceptions filed by Kenneth Springirth on May 3, 2001, to the Recommended Decision of Administrative Law Judge Larry Gesoff herein, are held in abeyance pending resolution of the Provider of Last Resort issues herein.
2. That the Exceptions filed by Citizen Power, Inc. on May 5, 2001, to the Recommended Decision of Administrative Law Judge Larry Gesoff herein, are denied.
3. That the Exceptions filed by Citizens for Pennsylvania’s Future on May 7, 2001, to the Recommended Decision of Administrative Law Judge Larry Gesoff herein, are denied.

4. That the Exceptions filed by the Honorable Camille “Bud” George on May 7, 2001, to the Recommended Decision of Administrative Law Judge Larry Gesoff herein, are denied.
5. That the Exceptions filed by Met-Ed Industrial Users Group and Penelec Industrial Customer Alliance on May 7, 2001, to the Recommended Decision of Administrative Law Judge Larry Gesoff herein, are denied.
6. That the Exceptions filed by the New Power Company on May 7, 2001, to the Recommended Decision of Administrative Law Judge Larry Gesoff herein, are denied.
7. That the Exceptions filed by the Clean Air Council on May 7, 2001, to the Recommended Decision of Administrative Law Judge Larry Gesoff herein, are denied.
8. That the Exceptions filed by Bruce Mangione on May 7, 2001, to the Recommended Decision of Administrative Law Judge Larry Gesoff herein, are denied.
9. That the Exceptions filed by PPL Electric Utilities Corporation and PPL EnergyPlus on May 7, 2001, to the Recommended Decision of Administrative Law Judge Larry Gesoff herein, are denied.
10. That the Exceptions filed by ARIPPA on May 7, 2001, to the Recommended Decision of Administrative Law Judge Larry Gesoff herein, are denied.
11. That the Exceptions filed by Mid-Atlantic Power Supply Association on May 7, 2001, to the Recommended Decision of Administrative Law Judge Larry Gesoff herein, are denied.
12. That the Exceptions filed by the Office of Consumer Advocate on May 7, 2001, to the Recommended Decision of Administrative Law Judge Larry Gesoff herein, are denied.

13. That the Exceptions filed by FirstEnergy Corporation, GPU, Inc., and its Pennsylvania public utility subsidiaries Metropolitan Edison Company and Pennsylvania Electric Company on May 7, 2001, to the Recommended Decision of Administrative Law Judge Larry Gesoff herein, are granted in part and denied in part, consistent with this Opinion and Order.

14. That the Exceptions filed by the Office of Trial Staff on May 7, 2001, on May 7, 2001, to the Recommended Decision of Administrative Law Judge Larry Gesoff herein, are held in abeyance, pending resolution of the PLR issues herein.

15. That the Recommended Decision of Administrative Law Judge Larry Gesoff issued herein on April 25, 2001, is adopted, as modified by this Opinion and Order.

16. That the merger of the GPU Companies and FirstEnergy Corporation is granted subject to the following conditions:

a. That the GPU Codes of Conduct apply to this merger and to the activities of FirstEnergy in Pennsylvania after the merger, and provided further that, within thirty days of the effective date of the merger, the merged company issue training and education material about the GPU Codes of Conduct to its employees

b. That the merged company shall not withdraw the transmission facilities of Metropolitan Edison Company or Pennsylvania Electric Company from the operational control of PJM Interconnection, L.L.C. unless the merged company, or such subsidiary or affiliate thereof, has first applied for and obtained authorization by order of this Commission, and such application shall be granted only upon an affirmative showing that withdrawal would not adversely affect the continued provision of adequate, safe and reliable electric service to the citizens and businesses of the Commonwealth nor adversely affect system reliability or the competitive market in the Commonwealth; and provided further that this condition is binding on the successors and assigns of the merged company and upon any buyer of any of the transmission facilities of Metropolitan Edison Company or Pennsylvania Electric Company;

c. That the merged company implement the Service Quality Index (“SQI”) set forth in this proceeding in Office of Consumer Advocate Statement No. 2, Exhibit BA-1; Surrebuttal; provided further that, on or before April 1 of each year, the merged company submit to the Commission, the Office of Trial Staff, the Office of Consumer Advocate and the Office of Small Business Advocate, a report of its service quality results; and provided further that the penalties and

customer restitution included in the SQI are not self-executing and are to be considered only as guides for the Commission's consideration in any complaint brought before it as a result of the annual SQI report;

d. That for ratemaking purposes, the costs to achieve the merger shall be expensed or amortized over the existing transmission and distribution rate cap periods, for Metropolitan Edison Company, Pennsylvania Electric Company, and Pennsylvania Power Company;

e. That the acquisition premium associated with the merger shall not be recovered from the ratepayers of Metropolitan Edison Company, Pennsylvania Electric Company, and Pennsylvania Power Company;

f. That the nuclear costs or obligations of FirstEnergy shall not be charged to the ratepayers of Metropolitan Edison Company and Pennsylvania Electric Company. GPU shall not be precluded from recovery of purchased power costs that include costs related to nuclear generation so long as the costs incurred by GPU are consistent with rate caps or the statutory PLR price;

g. That the merged company agrees that it will not assert a defense that an SEC determination preempts this Commission's jurisdiction;

h. That the merged company adhere to Chapters 11 and 21 of the Public Utility Code in the same manner as the existing obligations of Metropolitan Edison Company and Pennsylvania Electric Company;

i. That consistent with federal law and regulations, the merged company shall not: (1) transfer the regulated pension fund assets of Metropolitan Edison Company or Pennsylvania Electric Company to FirstEnergy Corp.; (2) commingle the regulated pension fund assets of Metropolitan Edison Company or Pennsylvania Electric Company with those of FirstEnergy Corp.; or (3) withdraw the excess pension funding of Metropolitan Edison Company or Pennsylvania Electric Company; provided further that the merged company shall establish separate pension trust funds for its regulated companies, and shall place in each fund the respective company's pension assets and obligations as they exist at the time of the merger, subject to review of the parties to the merger proceeding; and provided further that the merged company shall not allow additional pension fund obligations or costs incurred in conjunction with the merger to diminish the value of the excess pension funding as it exists at the time of the merger;

j. That Metropolitan Edison Company and Pennsylvania Electric Company explore modifications to its WARM weatherization program so that customers enrolled in their customer assistance programs obtain timely service from the energy management program; provided further that, within ninety days of the entry of this Opinion and Order, Metropolitan Edison Company and Pennsylvania Electric Company report to the Commission on this matter;

k. That the merged company maintain at least the current Metropolitan Edison Company and Pennsylvania Electric Company level of community support programs for three years following the merger;

l. That the merged company maintain at least the current Metropolitan Edison Company and Pennsylvania Electric Company level of economic development initiatives for the three years following the merger;

m. That, within sixty days of the effective date of the merger, the merged company shall file a detailed plan to achieve projected labor cost savings; provided further that the plan shall include a detailed list of job cuts by company, by function, and by job title to allow the Commission to determine whether Pennsylvania would bear a disproportionate share of job cuts; and provided further that the plan shall specify how the job cuts will be achieved, through layoffs, early retirement programs, or attrition; provided further that the plan shall include detailed information concerning any programs that the merged company will use to minimize the impact of any work force reductions on their employees, including but not limited to the provision of outplacement services, educational or retraining reimbursement, early retirement, and severance benefits.

17. That FirstEnergy Corporation, GPU, Inc., and its Pennsylvania public utility subsidiaries Metropolitan Edison Company and Pennsylvania Electric Company, the Applicants, have thirty (30) days from the date of entry of this Opinion and Order to notify the Secretary of the Commission of their acceptance of the above-outlined conditions.

18. That the Provider of Last Resort cost proceeding and the disposition of merger benefits be held in abeyance to afford the Parties an opportunity to attempt to resolve this matter in a Commission-facilitated collaborative. The collaborative will conclude no later than June 20, 2001. Whether the collaborative is successful or not, the Commission will decide this matter no later than Public Meeting of July 13, 2001.

19. That this Commission-facilitated collaborative shall be held in the Commission's Executive Chambers, 3rd Floor, Commonwealth Keystone Building, commencing on Tuesday, May 29, 2001, at 10:30 a.m., and continuing through Thursday, May 31, 2001. Additional days may be scheduled.

ENTERED: June 20, 2001.

JUNE 14, 2001 ORDER (“Stipulated Order”)

ORDERED:

1. That the Settlement Stipulation filed on June 11, 2001 is in the public interest and is approved without modification.
2. That the deferral accounting and subsequent recovery mechanism for the accumulated difference between the charges to retail customers for provider of last resort service and the actual supply costs incurred by Metropolitan Edison Company and Pennsylvania Electric Company, together with carrying costs, beginning on January 1, 2001, as proposed by the Settlement Stipulation, is hereby approved.
3. That the Recommended Decision of Administrative Law Judge Larry Gesoff is adopted, as modified by the Settlement Stipulation.
4. That the Exceptions and Reply Exceptions of the parties are granted in part and denied in part consistent with this Order.
5. That the Order adopted by the Commission on May 24, 2001, in these proceedings is amended as necessary to adopt and implement the provisions of the Settlement Stipulation.

ENTERED: June 20, 2001

IV. STATEMENT OF THE QUESTIONS

1. Did the Commission commit an error of law and abuse its discretion by approving the FirstEnergy-GPU merger despite a lack of substantial evidence to show that the merger will affirmatively promote the service, accommodation, convenience, or safety of the public in some substantial way?

Answered in the Negative Below.

2. Did the Commission commit an error of law by approving the merger between GPU and FirstEnergy despite the Applicants' failure to show by substantial evidence that the merger is not likely to adversely affect competition in retail markets?

Answered in the Negative Below.

3. Did the Commission violate due process or otherwise abuse its discretion by substantially abrogating the Restructuring Settlement of 1998, as adopted by the Commission.

Answered in the Negative Below.

4. Did the Commission commit an error of law by approving the Met-Ed and Penelec request for rate relief despite the acknowledged failure of Met-Ed and Penelec to demonstrate through substantial evidence that they were entitled to rate cap relief under Section 2804(4)(iii)(D) of the Competition Act?

Answered in the Negative Below.

5. Did the Commission commit an error of law by allowing POLR costs in excess of generation rate cap levels to be recovered through the competitive transition charge?

Answered in the Negative Below.

V. STATEMENT OF THE CASE

This case is a Petition for Review from two Orders of the Pennsylvania Public Utility Commission entered on June 20, 2001.

GPU, Inc. of Morristown, NJ and FirstEnergy of Akron, OH, filed a Joint Application with the Commission on November 9, 2000 at Docket Nos. A-110300F0095 and A-110400F0040 seeking approval of their proposed merger under 66 Pa. C.S. § 1102(a)(3), (“A” Dockets) On November 29, 2000, GPU energy filed a Petition for Relief (“POLR Petition”) under paragraph F.2. of the Restructuring Settlement of 1998 with the Commission at Docket Nos. P-00001860 and P-00001861. (“P” Dockets) The Joint Application and supporting testimony provide some description of the manner in which the merger would be accomplished and its anticipated effects. On December 11, 2000, Clean Air Council, a signatory to the Restructuring Settlement of 1998, filed its Protest and Petition to Intervene. Citizen Power, Inc. filed its Protest and Petition to Intervene on or about December 11, 2000. Numerous additional private and statutory parties also intervened in a timely manner. At a pre-hearing conference on January 10, 2001, formal intervention was granted to all parties, including Clean Air Council and Citizen Power., Inc., with the exception of Peek ‘n’ Peak Resorts, James K. Sisson, and Citizens For Pennsylvania’s Future. GPU filed a Motion for Consolidation of the Petition (the P-Docket) and the Joint Application (the A-Docket), which was subsequently granted by the Commission.

On February 9, 2001, Clean Air Council submitted the direct testimony of Andrew Altman. On March 12 through March 15, evidentiary hearings were held in

Harrisburg, with Administrative Law Judge Larry Gesoff presiding. At said hearings, the testimony of Andrew Altman was admitted into the record, along with the testimony of 29 other witnesses from the Joint Applicants and Intervenors.

As part of its evidentiary support for the merger, the Joint Applicants asserted that the merger would result in about \$150 million in savings annually to the merged company, and, although it did not propose to share any portion of those savings with rate payers, the Applicants asserted that there were a number of other merger benefits that satisfied the statutory requirements. Among other things, the Applicants asserted that GPU would become a financially stronger entity, that reliability of service to customers would improve and that its association with FirstEnergy would reduce the likelihood that it would need future POLR relief. Concurrent with its evidentiary presentation in support of its merger application, GPU presented testimony in defense of its application for POLR relief. GPU has asserted that it is entitled to rate cap relief under 2804(4)(iii)(D) of the Competition to allow it to recover from ratepayers the excess costs incurred above the generation rate cap through its provider of last resort obligation to GPU customers.

Both the claim of merger benefit and the assertion that GPU needed POLR relief were widely disputed by parties who filed briefs with the ALJ opposing the company's position. With respect to the merger application, opponents, including Citizen Power and Clean Air Council, made several contentions: that the merger would diminish retail competition and that the company had presented no evidence on the effect of the merger on retail competition; that if the Applicants' claim that energy power supplies from FirstEnergy would aid GPU in serving its POLR load were true, the consequence would be an increase in air pollution resulting from increased production of power from heavily

polluting power plants located in Ohio; that without a demonstration of quantifiable benefits resulting from the merger, the applicants would have to accept conditions that would assure positive benefits to ratepayers, including some sharing of the claims stating that would result from the merger.

Other parties to the proceeding, such as Office of Trial Staff, Citizens for Pennsylvania's Future, and Office of the Consumer Advocate ("OCA"), also contested GPU's claim for POLR relief, asserting that GPU had failed to justify the relief under the law, because, *inter alia*, they could not demonstrate that the incurred excess costs were outside their control.

On April 23, 2001, ALJ Gesoff issued a Recommended Decision in these proceedings which approved the Application for Merger with conditions and granted in part / denied in part the Petition for Relief under paragraph F.2 by rejecting GPU's request for a deferral tracking mechanism in favor of \$316 million in immediate rate increases.

Clean Air Council and Citizen Power were among numerous parties to submit timely Exceptions to the Recommended Decision. On May 24, 2001, the Commission voted to adopt with modifications the ALJ's Recommended Decision. The Commission indicated it would approve the Merger but would not permit the immediate rate increases, instead directing the formation of a "collaborative" among the Parties to achieve a resolution on the Petition for Rate Relief. Upon establishing the collaborative, the Commission also concluded that the company had not demonstrated that positive benefits would flow to ratepayers as a result of the merger. The collaborative was convened on May 29, 2001 by Commissioner Fitzpatrick, but it failed to achieve a resolution, and

dissolved within the week.

On June 11, 2001 the Joint Applicants filed a “Settlement Stipulation” with the Commission signed by several parties. That evening the Commission notified the parties by electronic mail to submit comments regarding the stipulation by 12 p.m. June 13, 2001. Clean Air Council and Citizen Power each submitted limited comments. The Commission entered two Orders on June 20, 2001 pertaining to the aforesaid dockets, one of which adopted the stipulation without modification. The Settlement Stipulation provided for, *inter alia*, the merger between GPU and First Energy; the establishment of a POLR deferral tracking mechanism to recover POLR stranded costs; and the modification of provisions in the 1998 Restructuring Settlement involving the GENCO Code of Conduct, the Sustainable Energy Fund, and the CDS program, without the consent of many of the signing parties, such as the Clean Air Council. Clean Air Council and Citizen Power filed the instant Petition for Review challenging these Orders.

The Officials involved in the challenged decision are the voting Commissioners of the Public Utility Commission at the time of the public meetings of May 24, 2001 and June 14, 2001. They are: Robert K. Bloom, Vice-Chairman; Nora Mead Brownell, Commissioner; Aaron Wilson, Jr., Commissioner; and Terrance Fitzpatrick, Commissioner.

VI. SUMMARY OF ARGUMENT

The Commission erred in approving the proposed merger of FirstEnergy and GPU because the Joint Applicants failed to adduce substantial evidence from which the Commission could have concluded that the merger was not likely to result in anticompetitive or discriminatory conduct, including the unlawful exercise of market power, which will prevent retail electricity customers from obtaining the benefits of a properly functioning and workable competitive retail electricity market, as required by Section 2811(e)(2) of the Electric Generation Customer Choice and Competition Act. 66 Pa. C.S. § 2811(e)(2). The testimony of the Applicants' sole witness on this issue was fully undermined and, thus, does not constitute substantial evidence to meet their burden under Section 2811(e)(2).

The Commission's approval of the merger must also be reversed because the Commission found that satisfaction of the applicable standard for merger approval required sharing of quantifiable merger savings in this case, but the Settlement Stipulation did not provide for such sharing of merger savings or point to other benefits that meet the York substantial benefits test. Further, the Commission improperly rejected substantial evidence of detriment to the environment that will be caused by the merger, and committed legal error by concluding that it did not have authority to condition approval of the merger upon Applicants redressing the potential adverse environmental impacts of the merger.

Approval of the Settlement Stipulation was contrary to law insofar as it abrogated the provisions of an existing contract – GPU Energy's 1998 Restructuring Settlement –

without the consent of all parties to that contract, including Petitioner Clean Air Council. The Settlement Stipulation materially modifies numerous important bargained-for provisions of the Restructuring Settlement, including provisions that encouraged the use and development of environmentally-friendly electric generating resources and provisions that promoted the development of a workably competitive retail electric market.

The Commission committed legal error and acted in the absence of substantial evidence in approving rate relief for Met-Ed and Penelec despite the utilities' failure to demonstrate: (i) that their increased purchased power costs would not allow the utilities to earn a fair rate of return; or (ii) that the increased purchased power costs were outside of their control, as required by the Competition Act, 66 Pa. C.S. § 2804(4)(iii)(D).

Finally, the Commission committed legal error by approving the Settlement Stipulation, which permits POLR costs to be recovered through the CTCs of Met-Ed and Penelec. The definition of stranded or transition costs as set forth in the Competition Act cannot reasonably be read to include recently-incurred purchased power costs acquired to serve POLR customers.

VII. ARGUMENT

A. The Commission erred and committed an abuse of discretion by approving the FirstEnergy-GPU merger despite a lack of substantial evidence demonstrating that the merger will affirmatively promote the service, accommodation, convenience, or safety of the public in a substantial way.

1. Approval of the merger is not supported under the applicable legal standards.

The law is clear in Pennsylvania that the transfer of property “used and useful” in the public service must be preceded by the issuance of a Certificate of Public Convenience by the Commission. 66 Pa.C.S. §1102(a)(3). The merger is to result in the transfer of GPU assets into a holding company known as FirstEnergy. Such assets fall within the “used and useful” category and thus an Application for Merger was needed to seek a Certificate from the Commission.

In determining whether to issue a Certificate, the Commission is bound to follow the restrictions of the Public Utility Code which provide that a Certificate shall issue only where it is “necessary or proper for the service, accommodation, convenience or safety of the public.” 66 Pa. C.S. §1103(a).

Where the Certificate is sought for the purpose of merger, the provision has been interpreted by the Supreme Court to require more than a mere absence of harm to the public. In the landmark case City of York v. Pa. PUC, 449 Pa. 136, 295 A.2d 825, (1972), the Court held that an applicant for a Certificate must “demonstrate that the merger will affirmatively promote the ‘service, accommodation, convenience or safety of the public’ in some substantial way.”

Further, the law requires that adverse impacts of the merger must be weighed against the alleged benefits. The Commission's decision neglected to do so and thereby fails the legal standard of Middletown Twp. v. Pa. PUC, 85 Pa. Cmwlth. 191, 482 A.2d 674 (Pa. Cmwlth Ct. 1984). "This Court's review of the record and applicable law indisputably indicates that a thorough consideration of the *benefits and detriments* that will result...is both advisable and mandated by the law." Id. 85 Pa. Cmwlth. at 202, at 482 A. 2d 682 (emphasis added).

The Application for Merger did not make a compelling demonstration that it would affirmatively promote the public interest as required. Most, if not all, of the intervenors in the PUC proceedings argued that the merger provided insufficient benefits to meet the legal standard.

The Public Utility Code also provides a mechanism by which a proposed merger which is deficient could be approved. "The Commission, in granting such certificate, may impose such conditions as it may deem to be just and reasonable." 66 Pa. C.S. §1103(a). It is well established that the Commission possesses wide latitude in the conditions that it may impose. Rheems Water Co. v. Pa. PUC, 153 Pa. Cmwlth. 49, 620 A.2d 609 (1993).

In this proceeding, the Commission approved the merger after imposing inconsequential conditions which primarily served to diminish outright harms which would be caused by the merger. The underlying merger clearly did not provide substantial affirmative benefits, and the conditions imposed by the PUC did not remedy the deficiency.

2. Joint Applicants failed to demonstrate net substantial public benefits.

Petitioners contend that substantial evidence did not exist in the record to support the Commission's determination to issue certificates of public convenience for this merger, and accordingly, the Commission erred in approving the merger.

2.(a) It was arbitrary for the Commission, after finding that sharing of quantifiable merger savings was necessary to meet the York test, to approve the merger despite Joint Applicants' failure to produce any quantification or distribution of savings or any other benefit that would enable the merger to meet the substantial benefits test.

In the hearing addressing the Joint Applicants' merger proposal, numerous parties, including Citizen Power and Clean Air Council, maintained that the Applicants had failed to show that the proposed merger would bring substantial affirmative net benefits to Pennsylvania, as required under City of York. *See, e.g.*, Citizen Power Main Brief at 12-47; R._____; Clean Air Council Main Brief at 12-20. The Applicants never conducted a study or analysis of the public benefits, if any, that the merger would create and that the record contains little more than Applicants' word that there would be benefits of some unspecified magnitude. *See id.* Among the particular arguments raised in opposition to the Joint Applicants' claims of benefit were that the Applicants did not offer substantial evidence that the merger will allow FirstEnergy to mitigate the costs and risks of GPU's procurement of power to provide POLR service. *See* Citizen Power Main Brief at 13-25; R.____. Even more important, it was noted that Applicants did not propose to share any of the \$150 million in annual savings that they estimated would accrue as a result of the merger. *See* Citizen Power Main Brief at 29-32; R.____, Clean Air Council Main Brief at 17; R.____.

In his Recommended Decision, the Administrative Law Judge correctly found

that the merger as proposed by the Joint Applicants did not meet the City of York substantial affirmative benefit test:

In my opinion, as proposed, the merger brings affirmative benefits to Pennsylvania consumers and Pennsylvania. But without the conditions I recommend below the merger does not bring *substantial*, affirmative benefits, City of York, Re: DOE, Inc., and it would not be in the public interest because it would introduce significant and unreasonable risks to Pennsylvania consumers.

Recommended Decision at 39; R. _____. (emphasis in original). One of the conditions that the Judge required for the merger to meet the substantial benefits test was sharing of merger savings with GPU customers. *See id.* at 62-63, 66. The mechanism that the Judge recommended for sharing such savings was an extension of the existing caps on the transmission and distribution (“T&D”) components of the rates of Met-Ed and Penelec.

Id. While endorsing the Judge’s conclusion that sharing of merger savings was appropriate, Citizen Power argued on exceptions that there was no record evidence that the mechanism that the Judge recommended, *i.e.*, extension of the T&D rate caps to 2007, would result in customers receiving savings as a result of the merger. *See* Citizen Power Exceptions at 17; R. _____. Met-Ed and Penelec would have no reason to file for a rate increase if they were already earning a reasonable return under the capped rates and no cost increases are expected. In fact, Mr. Thomas Caitlin, testifying on behalf of OCA in the POLR proceeding, concluded that Met-Ed and Penelec are currently *overearning* a reasonable rate of return on the companies’ T&D assets. *See* OCA St. No. 2-PLR; R._____.

In addition to its objection to the Judge’s extension of the T&D rate cap to share savings with customers, Citizen Power took exception to the Judge’s finding that customers would benefit from FirstEnergy’s purported ability to assist Met-Ed and

Penelec in mitigating their POLR supply costs. *See* Citizen Power Exceptions at 13-16; R. _____. Citizen Power demonstrated that the Joint Applicants had failed to show that customers would receive *any* POLR costs savings as a result of the merger. *See id.*; see also Citizen Power Main Brief at 13-25; R._____.

In its June 20, 2001 Merger Order the Commission reached conclusions consistent with the arguments of Citizen Power and Clean Air Council and it ordered the parties to address these issues in the collaborative:

:

“The record before us clearly demonstrates that the merger will provide significant benefits to shareholders. However, the record also demonstrates that a mechanism for passing merger savings through to ratepayers is necessary to ensure that the merger will not [sic] bring substantial, affirmative benefits, as required by City of York, *supra*.

We conclude that the lack of evidence regarding such issues as the specific role FirstEnergy will play in assisting the Companies, both monetarily and in terms of generation, in meeting their PLR responsibilities, and the quantification of merger savings that would flow to ratepayers makes it impossible, at this point, to approve the disposition of the merger savings. This lack of clarity is all the more pressing when we consider the alleged generation funding shortfall of which GPU Companies complain.

Accordingly, the disposition of merger savings will be addressed in the collaborative on rate cap issues and the Exceptions of the Parties in this regard are held in abeyance.”

Merger Order at 38; R. _____.

The Commission acted correctly in seeking an appropriate sharing of merger savings. Indeed, there is recent precedent at the Public Utility Commission for returning merger savings to ratepayers, a fact which the ALJ acknowledged.

“In Re: DQE, Inc., 88 Pa. PUC at 486 (1998) and Re: Duquesne, 89 Pa. PUC

at 72 (1998), the Commission required that the merger Applicants return 100% of the merger savings to ratepayers as a condition of the merger through the company's restructuring proceeding.”

Recommended Decision, p. 66; R ____.

The collaborative was dissolved without a comprehensive agreement, though ultimately a Settlement Stipulation that was supported by roughly a third of the active parties to the proceedings was produced. The Stipulation, however, failed to resolve the issue of how customers would receive savings from the merger. Nowhere in the Stipulation are merger savings quantified, nor is their disposition addressed. FirstEnergy and GPU make no commitment that savings will be passed on to, or will otherwise benefit, customers. Further, the Stipulation does not quantify the “role FirstEnergy will play in assisting the Companies, both monetarily and in terms of generation, in meeting their PLR responsibilities.” Merger Order at 38; R. ____.

The Commission approved the Settlement Stipulation without discussing either FirstEnergy's lack of commitment to mitigate Met-Ed and Penelec POLR costs, or the quantification or disposition of merger savings. Instead, the Commission offered two assertions, which taken together, do not resolve the issues it had set out.

First, as explained above, there is no clear evidence that freezing T&D rates for three more years is a benefit to customers at all, let alone one that is sufficient to establish that the merger meets the substantial benefits test under City of York. The Order claims, however, that customers will benefit from the rate cap extension because: “the additional three years of rate stability will allow the companies to perform long-term system planning, and enable the companies to implement coordinated system improvements, resulting in a safe and more reliable transmission and distribution system.” Stipulation

Order at 28-29; R.____. Petitioners disagree. The choice as to rates from 2005 through 2007 is simple: either they would be frozen, or the companies would have the flexibility to seek an increase should circumstances, e.g., costs, warrant. Clearly, long-term planning would be facilitated more by allowing the companies the flexibility to change rates than by freezing them. More than that, system improvements are more likely if the companies have the option to raise rates to pay for them, than if they cannot.

Second, the order now asserts that a T&D rate cap is a reasonable mechanism to address the issue of merger savings. Stipulation Order at 29; R.____. This is true if: (i) likely savings have been reliably estimated; and (ii) the cap freeze is, in fact, a benefit to customers. Neither condition was shown to be satisfied here. Savings have not been quantified, and it remains “impossible” to approve their disposition, according to the Commission’s own conclusion. Merger Order at 38; R. _____. Further, there is no evidence that the freeze benefits customers.

Accordingly, the Commission has approved a Settlement in the absence of substantial evidence that the Stipulation provides the benefits that the Judge and the Commission specifically stated were required to meet the City of York standard. Because the Commission’s order approving the merger is not based on substantial evidence, it must be reversed.

2.(b) Even assuming that the Commission had found that the conditions it had imposed would produce positive benefits to the public, it never examined whether those benefits would be offset by the merger-induced environmental and competitive harms Petitioners brought to its attention.

Even assuming that the rate freeze condition discussed in Section 2(a) above constituted a benefit to the public, the Commission could not rationally have found that

these benefits constituted substantial benefits without weighing them against the detrimental environmental and competitive impact of the merger outlined by Petitioners. The Commission adopted the Recommended Decision of the Administrative Law Judge (ALJ) regarding environmental issues in which it was claimed that the “record does not support a finding that the merger will benefit or harm the environment.” Recommended Decision, at 93; R. _____. In so doing, the Commission ignored substantial record evidence of adverse consequences to Pennsylvania air quality which will result from the merger. Despite the ALJ’s view, there is, in fact, a direct nexus between the merger and these adverse consequences.

The record is clear that FirstEnergy intends to run certain of its coal-fired power plants at a higher capacity factor to provide a portion of GPU’s POLR obligation. Joint Applicant witness Robert Kaiser testified that a 5% increase could be expected from the FirstEnergy Bruce Mansfield generating station in Northwest Pennsylvania and the W.H. Sammis generating station in Ohio very close to the Pennsylvania border. *See* Tr. at 1082; R._____. Sammis emits air pollutants at high rates. Sulfur dioxide, for example, is emitted at a rate five to six times the U. S. Environmental Protection Agency New Source Performance Standard for a coal-fired power plant. Tr. at 1119; R._____. Joint Applicants produced a chart in discovery detailing air pollution output and performance of FirstEnergy plants from which Mr. Kaiser’s testimony on this point was drawn. *See* CAC Crs. Exh. 4; R._____. A five (5%) percent increase in the capacity factor will result in the emission of thousands of tons of additional pollutants. (CAC Main Brief, p. 13-14) Such an increase can only exacerbate ozone smog, acid rain, and mercury contamination problems in the Commonwealth. (For record evidence that air pollution is

transported from Ohio into Pennsylvania See Clean Air Council St. 1, p. 4; R.____.)

This outcome is a serious detriment to the public, since power plant air pollution is known to cause premature death and other major health impacts in Pennsylvania. See Clean Air Council St. 1, at p. 4; R.____.

The Commission cannot avoid the issue by declaring there is no connection between the merger and environmental consequences, because, in fact, the merger will directly cause the environmental impacts Petitioners allege. The Commission is charged with the legal responsibility of finding net substantial benefits to the public prior to approval of the merger, and this analysis involves weighing all the impacts of the merger as they affect all parties. Middletown Twp., 85 Pa. Cmwlth. at 202, 482 A.2d at 682. Therefore, to the extent that the Commission abdicates its duty to consider the environmental impacts in this analysis, it commits an error of law. The Commission has improperly characterized the evidence of environmental impact. It is arbitrary and capricious for the Commission to dismiss solid, record evidence of increased air pollution when assessing a merger detriment where it simultaneously accepts claims of alleged merger benefits which appear to be little more than speculation, such as enhanced combined capabilities in a changing industry; extension of T & D rate caps. Merger Order at 17-18; R. _____, and at 68; R. _____; Recommended Decision at 62-63; R. _____.

The Commission's authority to determine whether a Certificate of Public Convenience is necessary or proper is broad and clearly encompasses environmental effects of the issuance of the Certificate as they impact the public safety. Indeed, the Pennsylvania Constitution, which the Commission must uphold, sets forth the public's

right to clean air and clean water. (PA. CONST. Art. 1, §27) It is incumbent upon the Commission to make decisions on public safety which are informed by that Constitutional right.

The manner in which both the ALJ's Recommended Decision and the Commission's Merger Order treated environmental aspects of the merger analysis unreasonably entangled issues which need to be considered independently. It must be recognized that there is a distinction between considering the adverse environmental impact of the merger in determining whether the City of York standard is met and the affirmative act of redressing those impacts through the imposition of conditions under §1103(a) of the Public Utility Code. Due to the uncertainty created by the Commission's Orders regarding its obligation to consider environmental impacts, clarification is needed.

This matter should be remanded to the Commission with instructions that it possesses jurisdiction to address environmental impacts in its determination upon an Application for the issuance of Certificates of Public Convenience. The Commission should be further instructed that substantial evidence of environmental harm from the merger is in the record and that the merger, on balance with other benefits and detriments shown, therefore fails to meet the City of York standard of substantial affirmative public benefits.

Similarly, the Commission failed to weigh the alleged rate freeze benefit against the harm to competition resulting from the merger. As discussed further herein, it is undisputed that the merger eliminates a retail competitor. Moreover, the Applicants never undertook an analysis to demonstrate that the loss of this retail competition would not be anticompetitive. In such circumstances, the Commission's failure to analyze

Petitioners' environmental and competitive claims disabled it from conducting the analysis of net public benefits logically required to support a conclusion that the merger would meet the statutory standard.

3. The Commission erred by claiming it did not have authority to condition merger approval on redressing of environmental impacts of the merger.

The Commission's finding that it did not have the requisite authority to condition the merger on the Applicants mitigating the environmental risks overlooks the Commission's broad discretion under 66 Pa. C.S. § 1103(a) to condition certificates, and, in fact, ignores the Commission's own interpretation of its authority concerning imposition of merger conditions.

In this regard, the courts have held that where a regulatory agency has the power to *deny* a certificate as inconsistent with the public interest, the agency also has the power to condition the certificate to remedy the aspects of the proposal inconsistent with the public interest. The Supreme Court has held that "as a general rule, the state, having power to deny a privilege altogether, may grant it upon such conditions as it sees fit to impose," subject to the qualification, not pertinent here, "that it may not impose conditions which require the relinquishment of constitutional rights." Frost v. Railroad Comm'n, 271 U.S. 583, 593 (1926); *see also*, American Liberty Oil Co. v. Federal Power Comm'n, 301 F.2d 15, 19 (5th Cir. 1962); Utah Power & Light Co., 45 FERC ¶ 61,095 at 61,280 (1988).

The Commission itself encapsulates the basic rule in this passage:

If a merger applicant fails to satisfy the public interest standard, the merger as proposed must be denied. However, under Section 1103(a) of the Code, outlined above, the Commission may choose to cure the deficiencies of the

proposed merger by applying conditions to the merger. The alternative to applying such conditions is denial of the proposed merger. In short, applicants for a merger are given a choice. They may agree to the conditions the Commission determines to be necessary for the public interest, or they may refuse to accept those conditions, upon which the merger will be denied.

Merger Order at 17, R. _____.

The FERC described the authority to condition with substantial clarity: “the power to condition approval is fairly subsumed within the broader power to disapprove.” Utah Power & Light Co., 45 FERC at 61,280. The same reasoning applies in this case. Having found that Intervenors had raised legitimate environmental concerns about the merger, the Commission was entitled to reject the merger on the grounds that granting the certificate in the face of such environmental concerns was not in the public interest. It is clear that “fairly subsumed within the broader power to disapprove” the merger was the power to apply conditions to remedy the problems, including environmental problems, raised by the merger.

Notwithstanding this broad power, the courts have specifically held that certificates of public convenience could be granted by the Commission upon condition that certain environmental harms be addressed. For instance, in Rheems Water Co. v. Pa. PUC, 153 Pa. Cmwlth. 49, 620 A.2d 609 (1993), the Commission conditioned the granting of a certificate to a water utility upon a requirement that it reduce nitrogen nitrates.

Air quality is referenced by the Competition Act itself (66 Pa.C.S. §2802(21)) as an issue of concern for the Commission, as is the continued promotion of environmentally beneficial energy conservation programs (66 Pa.C.S. §2802(17)), which the Act defines to include renewable resources such as wind power and solar power. 66

Pa.C.S. §2803. The Commission has accepted this interpretation of its jurisdiction and sets standards for renewable energy pilot programs within the universal service and conservation obligations of electric distribution companies, such as GPU. Furthermore, the Commission's own regulations at 52 Pa. Code, Chapter 69 discuss Commission input into air pollution control issues for coal fired power plants. The Commission is involved at the level of providing approval of compliance plans for utilities for pollution trading. *See* 52 Pa. Code §69.293 (1993), (Regulatory oversight of emission allowance trading).

As indicated above, the Commission has the authority to impose conditions to mitigate the harms caused by a merger so long as those harms are connected to the merger, regardless of whether the conditions pertain to utility service matters or are jurisdictional for the Commission. It is not necessary to look any further than the Commission's Order in this very case for evidence of the same. The Commission imposed merger conditions that FirstEnergy maintain current levels of charitable, community support and "an appropriate level of management employees" in Pennsylvania. *See* Merger Order at 59; R. _____. The Commission also conditioned the merger on FirstEnergy's agreement to obtain Commission authorization prior to removing transmission facilities from the operational control of the PJM Interconnection, LLC, an independent system operator to which pre-merger FirstEnergy does not belong. *See* Merger Order at 82 (16b); R. _____.

Therefore, the imposition of conditions which offset the anticipated environmental harms of this merger are within the Commission's jurisdiction just as surely as the conditions referenced above, or those which would redress an adverse impact to universal service programs or fairness in competition. As an example, Clean

Air Council argued that a commitment of \$10 million for wind production grants which would result in several dozen megawatts of clean, renewable wind energy in Pennsylvania would act as a reasonable counterbalance to the increased emissions from the FirstEnergy plants and perhaps make those emissions unnecessary. The condition would merely establish a desirable use for a small portion of merger savings. There is nothing inherently different about such a condition than the commitment to place several million dollars into the creation of a Sustainable Energy Fund (SEF) in GPU's Met-Ed and Penelec territories to promote renewable energy and conservation. Indeed, that very commitment became part of the Restructuring Settlement, was approved by the Commission and is monitored by a Commission which additionally seeks to establish a statewide SEF. *See* Joint Petition for Settlement, p. 49-50, Paragraph H.5; R. _____. GPU, Inc. entered the agreement and did not appeal the creation of the SEF. Therefore, neither the Commission nor GPU can be heard now to argue that the directing of funds into sustainable energy programs which will result in more renewable energy is beyond Commission jurisdiction.

The Court should instruct the Commission that it does have the authority to place just and reasonable conditions upon the issuance of a Certificate of Public Convenience to address adverse environmental effects caused thereby.

B. The Commission erred by approving the merger between GPU and FirstEnergy despite the Applicants' failure to show by substantial evidence that the merger is not likely to adversely affect competition in retail markets in violation of Section 2811(e) of the Competition Act.

1. Introduction

By deregulating the retail price of electric generation, the 1996 Competition Act relies on effective competition in the marketplace to protect customers against the exercise of market power by suppliers. Thus, when considering a proposed merger, it is particularly important for the Commission to evaluate whether the merger is likely to adversely affect competition. In this regard, Section 2811(e) of the Competition Act specifically requires the Commission to determine whether a proposed merger “is likely to result in anticompetitive or discriminatory conduct, including the unlawful exercise of market power, which will prevent retail electricity customers in this commonwealth from obtaining the benefits of a properly functioning and workable competitive retail electricity market” 66 Pa. C.S. § 2811(e)(2). If the Commission finds that the merger is likely to result in such conduct detrimental to the development of the competitive retail market, the Commission “shall not approve such proposed merger . . . except upon such terms and conditions as it finds necessary to preserve the benefits of a properly functioning and workable competitive retail electricity market.” *Id.*

In this case, the Joint Applicants acknowledged that the proposed merger of FirstEnergy and GPU could raise several potential competitive problems. *See* App. St. 4 at 9-13; R._____. Most notably, both GPU and FirstEnergy have subsidiaries that compete with one another to supply electricity to retail customers in Pennsylvania. Tr. at 573; R._____. Thus, as Applicants acknowledged, the merger would eliminate competition between the retail supply subsidiaries of the two merging companies. *See* App. St. 4 at 10; R._____; Tr. 573; R._____.

2. The lack of evidence adduced by the Joint Applicants

The only evidence that the Joint Applicants offered to meet their burden under Section 2811(e) was the testimony of Mr. Rodney M. Frame. *See* App. St. 4; R._____. The primary focus of Mr. Frame’s testimony was a lengthy competitive analysis lifted from his testimony at the FERC. That analysis focused exclusively on the effect of the merger on competition in the *wholesale* markets supplying electricity to Pennsylvania.¹ *See* App. St. 4 at 4-11; R._____. His conclusion was that the merger “will not adversely affect competition in wholesale electricity markets within PJM.”² App. St. 4 at 7; R._____.

As the plain language of Section 2811(e) makes clear, however, the Commission is required to find that a proposed merger will not adversely affect “a properly functioning and workable competitive *retail* electricity market.” 66 Pa. C.S. § 2811(e) (2) (emphasis added). On this issue, Mr. Frame admitted that, in contrast to his lengthy “Appendix A” study of wholesale markets, he did not even examine, let alone analyze, the potential effect of the merger on competition in the relevant retail electricity markets. *See* Tr. at 621; R._____. In lieu of an analysis of retail markets, Mr. Frame merely offered several general observations about why he believed that the merger would be unlikely to result in anticompetitive conduct in the retail markets: (i) the purported existence of robust competition in the wholesale markets; (ii) the purported existence of numerous potential, as opposed to actual, competitive retail suppliers; and (iii) the

¹ *See* App. St. 4 at Ex. APP-300; R._____. The study is an “Appendix A” Competitive Analysis, named for Appendix A to FERC’s Merger Policy Statement. *See Inquiry Concerning the Commission’s Merger Policy Under the Federal Power Act*, 77 FERC (CCH) ¶ 61,263 (1996). Generally speaking, the Appendix A analysis measures the competitive impact of a merger in relevant product and geographic markets by using the Herfindahl-Hirschmann Index or “HHI.” *See* App. St. 4 at 6; R._____.

² “PJM” is shorthand for the electric control area operated by the PJM Interconnection LLC and covering all or parts of Pennsylvania, New Jersey, Maryland, Delaware, Virginia, and the District of Columbia. *See generally* App. St. 4 at 5; R._____.

continuation of caps on the generation component of Met-Ed and Penelec rates. *See* App. St. 4 at 8-11; R._____; Tr. at 617; R._____.

Each of these observations was thoroughly discredited on the record. Thus, Mr. Frame’s testimony--the only witness offered by the Applicants on this issue--cannot constitute substantial evidence from which the Commission could make a reasoned finding under Section 2811(e) that the proposed merger is unlikely to result in anticompetitive or discriminatory conduct, which will prevent *retail* electricity customers from obtaining the benefits of a properly functioning and workable competitive *retail* electricity market.

- 2(a) The Commission rejected the Joint Applicants’ position regarding the “Most Important Factor” for ensuring retail competition – the existence of a competitive wholesale market.

Mr. Frame observed that, in his view, “the most important factor for maintaining competitive retail markets is ensuring that retailing entities are able to procure the wholesale supplies that they need to resell to customers in markets that are characterized by an absence of market power.” App. St. 4 at 9; R._____. Pointing to his analysis of the PJM markets, he concluded that “there should be no concerns about market power being exercised in wholesale electricity markets within PJM either before or after the FirstEnergy-GPU merger.” *Id.*

Mr. Frame did, however, acknowledge that other witnesses for the Applicants in the POLR proceeding took the *opposite* position by arguing that PJM markets were not competitive. *See* Tr. at 611-12; R._____. As part of their efforts to portray their increased POLR costs as beyond their control, Mr. Charles A. Mascari, Vice President – Technical Services for GPU Energy, argued that “market power exists and is being

exercised opportunistically” in PJM wholesale markets. MetEd/Penelec St. 1-PLR at 19; R._____; App. Reb. St. 5 at 14; R._____.

The Presiding Administrative Law Judge agreed with Mr. Mascari, implicitly rejecting Mr. Frame’s contention that the wholesale markets supplying GPU were workably competitive. *See* Recommended Decision at 126; R._____. Incredibly, the Judge nevertheless concluded, without explanation, or reference to any evidence, that “Applicants have shown that the merger is not likely to result in anticompetitive or discriminatory conduct or the unlawful exercise of market power.”³ Recommended Decision at 102; R._____. The Judge reached this “conclusion” despite his acknowledgment of Citizen Power’s argument that “Mr. Frame had no basis to determine whether the loss of FirstEnergy as a retail competitor was significant or not.” *Id.* at 101.

In its order approving the merger, the Commission references only the Judge’s unsupported finding that the merger is unlikely to result in anticompetitive conduct. Merger Order at 74; R._____. The order simply concludes, also without explanation, that “the merger does not foster anticompetitive conduct.” *Id.* The Commission does not reference any evidence that supports its “conclusion.” In fact, the Commission does not even identify which markets it is referring to when it says that the merger will not foster anticompetitive conduct, nor does the Commission make any attempt to explain its finding

³ The Presiding Judge appears to have concluded that application of the GPU “Code of Conduct” would ameliorate most anticompetitive concerns. *See* Recommended Decision at 102; R._____. Reliance on the code of conduct, however, fails to address the objections raised by Citizen Power, which have to do largely with *horizontal* competitive concerns created by the merger. The Code of Conduct is intended as a protection against *vertical* anticompetitive problems, *i.e.*, to ensure that the company does not favor its affiliates. Not even the Applicants suggested that GPU’s code of conduct had anything to do with the horizontal competitive effects of the merger, which related, *as the Applicants themselves recognized*, to the elimination of FirstEnergy’s marketing arm as a competitor of GPU. Applicants St. 4 at 10; R._____.

of no adverse affects in the retail market in the context of the ALJ's finding, which it adopts, that the wholesale market is not competitive.

Thus, to the extent that the Commission's finding under Section 2811(e) was premised on Joint Applicants' central contention that a workably competitive wholesale market exists, such conclusion must be reversed.

2(b) The purported existence of current or potential competitive retail suppliers that would act to restrain prices was not proven, and, in fact, the evidence is to the contrary.

Even accepting the proposition that the relevant *wholesale* markets are characterized by the absence of market power, the Applicants did not show, and the Commission could not have found, that the merger is unlikely to adversely affect competitive *retail* markets. Mr. Frame acknowledged that, even if wholesale markets are competitive, the public interest can be thwarted if a few sellers with market power can control retail markets. *See* Applicants St. 4 at 10; R.____; Tr. at 617; R.____. If a few suppliers can exert market power over prices, they can capture the benefits of competitive wholesale rates as lower costs, while charging prices above competitive levels at retail. Mr. Frame acknowledged this point. He explained that, even assuming the existence of competitive wholesale markets, the merger could still have an adverse effect on retail prices. Applicants St. 4 at 10; Tr. at 624. It is therefore clear that, to meet the statutory standard, retail markets must be studied to evaluate the merger's effect on competition.

In studying retail markets, it is clear that the fewer the number of competitors in the market to begin with, the greater the danger of competitive harm when another competitor drops out of the market. In this case, the merger between FirstEnergy and GPU would mean that the Joint Applicants' respective retail marketing affiliates, FirstEnergy Services and GPU Advanced Resources, would no longer compete with one

another. *See* Tr. at 573; R._____. Thus, as the Joint Applicants themselves acknowledged, it is necessary to determine whether the loss of competition between FirstEnergy and GPU retail suppliers reduces retail competition by “too much.” App. St. 4 at 10; R._____.

Mr. Frame admitted, however, that he never even looked at, let alone analyzed, the merger’s effect on, retail markets. He never defined those markets, and, as one consequence, he had no idea how many suppliers now offer or have offered power in those markets.

Instead, in his direct testimony, Mr. Frame merely made general statements about the number of licensees in some unspecified market: “there are more than 50 electricity retailers that now have been licensed by the Commission. The loss of one independent supplier does not seem particularly important when so many others remain.” App. St. 4 at 10; R._____. On cross-examination, however, Mr. Frame acknowledged that, of the fifty suppliers licensed by the Commission, only about half of this number have actually been licensed as electric suppliers in the GPU Energy service territory. Tr. at 618-19; R._____. More importantly, Mr. Frame conceded that he did not attempt to ascertain how many of these licensed retail suppliers are making price offers or actually supplying retail power in the GPU Energy service territory. Tr. at 572, 619; R._____. In other words, Mr. Frame had no knowledge of whether there are or ever have been *any* competitive suppliers in the relevant retail markets. *See* Tr. at 619.

In the face of this admission, Mr. Frame asserted that his ignorance about sellers was unimportant: “I don’t know how many were still selling, and it just doesn’t matter.” Tr. at 619-620; R._____. Mr. Frame explained for the first time on cross-examination

that “a market can have perfectly competitive results, and there can be only one supplier in the market, so long as when that supplier stubs his toe, others can quickly jump in.” Tr. at 617; R._____. In their Brief to the Presiding Judge, the Joint Applicants cited this testimony and asserted that “even in a market without many active alternative suppliers, if there are low barriers to entry and many potential participants, the market may still be considered competitive.” Main Brief of Joint Applicants and Joint Petitioners at 38; R. _____. Thus, Joint Applicants argued that those customers who buy from a monopolist may still see “perfectly competitive” prices because of the pressure exerted by the *potential* entry of other suppliers. Such entry, it is argued, would swiftly and surely occur should that monopolist try to exert its market power to raise prices above competitive levels.

The assertion that a highly concentrated market without many active alternative suppliers *may* be considered competitive if there are low barriers to entry and many potential participants was simply made by the Applicants in the abstract. *See* App.Main Brief at 38; R._____. Applicants never made the claim, let alone introduced substantial evidence, that *Pennsylvania retail markets at issue here* are in fact characterized by low barriers to entry and many potential participants. As such, an abstract assertion unsupported by evidence, is worthless and is entitled to be given no weight when considering the effects of the merger.

Moreover, the record shows that the lack of actual competitive retail suppliers is not a hypothetical problem. Met-Ed and Penelec themselves argued in this proceeding that there had been a “mass exodus of alternative suppliers from the GPU Energy market.” Reply Brief on Behalf of Joint Applicants and Petitioners at 35; R._____.

Further, for the Met-Ed service territory, unrebutted testimony established that there were no suppliers offering power to residential customers at or below GPU's price to compare as of January 1, 2001.⁴ Nor did Applicants presented any evidence that competition was any more robust in the Penelec territory. *See* Mangione St. 1 at 11 and Exh. BM-3; R._____.

Without inquiring as to the number of existing or potential retail suppliers in the market, neither Mr. Frame nor the Commission had any basis to conclude whether the loss of FirstEnergy as a retail competitor was significant or not. Thus, Applicants failed to carry their burden to show that the loss of a competitive retail supplier as a result of the proposed merger will not reduce retail competition by "too much," and the Commission erred in finding that such burden had been met.

c. Reliance on generation rate caps is misplaced.

The Applicants also suggested that the Commission need not be concerned with adverse competitive effects of the merger because existing generation price caps protect customers from the exercise of market power. *See* App. St. 4 at 11; R._____. The Applicants' reliance on generation price caps is misplaced because the existence of rate caps says nothing about whether the merger is likely to result in anticompetitive conduct in the retail markets, the standard under Section 2811(e). Price caps merely shield customers from the adverse *effects* of anticompetitive conduct. Indeed, if there were no retail market power concerns, a price cap would be superfluous. Further, price caps are

⁴ Moreover, the testimony explained that there was only one alternative supplier offering power to Met-Ed residential customers at any price.

temporary, and Mr. Frame acknowledged that he did not perform an analysis of the effect on retail ratepayers when price caps were removed. *See* Tr. at 627-33; R._____.

3. Conclusion

The Competition Act requires the Applicants to show that the merger is not likely to harm retail competition. Applicants' witness Mr. Frame, however, offered no such evidence, and in fact, did not even study the relevant markets. He admitted that he knows nothing about the level of competition, currently or in the recent past, in those markets, including how many, if any, suppliers compete, or have competed, there. Mr. Frame concluded the PJM *wholesale* markets are competitive, though he admitted such a conclusion was not dispositive, since, even if he were correct, it would not establish that retail markets were also competitive. Even so, in the course of his Recommended Decision in the POLR case, the Presiding Judge found that PJM wholesale markets are not competitive, and the Commission's order adopted this position. When confronted with Applicants' lack of evidence on retail competition, Mr. Frame tried to claim "potential" competitors would restrain prices, even in the absence of actual competitors. But he offered no evidence for this claim, and the recent sharp rise in wholesale prices belie his conjecture. Finally, Mr. Frame's claims about price cap protections are simply irrelevant to the analysis of the merger's likely effects on retail competition.

Yet, given the complete absence of any supporting evidence, the Presiding Judge and the Commission nevertheless assert, without elaboration, that the merger would not be likely to harm retail competition. These "findings" are, to say the least, baseless, and, given the lack of substantial evidence to support them, the Commission's finding that the

Applicants had met their burden under Section 2811(e) was unsupported and must be reversed.

C. The Commission erred through its Stipulation Order, violating due process requirements of the Administrative Agency Law (2 Pa. C.S.A. §504), Art. I, §1 of the Pennsylvania Constitution, and the 5th and 14th Amendments to the U.S. Constitution, and abused its discretion by substantially abrogating the Restructuring Settlement of 1998, as adopted by the Commission.

1. Without consent of the parties to an agreement, the Commission violates the principles of contract law and the Pennsylvania Constitutional prohibition on ex post facto law by altering the terms of that agreement.

The Pennsylvania Supreme Court has stated: “The enforceability of settlement agreements is governed by principles of contract law.” Mazella v. Koken, 559 Pa. 216, 224, 739 A.2d 531, 536 (1999). Under the common law, no modification of a contract can be made without the consent of those who were parties to that contract. See Texas Energy Fuels Corp. v. PEMCO Supply Co., 640 F.Supp. 2, 5 (M.D. Pa. 1985) (citing Clarkson v. Crawford, 285 Pa. 299, 132 A. 350 (1926)). The Pennsylvania Supreme Court is clear on this point: “[A] contract, once made, cannot be altered or changed without the consent of both parties.” Clarkson, 285 Pa. 299, 304, 132 A. 350, 351.

What parties to a contract cannot unilaterally do under the common law, the state cannot do under the Pennsylvania Constitution. See Harristown Development Corp. v. Pa. Dep’t of Gen. Svcs., 580 A.2d 1174 (Pa. Cmwlth. 1990), *rev’d on other grounds*, 532 Pa. 45, 614 A.2d 1128 (1992). “No ex post facto law, nor any law impairing the obligation of contracts ... shall be passed.” PA. CONST. Art I, § 17. Courts have

applied this provision not only to actions of the General Assembly but to agencies, like the PUC, as well. See AT&T v. PA. PUC, 709 A.2d 980 (Pa. Cmwlth. 1998), *rev'd on other grounds*, 518 Pa. 290, 737 A.2d 201 (1999). “[A] government agency does not have the authority to abrogate or reform contracts between private parties because that would be an *ex post facto* impairment of a contractual obligation that was entered into through arms-length negotiations by the parties.” *Id.* at 985 (citing Harristown, 580 A.2d. 1174).

The contested Settlement approved by the Commission unlawfully makes a number of significant changes to the Restructuring Settlement without Clean Air Council’s consent. The common law holds that these changes are unenforceable. The fact that these changes have been approved by the PUC is of no moment, because such agency-approved reformations or abrogations of the Restructuring Settlement are unconstitutional *ex post facto* impairments of contractual obligations. Therefore, under both the common law of Pennsylvania and the Pennsylvania Constitution, the Stipulated Order must be rejected.

2. The Stipulation Order significantly Reduces Restructuring Settlement-established GPU financial commitments to the Sustainable Energy Fund without a demonstration that such action is reasonable.

The Sustainable Energy Fund was set up to provide an initial lump sum in each of Met-Ed and Penelec territories to an Advisory Board which would administer the fund and select projects to build or promote renewable energy. In 2005, an annual disbursement was scheduled to resume.

“Beginning January 1, 2005, the fund shall be funded from the 2.57 (Met-Ed) and 2.50 (Penelec) cents per KWH transmission and distribution rates at .01

cents per KWH for each Company (less applicable gross receipts tax) on all KWH sold after that date, unless the Commission establishes new distribution rates.” (Restructuring Settlement, para. H.5)

The Commission has approved an extension of those rates through 2007 in this Stipulation Order. Despite this clear obligation to fund the Sustainable Energy Fund, the companies have, through the Settlement Stipulation, effectively eliminated three years of funding, and replaced it with a substantially reduced lump sum. Based on the companies’ own predictions for annual T&D KWH sales in the years 2005-2007 (1998 Joint Petition For Settlement, Appendices A and B (Summary of unbundled rates and CTC revenues); R. ____.) the fund would have been due to receive \$8.5 million. Paragraph 7 of Attachment A of the Settlement Stipulation, provides \$5 million to the fund in lieu of the 2005-2007 obligation, representing a net loss to the Sustainable Energy Fund of \$3.5 million.

Clean Air Council is a signatory to the 1998 Restructuring Settlement which established the Fund, and specifically negotiated for its creation. Since the Fund provides important seed money for renewable energy projects, a reduction in the allocation is anticipated to be detrimental to environmental progress. The Council did not consent to the abrogation of the Commission-approved Settlement in this manner and views it as a contractual violation. Furthermore, the Stipulation’s provision of replacement funding, ostensibly for environmentally beneficial projects, is in no way equivalent and is completely unacceptable since that funding remains within the exclusive control of the merged company. *See* Stipulation, Paragraph 7; R. ____.

3. ____ The Stipulation Order eliminates the GENCO Code of Conduct with no demonstration such action is reasonable.

The Commission-approved Settlement Stipulation eliminates the GENCO Code of Conduct. The purpose of the Code, established in the 1998 Restructuring Settlement, was to prevent GPU affiliates from favoring each other through cross-subsidization in market transactions. In this way, fair competition is protected, and customers benefit in the form of lower prices.

The Commission attempts to justify the elimination of the Code of Conduct by defining its “overall objectives” as that of minimizing excess POLR costs to GPU. *See* Stipulation Order at 24; R. _____. This is logically unsupportable. It is the Code itself, not its elimination, which helps minimize POLR costs by preventing sweetheart deals between affiliates. When pursued at the expense of competitive safeguards like the Code, the Commission-identified “overall objectives” are not consistent with the Competition Act, which the Commission is charged with implementing and enforcing. The Commission’s action is more akin to dismantling that law. The Commission’s explanation here is five lines long and offers no support for elimination of this important component of the 1998 Restructuring Settlement. Nor did the Commission rely on the Settlement document for a reasonable explanation. The Settlement Stipulation itself is likewise devoid of any rationale for the removal of the Code of Conduct. It is evident that the Commission’s decision was not based on substantial record evidence. Consequently, the Order of the Commission must be reversed and remanded with instructions to restore the GENCO Code of Conduct.

4. The Stipulation Order violates the 1998 Restructuring Settlement by unlawfully permitting money contractually obligated to be paid to non-utility generators (“NUGS”) to be used to pay POLR and non-NUG stranded costs.

The Commission's approval of the Settlement Stipulation also improperly modified the Restructuring Settlement provisions addressing NUG cost recovery. In this regard, the Commission readily admits that the Settlement Stipulation "amends the 1998 Restructuring Settlement as to use of the NUG Trust Funds." Stipulation Order at 32; R._____. Not only did the NUGs and other parties to the Settlement, including Clean Air Council, not consent to this and other modifications, such modifications were vigorously opposed. *See* Response of ARIPPA to the Settlement Stipulation at 13-32; R._____.

The Commission attempted to minimize the significance of its involuntary modification of the Restructuring Settlement by asserting that "the amendment [allowing POLR costs to be paid from NUG Trust Funds] does not place the NUGs in a less secure position than they were under the Restructuring Agreement." Stipulation Order at 33; R._____. The Commission also observes that the existing NUG contracts remain unchanged and that Met-Ed and Penelec are not relieved of their duty to perform under the contracts. Id.

First, the Commission is wrong to say that the NUGs are not in a less secure position now than they were under the Restructuring Settlement. Various aspects of the Restructuring Settlement worked together to provide the NUGs a high degree of certainty in cost recovery. In particular, the Restructuring Settlement provided that Met-Ed and Penelec would establish and maintain separate NUG "Trust Funds" into which the Companies were to place any remaining net proceeds from the divestiture of generating plants plus over-recoveries, if any, of the NUG stranded costs that were received from CTC revenues. As stated in the Restructuring Settlement, "[t]he primary purpose of these separate NUG Trusts is to ensure an actual source of cash from which the Companies can

pay their respective on-going NUG obligations under existing NUG power purchase contracts.” Restructuring Settlement at 18-20, Paragraph C.9; R. _____.

On its face, the Settlement Stipulation alters the Restructuring Settlement in ways that, all else being equal, reduce the certainty of recovery of NUG cost recovery. In this regard, the Settlement Stipulation permits the amounts in the NUG Trust Funds to be applied to ongoing NUG costs as opposed to NUG “stranded” or above-market costs. Settlement Stipulation at Paragraph 3; R._____. The Stipulation also lowers the CTC rate and shortens by five years the existing term of the recovery plan during which the CTC is to be collected.

Most importantly, the Settlement Stipulation allows CTC revenues to be used to pay POLR costs, while NUG stranded costs are deferred for later recovery, possibly until after 2010. Taken together, these modifications increase the risk that the NUG Trust Funds and CTC revenues will be inadequate to recover NUG stranded costs, or that recovery will be deferred so significantly as to financially harm the NUGs.

Second, the observation that the obligations of Met-Ed and Penelec under the *contracts* are unchanged is a non-sequitur. The NUG contracts remain unchanged, but the agreement among the parties and approved by the Commission as to how the costs to be charged under the contracts are to be recovered from customers has clearly been changed to the detriment of the NUGs.

Once again, the salient point is that the parties to the Restructuring Settlement negotiated specific and interdependent mechanisms that would provide the surety in cost recovery necessary for the NUGs to support the Restructuring Settlement. The

Commission may not simply approve modifications to those procedures without the consent of the parties.

5. The Stipulation Order effectively eliminates Competitive Default Supply (CDS) provisions of the Restructuring Settlement by: providing FirstEnergy the exclusive right to decide whether it will be implemented; allowing FirstEnergy affiliates to participate in derogation of the Restructuring Settlement, and removing the renewable portfolio standard of the CDS provisions without a demonstration that such action is reasonable.

Competitive Default Supply is a program established by the Restructuring Settlement for the purpose of ensuring that monopoly conditions in the retail market would be diminished after the commencement of full competition in the GPU service territories by attempting to increase the number of competitive suppliers. Qualified suppliers would make bids to receive randomly selected blocks of customers who had not affirmatively chosen to shop for a generation supplier. Customers who had never chosen to switch or who had been dropped by their supplier currently receive service from the incumbent EDC, which is considered the “provider of last resort” until the end of the electric competition transition period. A supplier selected in the CDS auction would stand in as “provider of last resort” in place of the EDC for that block of customers. Twenty (20%) percent of GPU’s retail customers were to have been re-assigned in this way in mid-year 2000, with additional percentages in each subsequent year.

Therefore, it would be highly inadvisable to allow the CDS program to be eviscerated in the manner authorized by the Commission in its Stipulation Order. First, it allows that the CDS program should only re-commence at FirstEnergy’s option. It is difficult to envision the scenario under which FirstEnergy would volunteer to give up a significant percentage of its market share, particularly if it is allowed to defer its excess

POLR costs under the Stipulation. Second, if for some reason, FirstEnergy sees an advantage to conducting the CDS auction again, the Stipulation allows its own generation affiliates to participate. Such a ridiculous arrangement was prohibited under the Restructuring Settlement for an obvious reason: it completely defeats the purpose of having a CDS system, which is to break up *de facto* monopoly conditions. Lastly, it is expected that since a FirstEnergy CDS program would be run “in a manner and under terms offered by FirstEnergy” (Settlement Stipulation paragraph 6), that the .2% renewable energy portfolio standard required of qualified suppliers by the Restructuring Settlement (Paragraph F5; R. _____.) would not be maintained. This total could amount to a modest-sized wind farm at a minimum with megawatts added as the years pass. Clean Air Council is a signatory to the Restructuring Settlement of 1998 and specifically negotiated to achieve a level of renewable energy in the supply of companies which obtain customers through CDS. The Council does not support this elimination and views such an abrogation of an existing, Commission-approved Settlement as a contractual violation. As it approves the dismantling of CDS, the Commission offers the cold comfort that parties are not precluded from “petitioning the Commission for approval of a program that results in having an alternative supplier provide POLR service to GPU customers.” Stipulation Order at 27-28; R. _____. Such an invitation does nothing to alter the fundamental unreasonableness of the Commission’s decision. The Council and Citizen Power contend that the Commission’s action in this regard is not in the public interest, was taken without substantial evidence in the record to support it, and is an abuse of discretion.

6. Even assuming the Commission had the Authority to Make Non-Consensual

Changes to the 1998 Restructuring Settlement, it could not do so without adequate notice to parties to that agreement. By allowing only one and one-half days to comment upon a complex Settlement Stipulation containing many facts not in the record, the Commission abused its discretion.

It is a matter of statutory and constitutional law that due process must be afforded by PUC adjudications. 2 Pa. C.S. §504, Clark v. Pa. DPW, 427 A.2d 712 (Pa. Cmwlth. 1980). Even assuming the Commission had the authority to abrogate a 1998 settlement agreement over the objections of signatories--which it does not--it was required to afford affected parties a reasonable opportunity to be heard. In this context, the Commission has acted to partially unravel a meticulously crafted, highly complex, bargained-for universal agreement among parties to GPU's Restructuring Plan. It was reasonable to conclude that a Settlement encouraged and approved by the Commission little more than two years prior would not be jeopardized by the cases now before the Commission.

An effort to solicit comment on the June 11, 2001 filed Settlement Stipulation was made by the Commission. For those participants in the current cases who would have received email, the correspondence sent after close of business on the 11th meant effective receipt on the morning of the 12th. In effect, participants in the merger and petition cases received 27 hours with which to respond to the Commission's solicitation of comment. Although it is difficult to conceive of such a time frame as adequate for due process purposes, the task becomes impossible when considering that several significant items in the Stipulation were not of record during the discovery phase and evidentiary hearings of the proceedings and thus the concepts therein contained were not explored and challenged to allow an appropriate response to be formulated.

Furthermore, the Commission's defense in the Stipulation Order that the parties actually had several weeks to assess the settlement because an earlier draft had been filed

by the Joint Applicants is not persuasive. The Stipulation, while similar in some respects, included numerous differences from the May 7, 2001 draft, most notably the addition of paragraph 16 which, among other things, guarantees GPU's 2001 POLR costs after June 1, in the event the merger is abandoned. This is a major change, the implications of which the Commission's Order does not even discuss. *See* Stipulation Order at 9, R. _____.

D. The Commission committed clear legal error by approving the Settlement Stipulation's deferral of POLR costs despite the failure of Met-Ed and Penelec to demonstrate through substantial evidence that they were entitled to relief under Section 2804(4)(iii)(D) of the Competition Act.

The Settlement Stipulation approved by the Commission allows Met-Ed and Penelec to defer for ratemaking and accounting purposes the difference between their charges to retail customers for POLR service and their actual cost of supply. Settlement Stipulation at Paragraph 2; R. _____. In addition, the Stipulation allows the Companies to apply CTC revenues to the POLR costs that exceed generation charges to customers. Stipulation at Paragraph 4; R. _____. Thus, the Commission has allowed Met-Ed and Penelec to create, and immediately begin to recover through the CTC, the amounts by which the revenues under the generation component of their rates undercollect their actual costs of supply. These amounts displace the collection of NUG and non-NUG stranded costs originally designated to be collected through GPU's CTC. While, as the Commission has noted, this approach does not result in an increase to the generation rate

caps of Met-Ed and Penelec through 2010, customers are now required to pay POLR costs that were not approved as part of GPU's Restructuring Settlement.⁵

Correctly recognizing that the approach adopted by the Settlement Stipulation still amounted to providing rate relief for Met-Ed and Penelec, the Commission found that the companies were required to satisfy the requirements of Section 2804(4)(iii)(D) of the Competition Act, 66 Pa. C.S. § 2804(4)(iii)(D). *See* Stipulation Order at 15; R._____. That section of the Act allows an electric distribution utility to seek an exception to the generation rate caps established by the Competition Act if “the electric distribution utility is subject to significant increases in the unit rate of fuel for utility generation or the price of purchased power that are outside of the control of the utility and that would not allow the utility to earn a fair rate of return.” 66 Pa. C.S. § 2804(4)(iii)(D). Thus, in order to be entitled to relief from increased purchased power costs under this section, Met-Ed and Penelec were required to show: (i) that they were incurring significant increases in the price of purchased power; (ii) that, absent relief, the increased prices would not allow Met-Ed and Penelec to earn fair rates of return; and (iii) that such price increases were outside of the control of Met-Ed and Penelec. While Joint Petitioners do not dispute that Met-Ed and Penelec are incurring significant increases in the price of purchased power, the Commission's conclusions with respect to the other two requirements of Section 2804(4)(iii)(D) were legally erroneous, arbitrary, and not based on substantial evidence.

1. Neither Met-Ed nor Penelec demonstrated that, absent relief, they would not be able to earn a fair rate of return, as required by The Competition Act.

⁵ After 2010, any NUG or non-NUG stranded cost deferred because POLR costs were recovered through the CTC instead will be collected.

Section 2804(4)(iii)(D) states that utilities seeking relief under the section must demonstrate that the increased costs “would not allow *the utility* to earn a fair rate of return.” (emphasis added). Ignoring the plain language of the statute, Met-Ed and Penelec took the position that they satisfied this provision because they were purportedly not earning a fair rate of return on the power supply function of their business, *i.e.*, *excluding revenues from the transmission and distribution functions* of the utilities. *See, e.g.*, Stipulation Order at 18; R._____.

The Commission explained that this was inappropriate:

Since we believe that an appropriate analysis of the rate of return issue should include a consideration of transmission and distribution revenues, we are not satisfied to rely solely on [GPU Energy’s] rate of return projections to support a grant of relief under Section 2804(iii)(D) [sic].

See Stipulation Order at 18; R._____.

The understanding of the statute’s requirements reflected in the quote presented above is clearly consistent with the plain meaning of the Act. If the legislature had intended that reduced return on power sales alone would be sufficient predicate for relief, it could have said as much and likely would not have used the “fair rate of return” language, as this concept has typically been focused on the overall return earned by the utility on the capital devoted to public service. *Cf. Duquesne Light Co. v. Barasch*, 488 U.S. 299, 310-314, 109 S.Ct. 609, 102 L.Ed.2d 646 (1989).

Moreover, the notion that the words “fair rate of return” in Section 2804(4)(iii)(D) could be read to apply only to the utility’s return on power supply sales is nonsensical when read in the context of the other subparts of Section 2804(4)(iii). *See, e.g.*, *Commonwealth v. Mayhue*, 536 Pa. 271, 307-308, 639 A.2d 421, 439 (1994) (explaining that when construing one section of a statute, the court must read that section with

reference to and in light of other sections of the same statute). For instance, Section 2804(4)(iii)(C) permits rate cap relief if the “utility is subject to significant increases in the rates of federal or state taxes or other significant changes in law or regulations that would not allow the utility to earn a fair rate of return.” 66 Pa. C.S. § 2804(4)(iii)(C). This section employs the same “fair rate of return” criteria for rate relief as is used in Section 2804(4)(iii)(D), but there is no reasonable way that the statute’s allowance for tax law changes could be interpreted to allow for rate relief due to a deficient return in a particular portion of the utility’s business, as tax laws generally do not affect only one segment of the business, but the utility as a whole.

Granting rate relief without taking into consideration earnings from other business lines raises the possibility that Met-Ed and Penelec would earn a return in excess of a fair rate of return, *i.e.*, their identified cost of capital. It would be absurd to interpret a provision that allows for a limited exception to the generation rate caps to provide the utility with the windfall opportunity to earn an excessive *overall* return. Instead, it is apparent that the legislature only intended Section 2804(4)(iii)(D) to be invoked in truly extraordinary and dire circumstances, *i.e.*, where the utility could show that it was not earning a fair return overall. This interpretation would be consistent with an understanding that the allowance for relief in order to earn a “fair rate of return” was intended merely to prevent utilities from incurring losses that would raise Constitutional questions regarding the sufficiency of their rates. *See Duquense Light Co.*, 488 U.S. at 310-314 (1989) (failure to allow regulated utility to earn fair rate of return potentially raises constitutional concerns).

In this connection, the OCA presented evidence that Met-Ed and Penelec are currently *overearning* a reasonable rate of return on the companies' transmission and distribution assets and that, allowing rate relief for purchased power costs would indeed result in overall rates of return for Met-Ed and Penelec in excess of the Companies' identified costs of capital. *See* OCA St. No. 2-PLR at 6-7; R._____. In her May 24, 2001 Statement, Commissioner Brownell opined that this was a "very compelling argument" against focusing simply on the return earned by Met-Ed and Penelec on the generation supply function of their operations. May 24, 2001 Statement of Nora Mead Brownell at 5; R._____. Commissioner Brownell concluded, moreover, that:

In making my determination, it is not necessary that I find that the OCA's arguments or any other adverse party are correct. However, before I can give affirmative relief to GPU, I must be able to determine that, on a preponderance of the evidence, GPU has shown that it cannot achieve a fair rate of return. I cannot make such a determination on the record before me. There is no question that GPU has the burden in its request for relief. It has simply not met it with regard to the rate of return issue.

Id.

As noted, the Commission found Applicants' rate of return analysis to be insufficient, stating that "an appropriate analysis of the rate of return issue should include a consideration of transmission and distribution revenues." Stipulation Order at 18; R._____. However, the Commission inexplicably and arbitrarily went on to conclude in the very next sentence:

Nevertheless, we believe that the evidence submitted by GPU of significant potential supply losses, combined with its showing of extremely low rates of return on its generation supply services, demonstrates the need for some form of relief from the statutory rate cap provisions. Further, we recognize the importance of preserving GPU's financial health and access to cash to the extent necessary

to enable it to continue purchasing wholesale power to meet its POLR obligations.

Id. (citation omitted).

The Commission's conclusion on this point constitutes clear legal error. There is no dispute that Met-Ed and Penelec did not demonstrate, or even attempt to demonstrate, that they were not earning fair rates of return when all of their revenues, including transmission and distribution revenues, were considered. Thus, there is no dispute that Met-Ed and Penelec failed to meet their burden under Section 2804(4)(iii)(D) as the Commission itself interpreted the statute's requirements.

.Given this background, the Commission was, quite literally, powerless to grant the relief requested by Met-Ed and Penelec. The Commission, as a creature of the legislature, may only exercise those powers that have been conferred upon it by statute. *See Western Pennsylvania Water Co. v. Pa. PUC*, 471 Pa. 347, 353, 370 A.2d 337, 339 (1977). By allowing rate relief notwithstanding that the acknowledged requirements of the statute were not met, the Commission has violated this principle, and, in essence, bestowed upon itself a power that it has not been delegated by the legislature, *i.e.*, the power to grant rate relief for increased purchased power costs in the absence of a showing that the utility will not be allowed to earn a fair rate of return.

The Commission's action is in no way supported by the rationales it offered for granting relief notwithstanding the absence of a showing that Met-Ed and Penelec will not be permitted to earn a fair rate of return. The Commission pointed to GPU Energy's "potential supply losses," "extremely low rates of return on its generation supply services," and "the importance of preserving GPU's financial health and access to cash" as justifications for granting the requested relief under Section 2804(4)(iii)(D).

Stipulation Order at 18; R._____. These rationales are all patently circular because they all, in one way or another, cite the purported financial distress of Met-Ed and Penelec as a basis for rate relief. The legislature has already provided, however, that a particular showing of financial distress *i.e.*, the inability of the utility to earn a fair rate of return, is required as a prerequisite for relief. The Commission concluded that Met-Ed and Penelec had not made this showing. Having found that GPU Energy had not satisfied the prescribed “financial distress” element of Section 2804(4)(iii)(D), the Commission was not free to grant relief by citing the purported financial distress of GPU Energy.

2. The Commission erred in finding that the increases in purchased power costs were outside of the control of Met-Ed and Penelec.

The Commission erred as a matter of law in concluding that the fact that wholesale prices have risen above projected levels was sufficient to satisfy the “outside of the utility’s control” requirement for purposes of granting Met-Ed and Penelec relief pursuant to Section 2804(4)(iii)(D). The choice to sell its generation and expose itself to the vagaries of the wholesale power market to the extent that it did, and its power supply strategies in that market, were decisions fully within the control of GPU. This decision was made with the expectation that stockholders would benefit. Had the decision to divest its generating plants lowered GPU’s costs and resulted in increased profits to stockholders, there is no doubt that GPU would not be offering to return the profits to customers. In relying on the market in this way, GPU must bear the losses that resulted from these strategic decisions, just as surely as it would have retained the gain.

In considering whether the “outside of utility control” requirement of Section 2804(4)(iii)(D) had been satisfied, the Commission noted that GPU Energy’s losses had

been “the result of a combination of events,” including GPU’s divestiture of its generation assets, the need to provide POLR service to a greater-than-anticipated number of customers, and the departure of several suppliers from the GPU territory. *See* Stipulation Order at 16-17; R._____. The Commission concluded, however, that “underlying each of these events, which together have led to GPU incurring significant losses, are volatile wholesale market prices that have been much higher than the projections of the parties to the 1998 restructuring proceeding.” *Id.* at 17; R._____.

Boiled down to its essence, the Commission concluded that GPU Energy met the requirements of the Act because (i) wholesale prices are not within GPU Energy’s control and (ii) these prices have unexpectedly gone up. The mere fact that purchased power costs have increased unexpectedly cannot reasonably serve as the basis for a conclusion that the “outside utility control” requirement has been satisfied. There is already implicit in Section 2804(4)(iii)(D) the assumption that the utility’s purchased power costs have “significantly increase[d]” beyond what was expected when the rate caps were established. If all that was required for rate cap relief was a showing that purchased power costs had unexpectedly increased, the “outside of the utility’s control” requirement would be redundant. It is axiomatic, however, that a statute should not be read in a manner that would render a portion of the statute extraneous. *See, e.g., Mikula v. Ford Motor Co.*, 451 Pa. Super. 560, 566-67, 680 A.2d 907, 910 (1996). The only reasonable reading of the statute is that the Commission was required to determine whether the circumstances that led the utility to be exposed to the higher costs were outside of the utility’s control. Met-Ed and Penelec did not satisfy their burden on this issue.

First, the record demonstrated that Met-Ed and Penelec are particularly exposed to the vagaries of the wholesale purchased power market because of the companies' decision to sell almost all of their own power plants in 1999. *See* Stipulation Order at 16; R._____. There was no statutory requirement that GPU Energy divest their generating resources. *See, e.g.*, Reply Brief on Behalf of Joint Applicants and Petitioners at 35. The decision to divest was within the control of the Companies and was a strategic business decision based on the judgment that GPU could not effectively compete as a power supplier. *See* MEIUG/PICA Cross-Exam Exh. No. 1 at 4, 11; R._____. GPU was well aware at the time of its divestiture, however, that it would be required to provide POLR service to retail customers and that such service entailed the risks inherent in the competitive power supply and business. *See* Tr. at 1517-20.

Second, and given GPU Energy's exposure to wholesale market prices as a POLR provider with little owned-generation, it was incumbent upon Met-Ed and Penelec to implement effective risk management strategies. Such strategies are within the exclusive control of the utilities. There was substantial evidence to show that Met-Ed and Penelec failed to implement effective risk management strategies to avoid exposure to volatile wholesale prices. In this regard, during the Summer of 1999, *i.e.*, prior to GPU's plant divestiture, "wholesale market prices exhibited volatility that should have signaled to GPU that risk management would be crucial in power supply portfolios." May 24, 2001 Statement of Commissioner Nora Mead Brownell at 3 (citing ME/PN St. 1-PLR, Exh. CAM-1; OCA St. 1-PLR at 13); R._____. The fact that GPU Energy's risk management strategies failed does not mean that the Companies exposure to high wholesale prices was

outside of their control. As Commissioner Brownell concluded in her May 24, 2001

Statement:

Understandably, GPU has made every effort to make the volatility of the wholesale energy markets the issue in this portion of the case. The issue, as set forth in the statute, is what did GPU do about that volatility. The answer is that it bet heavily on the spot market and a short-term portfolio without appropriate hedging mechanisms. The fact that it lost the bet does not automatically trigger rate relief. Had GPU won that bet, it is highly unlikely that it would be before the Commission seeking a return of profits to ratepayers. It is equally unlikely that this Commission would have a basis to order it to do so. However, the statute did not establish a “heads I win, tails you lose” construct.

May 24, 2001 Statement of Commissioner Nora Mead Brownell at 4; R._____.

In sum, the Commission acknowledged that Met-Ed and Penelec were obliged to satisfy the requirements of Section 2804(4)(iii)(D) in order to obtain relief from increased POLR costs. The utilities thus had to show that the increased purchased power costs would not allow them to earn fair rates of return and that they were outside of their control. Met-Ed and Penelec, however, did not provide substantial evidence sufficient to meet either standard. Further, to satisfy the former requirement, the Commission itself agreed, it was not enough to demonstrate an insufficient return on only one portion of the utility’s operations. It is undisputed, however, that Met-Ed and Penelec did not even *attempt* to show that they were earning an insufficient *overall* return. The Commission’s approval of relief under Section 2804(4)(iii)(D) notwithstanding this clear failure of proof constituted legal error. Accordingly, the Commission’s approval of rate relief under Section 2804(4)(iii)(D) of the Competition Act must be reversed.

E. The Commission erred in its Stipulation Order by allowing Provider Of Last

Resort (POLR) costs in excess of generation rate cap levels to be recovered through the competitive transition charge in contravention of 66 Pa. C.S. §2808 and the Restructuring Settlement.

The Stipulation Order approved a mechanism devised by the Joint Applicants and contained in the Settlement Stipulation the purpose of which is to include excess “provider of last resort” costs incurred by GPU in the competitive transition charge (CTC) paid by ratepayers. The approval of this expansion of the CTC marks the creation of a wholly new category of stranded cost not contemplated by the Act and not authorized by the 1998 Restructuring Settlement.

Furthermore, the Settlement Order authorizes a re-ordering of the priority of payment of CTC collections, such that this new, illegal category of excess POLR costs stands at the front of the line. True stranded costs, including NUG stranded costs, are thereby relegated to the rear, only to receive payment should there be any remainder in the CTC collection after the excess POLR payment is made. The approved Settlement Stipulation provides that:

“FirstEnergy will apply CTC revenues to costs in the following order of priority: Met-Ed and Penelec POLR costs that exceed generation charges to customers, non-NUG stranded costs, and NUG costs.”

(Settlement Stipulation, portion of paragraph #4)

The composition of the CTC was determined by the Commission in the Restructuring Plan proceeding in accordance with principles set forth in the Act. These principles direct the Commission to include in the CTC: regulatory assets and other deferred charges typically recoverable *under current regulatory practice*; the unfunded portion of the utility’s projected nuclear generating plant decommissioning costs; cost

obligations under contracts with nonutility generating projects that have received a commission order; prudently incurred costs relating to buydown, cancellation or renegotiation of certain NUG projects and other generation-related transition or stranded costs. (emphasis added) *See 66 Pa.C.S. §2808(c).*

Stranded costs or Transition Costs are defined in the Act as:

“An electric utility's known and measurable net electric generation-related costs, determined on a net present value basis over the life of the asset or liability as part of its restructuring plan, which traditionally would be recoverable under a regulated environment but which may not be recoverable in a competitive electric generation market and which the commission determines will remain following mitigation by the electric utility. This term includes:

(1) Regulatory assets and other deferred charges typically recoverable under current regulatory practice, the unfunded portion of the utility's projected nuclear generating plant decommissioning costs and cost obligations under contracts with nonutility generating projects which have received a commission order, the recoverability of which shall be determined under section 2808(c)(1) (relating to competitive transition charge).

(2) Prudently incurred costs related to cancellation, buyout, buydown or renegotiation of nonutility generating projects consistent with section 527 (relating to cogeneration rules and regulations), the recoverability of which shall be determined pursuant to section 2808(c)(2).

(3) The following costs, the recoverability of which shall be determined pursuant to section 2808(c)(3):

(i) Net plant investments and costs attributable to the utility's existing generation plants and facilities.

(ii) The utility's disposal of spent nuclear fuel.

(iii) The utility's long-term purchase power commitments other than the costs defined in paragraphs (1) and (2).

(iv) Retirement costs attributable to the utility's existing generating plants other than the costs defined in paragraph (1).

(v) Other transition costs of the utility, including costs of employee severance, retraining, early retirement, outplacement and related expenses, at reasonable levels, for employees who are affected by changes that occur as a result of the restructuring of the electric industry occasioned by this chapter.

The term includes any costs attributable to physical plants no longer used and useful because of the transition to retail competition. The term excludes any amounts previously disallowed by the commission as imprudently incurred. To the extent that the recoverability of amounts that are sought to be included as transition or stranded costs are

subject to appellate review as of the time of the commission determination, any determination to include such costs shall be reversed to the extent required by the results of that appellate review.”

(66 Pa. C.S. §2803)

The excess POLR costs incurred by GPU, which Petitioners contend were within GPU’s power to mitigate and avoid, simply do not conform to the principles for stranded cost types appropriate for the CTC set forth in the Act, nor to the definition of stranded cost provided at §2803.

Stranded costs are created by the switch from regulation to market rates, literally “stranding” costs alleged to be not recoverable in a market. . In fact, the amount of stranded costs is determined by the difference between the amount of revenue that can be collected under regulation and the amount that can be recovered in the marketplace. The costs in question here are simply expenses, that is, purchased power costs for power needed by GPU to meet its POLR obligations. In other words, POLR costs at issue here are merely current expenses, the price of which is determined by the market. The Commission cannot turn these expenses into a regulatory asset that meets the terms of the Act, so that they may be collected through the CTC by merely deferring them and requiring customers to pay for them.

The Commission nevertheless maintains that the

“creation of a regulatory asset through the deferral of specific costs is a traditional ratemaking tool that is available to the Commission under our general powers and ratemaking authority under Section 501 and Chapter 13 of the Public Utility Code. Moreover, it is completely consistent with the provisions of Chapter 28 of the Public Utility code that seek to protect utilities from being financially devastated by electric restructuring or their attendant POLR obligations See 66 Pa.C.S. §§2803 and 2804(4).”

(Stipulation Order, p. 19)

The Commission then summarily concludes that:

“Stranded costs are specifically defined by the statute to include regulatory assets and other deferred charges typically recoverable under current regulatory practice. 66 Pa.C.S. §2803 (definitions). As such, deferred POLR costs are clearly within the category of items that are recoverable under the CTC.”

(Stipulation Order, p. 20)

The Commission’s argument does not withstand analysis. First, it has omitted a crucial fact from its reference to stranded cost. For the electric utility, stranded cost is to be determined “*as part of its restructuring plan.*” 66 Pa.C.S. §2803 (at line three of its reproduction on the previous page of this brief.)

The process of defining a utility’s stranded costs and establishing a CTC was a one-time event prescribed by the Act to take place in the context of a Restructuring Plan proceeding. That proceeding was completed and finalized through the Restructuring Settlement of 1998. Although the Act and the Restructuring Settlement contemplate adjustments to the CTC in the form of “true-ups,” they do not allow for the altering of the components of the CTC.

Furthermore, Petitioners strongly dispute the claim that the creation of a new form of stranded cost and its insertion into the CTC is consistent with Chapter 28. To the extent that these excess POLR costs could be characterized as “deferred charges” by virtue of the “deferral mechanism,” also present in the Settlement Stipulation, they would still not qualify as legitimate forms of CTC. Even if the Act contemplated re-opening the restructuring plan in order to re-visit the nature of the CTC, which it clearly does not, deferred charges permissible in the CTC are limited to those “recoverable under current regulatory practice.” 66 Pa.C.S. §2803. At the time of the Act’s passage, “excess provider of last resort costs” did not even exist, and therefore were not recoverable.

The Commission’s second reference to the Act to substantiate its claim that this

expansion of the CTC is consistent with Chapter 28 ultimately provides no such support. Section 2804(4) pertains to the establishment of rate caps and procedures for seeking exceptions thereto, but does not at all deal with the components of, or changes to, the CTC. It is inconceivable that this section would be taken to permit a CTC expansion.

The Commission's approval of POLR cost insertion into the CTC therefore violates the Act and abrogates the Restructuring Settlement. The Commission's action constitutes an abuse of discretion and must be reversed.

VIII. CONCLUSION

Clean Air Council and Citizen Power have requested this Honorable Court to reverse the Orders of the Commission entered June 20, 2001, at PUC Docket Nos. A-110300F0095, A-110400F0040, P-00001860 and P-00001861, to restore the provisions of the 1998 Restructuring Settlement, to direct that the errors in the Orders be corrected, to deny the Joint Application for Merger, and to grant such other relief as may be necessary to ensure a just and reasonable outcome in the proceedings.

Respectfully submitted,

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APPENDIX A. AND B.

OPINIONS AND ORDERS BELOW

The Opinions and Orders of the Pennsylvania Public Utility Commission entered on June 20, 2001 in Dockets A-110300F0095, A-110400F0040, P-00001860 and P-00001861 are included in the Reproduced Record at R. _____, by allowance granted by Order of this Court entered on September 6, 2001 from Application for Relief sought by Petitioners.