COMMONWEALTH OF PENNSYLVANIA
BEFORE THE
PUBLIC UTILITY COMMISSION

Joint Application for Approval of the Merger of GPU, Inc. with FirstEnergy Corp.	)))	**Docket Nos. A-110300F.0095 A-110400F.0040**
Petition of Metropolitan Edison Company and Pennsylvania Electric Company, As Supplemented, for Interim Relief Pursuant to Section F.2 of Their Approved Restructuring Plan and the Electricity Generation Customer Choice and Competition Act	))))))))	**Docket Nos. P-00001860 P-00001861**

MAIN BRIEF OF CITIZEN POWER, INC.

To: The Honorable Larry Gesoff
Presiding Administrative Law Judge

In accordance with 52 Pa. Code § 5.501 and the March 27, 2001 Order of the Presiding Administrative Law Judge, Citizen Power, Inc. ("Citizen Power") hereby files its Main Post-Hearing Brief in the captioned proceedings.

I. INTRODUCTION

These proceedings comprise two cases consolidated by the Presiding Judge for decision by the Commission. The first case, Docket Nos. A-110300F.0095 and A-110400F.0040, involves the proposed merger of FirstEnergy Corp. ("FirstEnergy") with GPU, Inc. ("GPU") ("Merger Proceeding"). In the Merger Proceeding, FirstEnergy, GPU and GPU's Pennsylvania public utility subsidiaries, Metropolitan Edison Company ("MetEd") and Pennsylvania Electric Company ("Penelec") (collectively "Applicants") seek approval and the issuance of any and all authorizations required under the Pennsylvania Public Utility Code to effectuate the merger of GPU with and into FirstEnergy. The second consolidated case, Docket Nos. P-00001860 and P-00001861, concerns a petition by the GPU Energy companies MetEd and Penelec (collectively

“GPUE”) to collect additional revenues to fund the acquisition of energy and capacity to supply GPUE’s provider-of-last-resort (“PLR”) obligations (“PLR Proceeding”). Citizen Power does not address matters at issue in the PLR Proceeding except to the extent that such issues are relevant to the Merger Proceeding.

As set forth below, the merger of FirstEnergy and GPU cannot be approved as proposed by the Applicants. The overwhelming weight of the evidence in this proceeding conclusively shows that the Applicants have failed to meet their burden of showing that the merger will affirmatively benefit the public interest. Conversely, the record shows that the merger poses numerous risks to GPUE customers and Pennsylvania citizens. In addition, Applicants have not met their burden under the Competition Act to prove that the merger will not have an adverse effect on retail competition.

It is Citizen Power’s belief that the complete lack of persuasive evidence demonstrating any benefit from the merger, weighed against the evidence of serious potential detriment to the public interest, warrants a finding that the merger should be rejected. The record shows that the merger would directly result in increased pollution in the Commonwealth, further impairing Pennsylvania’s ability to meet EPA air quality standards. Further, Applicants have failed their burden to show that the merger is unlikely to result in harm to Pennsylvania retail competition, as required by Section 2811(e) of the Electricity Generation Customer Choice and Competition Act (“Competition Act”), 66 Pa. C.S. § 2811(e). Given these and other substantial detriments of the proposed combination, the merger should not be salvaged by attaching conditions, which, in all likelihood, would fail to provide the permanent bond of protection that would be afforded by denying the merger.

If, however, the Commission chooses to exercise its discretion to approve the merger with conditions, the Commission should attach the conditions set forth in sections IV.D and IV.E below. Short of rejection, such conditions are the minimum necessary to protect GPUE customers and Pennsylvanians by mitigating the adverse competitive and environmental effects of the merger and requiring that the merger affirmatively benefit the public interest in some substantial way, as required by Pennsylvania law.

II. STATEMENT OF THE CASE AND PROCEDURAL HISTORY

On November 9, 2000, Applicants filed an application seeking approval and the issuance of any and all authorizations required under the Pennsylvania Public Utility Code to effectuate the merger of GPU with and into FirstEnergy. *See* Joint Application at 1-6. The Commission convened an organizational conference on December 21, 2000 and Prehearing Conferences on January 4 and 10, 2001. Following the Second Prehearing Conference, the Presiding Judge issued an order setting the schedule for the Merger Proceeding and establishing certain hearing rules. *See* First Prehearing Order (January 10, 2001). On January 11, 2001, the Presiding Judge issued an order granting the petitions to intervene of Citizen Power and numerous other intervenors. *See* First Interim Order.

On November 29, 2000, MetEd and Penelec initiated the PLR Proceeding by filing a petition requesting authorization to implement a cost tracking and recovery mechanism permitting the GPUE companies to defer for accounting and regulatory purposes, beginning January 1, 2001, the net difference between their retail charges for PLR service and their actual market costs of supply. *See* GPUE Supplement to Petition at 2 (February 9, 2001). In response to GPUE's petition, the Office of Trial Staff ("OTS"), the Office of Consumer Advocate ("OCA"), the Met-Ed Industrial Users Group ("MEIUG") and the Penelec Industrial Customer

Alliances ("PICA") filed motions to dismiss the petition. The Presiding Judge certified the questions raised by the motions to dismiss to the Commission for a ruling.

On February 1, 2001, the Commission issued its order on the material questions. The Commission concluded that GPUE had failed to address the requirements of 66 Pa. C.S. § 2804(4)(iii)(D) relating to rate cap relief under the Electricity Generation Customer Choice and Competition Act, including, in particular, the Act's requirement that GPUE demonstrate that it would not earn a fair rate of return. *See* Order on Material Question at 4-5. The Commission remanded the case to the Presiding Judge and allowed FirstEnergy to "perfect" its Petition without prejudice to GPUE or the other parties to raise arguments in support of or in opposition to GPUE's request for relief. *Id.* at 5-6. In addition, the Commission ordered the Presiding Judge to consolidate the PLR proceeding with the Merger Proceeding. *Id.* at 5.

On February 2, 2001, the Presiding Judge issued an Order incorporating the PLR Proceeding into the existing Merger Proceeding hearing schedule. *See* Second Prehearing Order. On February 9, 2001, GPUE submitted a supplement to its November 29, 2000 Petition, setting forth its arguments in support of rate cap relief. In its Amended Petition, GPUE also advanced an alternative proposal, whereby a deferral approach would be combined with an increase to the rate cap. *See* Amended Petition at 13-15.

In accordance with the schedule established by the Presiding Judge, the parties conducted discovery and filed several rounds of testimony in both the Merger and PLR Proceedings. The hearing was convened at the Commission offices during the week of March 12 to 16, 2001.

III. SUMMARY OF ARGUMENT

To obtain approval for their proposed merger, Applicants must show that the merger will affirmatively benefit the public interest in some substantial way. As a separate and independent requirement, Applicants must demonstrate, pursuant to 66 Pa. C.S. § 2811(e), that the merger is

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 electricity market. Applicants have not met their burden as to either of these standards.

In the main, Applicants cite two primary benefits in support of a finding that the merger will benefit the public interest: (i) the ability to mitigate the costs and risks of GPUE's PLR obligations; and (ii) improved customer service and reliability in utility operations. The record clearly shows these purported benefits to be illusory. Balanced against Applicants' meritless claims of merger benefits is substantial evidence that the merger of GPU and FirstEnergy will have significant adverse effects. Accordingly, any weighting of the benefits and detriments of the proposed merger must result in a conclusion that the proposed merger is not in the public interest and should be rejected.

The Presiding Judge and the Commission should reject Applicants' claimed ability to mitigate GPUE's PLR costs and risks. First, the Applicants have not shown why mitigating GPUE's alleged costs and risks of procuring PLR supplies, even if feasible and likely to occur, should be considered a benefit to the *public interest* – as opposed to the *private* interests of the Applicants – given that GPUE customers are protected by a generation rate cap and that the risk of PLR supplies is borne by GPU shareholders. Second, even assuming that it could be considered a benefit to the public interest, the Applicants have not offered credible evidence that the merger will allow FirstEnergy to mitigate the costs and risks of procuring PLR service. If, as its economic witness has claimed, the PJM markets in which GPU purchases energy to meet its PLR obligations is competitive, then, as he also conceded, it makes no difference whether GPUE purchases energy from FirstEnergy since its prices and services will not differ materially from

those available from other suppliers. Third, even if FirstEnergy is somehow able to reduce PLR supply costs to GPUE, there is no mechanism in place to ensure that customers will see any benefit from such lower prices once the protection of price caps is removed. Finally, the actions FirstEnergy has identified that will purportedly mitigate PLR costs and risks could all be accomplished today without the need for the merger with its attendant adverse effects.

With respect to the other purported primary benefit of the merger – improved customer service and reliability – the Applicants do not offer anything by way of a commitment to assure Pennsylvania customers that the merger will improve existing reliability and/or customer service. Indeed, much of the Applicants' evidence on customer service and reliability issues describes FirstEnergy's methods, without providing any proof that implementation of such practices by the merged company would constitute an improvement over GPUE's historical methods or over what GPUE could do absent the merger. On the contrary, GPUE testimony indicated that its employees were fully capable of implementing the best practices of FirstEnergy or any other utility.

Further, the Applicants do not offer any of the benefits that are often present in a proposed merger. For instance, Applicants do not propose to share any of the estimated merger savings with customers. Nor do they commit to increase funding for renewable energy sources, universal service programs, or charitable contributions.

In contrast to this complete failure of proof of affirmative benefits resulting from the merger, there is substantial record evidence demonstrating that the merger will have a substantial adverse impact on GPUE customers and on Pennsylvania generally. Of greatest concern is the fact that the merger would have a direct adverse effect on the environment if, as FirstEnergy claims, it will be running certain of its coal-fired plants at a higher capacity factor in order to

supply GPUE's PLR requirements. Further, the evidence raises substantial questions concerning FirstEnergy's environmental compliance record and shows that FirstEnergy faces potential serious financial consequences from its environmental record, potentially adversely affecting GPU's creditworthiness.

The record also shows that the merger is likely to, *inter alia*, expose GPU to the risks of generation ownership, further adversely impacting GPU's credit quality; create uncertainty with respect to the operation of PJM; and further distance GPUE operations from parent company management. Accordingly, Applicants have failed to meet their burden to show that, weighing the benefits and detriments to all affected parties, the merger will affirmatively benefit the public interest in some substantial way.

Separate and apart from Applicants' failure to show affirmative benefit to the public interest, Applicants have not met their burden under Section 2811(e) of the Competition Act. The Applicants' direct case on this issue relied exclusively on the testimony of Mr. Rodney Frame, who claims that that the merger is competitively benign, in part, because the *wholesale* markets in which GPUE purchases power are competitive and will remain so after the merger. On this issue, Mr. Frame was directly contradicted by Applicants' own PLR witnesses, who claimed that these same markets were uncompetitive. Applicants cannot offer contradictory evidence and then claim that they have met their burden of proof by choosing one version to support their PLR claims and the opposite to support their merger application.

Mr. Frame's testimony fails to prove, moreover, that the merger is unlikely to result in anticompetitive conduct in the *retail* markets where Penelec and MetEd operate. Indeed, while he acknowledged that the loss of FirstEnergy as a retail competitor could make a difference if there were few remaining retail suppliers in the Penelec and MetEd service territories, he never

tried to ascertain whether that was the case. On the contrary, he performed no analysis of the retail market and thus did not know how many retail suppliers actually have the ability or interest to serve in GPU's franchise areas. Because Applicants have failed to satisfy their burden to show that the merger satisfies the requirements of section 2811(e), the merger may not be approved as proposed.

The merger should be denied outright because Applicants have failed to meet their burden under either legal standard applicable to this proposed merger, and because the substantial harm to the public interest that may result if the merger is approved is not easily remediable by attaching conditions. If, however, the Commission chooses to exercise its discretion to approve the merger subject to conditions, the Commission may not approve the merger without imposing conditions that will protect GPUE customers and Pennsylvanians from adverse effects of the merger and that will guarantee that the public interest affirmatively benefits substantially from the merger.

The conditions necessary to meet these requirements before the proposed merger can be approved are set forth in sections IV.D and IV.E below. Necessary merger conditions include:

- A requirement that GPUE retain the existing generation price caps beyond the current expiration date unless and until the merged company submits a study for commission review and approval demonstrating that workable competition in the relevant retail geographic and product markets exists and is sufficient to restrain prices.
- A requirement that GPU commit to retain its membership in PJM as long as PJM remains a viable regional transmission organization.
- A requirement that the merged company commit to installing the best available control technology at all its coal-fired generating units to reduce air pollution.
- A requirement that FirstEnergy settle the pending DOJ/EPA environmental lawsuit relating to the Sammis plant.
- A requirement to flow back to customers merger savings at a level equal to five percent of the O&M expenses of MetEd, Penn Power and Pennelec.

- A requirement that the acquisition premium paid by FirstEnergy is not passed on to its customers in any way, including specifically that the acquisition premium shall not be recovered "indirectly" from customers by offsetting amortization of the acquisition premium against cost savings that would otherwise benefit customers.

- A requirement that the acquisition premium received by GPU be credited against customers' stranded cost payments

- A requirement that a reasonable increment, to be determined by the Commission, be added to each of the annual universal spending levels established for MetEd and Pennelec in their restructuring settlement, and that a proportionate increase be applied to PennPower's annual universal service program spending levels.

- A requirement that the merged company establish a Sustainable Development Fund, similar in arrangement and in proportionate size to the four funds already established in Pennsylvania, in the PennPower service territory.

- A requirement that the merged company develop at least two 10-15 MW wind farms in the merged company's operating territories.

- A requirement that the merged company invest a total of $2 million in photovoltaic roof top installations in the merged company's operating territories.

- A requirement that the merged company agree to the demand-side management conditions proposed by the Clean Air Council and the PennFuture Individual Intervenors in this proceeding

- A requirement that the merged company provide $50 million to implement a statewide sustainable development fund to support renewable energy in Pennsylvania.

Thus, while it is Citizen Power's belief that the substantial risks posed by the merger warrant rejecting the merger, the Commission should, at a minimum, attach the conditions proposed by Citizen Power so as to protect GPUE customers and Pennsylvanians from adverse effects of the merger and to provide substantial public benefits.

IV. MERGER–DOCKET NOS. A-110300F.095 AND A-110400F.040

A. Introduction/Merger Proposal

On August 8, 2000, GPU and FirstEnergy announced that their respective boards of directors had approved a merger agreement between the two companies. *See* Applicants St. 2 at 2. The terms of the merger agreement call for GPU to be merged with and into FirstEnergy. *Id.* FirstEnergy will acquire all of the outstanding shares of GPU for approximately $4.5 billion in cash and FirstEnergy common stock and assume approximately $7.4 billion of GPU's debt and preferred stock. *Id.* Holders of GPU common shares will be entitled to receive $36.50 in cash for each share of GPU, or an amount of FirstEnergy common stock to be determined based upon an exchange ratio set forth in the Merger Agreement. *Id.*[1]

Following the merger, FirstEnergy Corp. will be the surviving company, and will become a registered holding company under the Public Utility Holding Company Act. *Id.* at 3. The merged company would have its headquarters in Akron, Ohio. *Id.* FirstEnergy will own all of the common stock of each of the GPUE companies as well as of FirstEnergy's current Ohio electric utilities, Ohio Edison Company ("Ohio Edison"), The Cleveland Electric Illuminating Company, and The Toledo Edison Company. *Id.* Pennsylvania Power Company ("Penn Power"), a Pennsylvania utility, will continue to be wholly owned by Ohio Edison. *Id.*

B. Applicable Legal Standards

The Applicants seek approval of the proposed merger pursuant to 66 Pa. C.S. Section 1102(a)(3). *See* Joint Application at 3. This statute requires that a certificate of public convenience must first be obtained from the Commission:

> For any public utility or an affiliated interest of a public utility . . .
> to acquire from, or transfer to, any person or corporation, including

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[1] However, in the aggregate, fifty percent of all issued and outstanding shares of GPU common stock must be exchanged for cash and fifty percent must be exchanged for FirstEnergy common stock. *Id.* at 2-3.

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

66 Pa. C.S. § 1102(a)(3). MetEd and Pennelec are public utilities for purposes of Section 1102(a)(3). *See* 66 Pa. C.S. § 102. GPU and FirstEnergy are affiliated interests of public utilities for purposes of Section 1102(a)(3). In accordance with its 1994 Statement of Policy on the issue, the Commission will review mergers as a transfer of utility property even if, as here, the merger is executed at the parent company level. *See* 52 Pa. Code § 69.901.

Interpreting the language contained in Section 1102(a)(3) in conjunction with the standards governing the issuance of certificates of public convenience, the Pennsylvania Supreme Court has held that those seeking approval of a utility merger must "demonstrate that the merger will *affirmatively promote* the service, accommodation, convenience, or safety of the public in some *substantial* way." *City of York v. Pennsylvania Pub. Util. Comm'n*, 449 Pa. 136, 141, 295 A.2d 825, 828 (1972) (emphasis added); *see also DQE, Inc.*, PaPUC Docket No. A-110150, F.0015 (April 30, 1998). In applying this public interest standard, the Commission is obligated to consider the benefits and detriments of the acquisition as they impact on all affected parties. *Middletown Township v. Pennsylvania Pub. Util. Comm'n*, 85 Pa. Commw. 191, 202, 482 A.2d 674, 682 (Pa. Commw. Ct. 1984); *see also DQE, Inc.* PaPUC Docket No. A-110150, F.0015 (April 30, 1998). Stated succinctly, the Applicants must show that the proposed merger will affirmatively benefit the public interest in some substantial way. The Applicants do not dispute that this is the proper standard to be applied. *See* Applicants Reb. St. 1 at 2.

In addition to the necessary finding of affirmative benefit to the public interest, the Competition Act requires the Commission to investigate 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 adversely affect the development of the competitive retail market, the Commission may not approve the 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.* The Applicants also acknowledge that they must satisfy the requirements of Section 2811(e). *See* Joint Application at 5.

C. Demonstration of Benefits of the Merger As Proposed

1. Introduction

The Applicants have failed to prove that the proposed merger of GPU and FirstEnergy will affirmatively benefit the public interest at all, let alone in a substantial way. As such, the merger should be rejected. While Applicants assert that the merger will reduce their annual costs by $150 million, Applicants St. 1 at 11, they propose to return none of those savings to ratepayers. Instead, they identify only two dubious and unquantified benefits as the "primary benefits" of the merger: (i) that distribution operations will somehow improve; and (ii) that FirstEnergy generation – which FirstEnergy can and does sell to GPU without the merger – will somehow assist GPU in meeting its PLR obligations. *See, e.g.,* Applicants Reb. St. 1 at 11.

The Applicants' witnesses consistently advance only general, nebulous claims regarding merger benefits without ever committing to specific actions or quantifying the purported benefits of the merger. This should not be surprising given that Pennsylvania customers were a mere afterthought in the proposed merger. In this regard, Mr. Michael J. Chesser, the President and CEO of GPUE, testified that he was unaware of any studies performed by GPU's consultants or by the Applicants to gauge how the merger might benefit customers. *See* Tr. at 529. Moreover,

many, if not all, of the professed "merger benefits" identified by the Applicants represent actions that GPUE is under an existing obligation to take, has already undertaken, or could take without the merger.

Thus, even if there were no evidence that the proposed merger could adversely affect the public interest, the Applicants' failure to prove affirmative benefits would preclude any finding that the proposed merger is in the public interest. There is, however, substantial evidence that the merger of GPU and FirstEnergy will have such an adverse effect. Accordingly, any weighting of the benefits and detriments of the proposed merger must result in a conclusion that the proposed merger is not in the public interest and should be rejected. At a minimum, it cannot be approved absent significant conditions.

2. PLR Service Issues

Perhaps the centerpiece of the Applicants' claim that the merger will affirmatively benefit the public interest is their contention that FirstEnergy will be able to mitigate the costs and risks of procuring electricity supplies GPU now purports to face in meeting its PLR obligations. *See, e.g.*, Applicants Reb. St. 1 at 3; Applicants Reb. St. 5 at 3-10. No credence should be given to these claims. First, the Applicants' have not shown why mitigating GPUE's alleged costs and risks of procuring PLR supplies, even if feasible and likely to occur, should be considered a benefit to the public interest, given that GPUE customers are protected by a generation rate cap and that the risk of PLR supply is borne by GPU shareholders. Second, even assuming that it could be considered a benefit to the public interest, the Applicants have not offered a plausible reason to believe – much less evidence – that the merger will allow FirstEnergy to mitigate the costs and risks of procuring PLR service. Third, even if FirstEnergy is somehow able to reduce PLR supply costs to GPUE, there is no mechanism in place to ensure that customers will see any benefit from such lower prices once the protection of price caps – now scheduled to terminate in

2010 – are removed. Finally, the actions FirstEnergy has identified that will purportedly mitigate PLR costs and risks could all be accomplished today without the need for the merger with its adverse effects and attendant risks. Accordingly, the Presiding Judge and the Commission should not credit the Applicants' claim that the public interest will benefit from FirstEnergy assisting with the procurement of GPUE's PLR supply. These points are discussed below.

a. The Applicants Have Not Shown That Any Mitigation Of PLR Supply Costs Is A Benefit To The Public Interest

The notion that the public interest will benefit from FirstEnergy mitigating the costs and risks of PLR procurement is based upon the flawed premise that GPUE customers are in need of protection from PLR cost exposure. GPUE customers are currently protected from PLR cost exposure by a rate cap on the generation component of retail rates. *See, e.g.*, OCA St. 1-PLR at 26-27. The existing generation rate cap was agreed to by GPU and interested parties as part of a comprehensive restructuring settlement that provided benefits and trade-offs for all the parties involved. *See id.* As Applicants' witness Mr. Rodney Frame explained, GPUE's rate caps provide customers with "the benefits of market supply when that is expected to produce lower prices and the benefits of regulated price caps when those price caps are expected to produce lower prices." Applicants St. 4 at 11. Thus, GPU customers are currently protected from volatile GPU supply costs by a rate cap.

In the PLR Proceeding, GPUE is seeking to exceed the generation rate cap and/or to defer for later recovery PLR wholesale costs in excess of the generation rate cap. *See* GPUE Supplement to Petition at 13-14 (February 9, 2001). The Commission has ruled that in order to obtain rate cap relief, GPUE must demonstrate that it satisfies the requirements of 66 Pa. C.S. § 2804(4)(iii)(D), Order on Material Question at 5, which provides that an exception to the rate cap may only be allowed upon a showing that:

> The electric distribution utility is subject to significant increases in the unit rate of fuel or utility generation or the price of purchased power that are outside the control of the utility and that would not allow the utility to earn a fair rate of return.

OCA and other parties are vigorously contesting a rate cap exception for GPUE, arguing that GPUE's increases in purchased power costs are not outside of its control or preventing GPUE from earning a fair return. *See, e.g.,* OCA St. 1-PLR; OCA St. 2-PLR; OCA St. 3-PLR. Thus, to say the least, there is a substantial question whether GPUE should be allowed to dispense with the rate cap and obtain the relief it requests. In this connection, if the position of the OCA and others opposing a rate cap exception is upheld, by definition, the merger provides no PLR benefits to the *public*, even if the merger somehow provided a PLR benefit to *GPUE.* Even if GPUE is found to be entitled to a rate cap exception, however, there is no proof that there will be a PLR supply benefit to GPUE customers as a result of the merger, for the reasons set forth below.

b. Even If Mitigation Of GPUE's PLR Risks Were A Public Benefit, There Is No Plausible Evidence That This Benefit Exists, Much Less That It Is Merger-Related

Even accepting, *arguendo*, that a proven capability to mitigate GPUE PLR costs and risks could be considered a public interest benefit, the Applicants have patently failed to present credible evidence that such mitigation can be accomplished. Typical of most, if not all, of their evidence in this proceeding, the Applicants provide only a general, oft-qualified discussion of steps that could possibly be taken by the merged company to reduce GPUE's power supply costs. When the Applicants' claims are evaluated in light of the relevant facts, the ability of FirstEnergy to meaningfully mitigate GPUE's PLR costs is virtually nonexistent. The indefinite, equivocal testimony provided by the Applicants regarding mitigation of PLR costs and risks

simply does not support a finding that the merger will provide benefits to Pennsylvania customers, especially when weighed against the relevant record evidence.

(i) Applicants Have Offered Only Bare, Unquantified Assertions Of PLR Benefit

As an initial matter, the Applicants have not committed to providing any specific level of PLR cost mitigation. *See* OCA St. 1 at 41. Indeed, Mr. Alexander unabashedly states that Applicants have not quantified the benefits of the merged company's capabilities to mitigate GPUE's PLR obligations. Applicants Reb. St. 1 at 4. Thus, even accepting the Applicants' claims concerning the steps the merged company could take to mitigate PLR costs, they have presented no evidence from which the Presiding Judge or the Commission could conclude that the actions the merged company proposes to take would result in any quantifiable benefit to Pennsylvania customers.

(ii) Applicants Have No Plan For Implementing PLR Mitigation

The actions the Applicants propose to take to mitigate PLR costs are described in the testimony of Mr. Robert A. Kaiser, Manager, Business Strategy Department for FirstEnergy. Applicants Reb. St. 5 at 1. Mr. Kaiser's testimony makes clear that nothing concrete has been determined with respect to how FirstEnergy proposes to mitigate PLR costs to GPUE customers. *See id.* at 4. Rather, the merger transition teams are only just developing "plans" as to how the PLR obligations can be mitigated. *Id.*; *see also* Tr. 1033-34. Notably when, in his Rebuttal Testimony, Mr. Kaiser is posed the question "[w]hat specifically will FirstEnergy do to benefit the customers of GPUE?" his answer provides no concrete commitments from which the Presiding Judge or the Commission could be assured that FirstEnergy will meaningfully mitigate GPUE's PLR cost exposure. *See* Applicants Reb. St. 5 at 4.

(iii) Applicants Have Offered No Evidence Demonstrating Any Ability To Provide Measurable PLR Mitigation

Where Applicants do attempt to reach beyond ambiguous and equivocal statements, their alleged ability to mitigate PLR costs is not credible. The evidence in the record demonstrates that any supply plans would face serious hurdles. FirstEnergy currently has extremely limited on-peak generating capacity with which it could supply GPUE PLR obligations. In fact, Mr. Kaiser agreed that the FirstEnergy companies do not own sufficient generating capacity to meet their existing peak load requirements and must purchase additional amounts of power to serve those loads. Tr. at 1041, 1108-09. Thus, under the current configuration of the wholesale markets, FirstEnergy's ability to serve GPUE loads would be limited to (i) off-peak periods; and (ii) periods where demand peaks in PJM and FirstEnergy's market area are not coincident. *See generally* Applicants Reb. St. 5 at 5-7.

The ability of FirstEnergy generation to serve GPUE's PLR obligations in the limited circumstances described above is restricted, however, by the scarcity of transmission capacity between FirstEnergy's market area and PJM. *See, e.g.*, PJM St. 1 at 14-19; OTS St. 2 at 13-14; Mangione St. 1 at 8. Indeed, Mr. Frame noted the lack of transmission capability into PJM as a reason that, in his opinion, the merger does not raise wholesale market power concerns:

> [W]hile FirstEnergy owns or has contract rights to approximately 13,000 MW of electricity generating resources, all but 435 MW . . . is located outside of PJM and must compete with other resources for a portion of the limited import capability into PJM. When the limited import capability into PJM is allocated among FirstEnergy and other potential suppliers, the share that FirstEnergy ultimately receives is relatively small in comparison to the market size as a whole.

Applicants St. 4 at 8.

The total transfer capability that exists between the FirstEnergy and GPU transmission systems is determined and administered by PJM. *See* PJM Cross-Exam. Exh. 1. Mr. Herling, testifying on behalf of PJM, concluded that it would be "very unlikely" that GPU could rely on FirstEnergy generation outside of PJM to satisfy its PLR obligations because use of those resources will continue to depend on GPU reserving firm available transmission capacity ("ATC") across PJM's border:

> If it is GPU's intention to satisfy [its PLR and PJM capacity obligations] utilizing FirstEnergy resources, it is very unlikely that this will be possible under PJM's tariff rules due to the limited transmission capability between FirstEnergy and PJM and the fact that GPU would have to compete for such capability with other PJM load serving entities.

PJM St. 1 at 16.

The merger will not give GPUE any preferential treatment in securing firm ATC at FirstEnergy's interconnection with PJM. *See id.* at 17. Thus, after the merger, as long as GPU remains a part of PJM, nothing in the record shows that FirstEnergy's ability to deliver power into PJM will be enhanced.

- **Applicants Admit That Their Claim That FirstEnergy Will Deliver 4 Million MWH Annually To GPU May Overstate Such Sales By 100 Percent And That This Dubious Figure Includes Energy FirstEnergy Already Provides To GPU**

The Applicants do not dispute that FirstEnergy's ability to serve GPUE is restricted by the limited firm transmission into PJM.[2] *See* Applicants Reb. St. 5 at 5. However, in one of

[2] In a thinly veiled attempt to shift the focus of the inquiry, however, Mr. Kaiser launches into a diatribe against existing PJM market rules, blaming the ISO for limiting FirstEnergy's ability to supply power to GPUE. *See* Applicants Reb. St. 5 at 10-15. Mr. Kaiser's critique is not relevant to the question of whether GPUE's PLR costs and risks can be mitigated by FirstEnergy generation resources. If anything, the Applicants' criticisms constitute an implicit concession that the PJM rules will strictly limit the ability of FirstEnergy to serve the GPUE PLR load whether or not there is a merger. Regardless of the merits of Applicants' contentions regarding PJM market rules,

Applicants' few specific claims, Mr. Kaiser estimates that "up to 4,000,000 MWH annually could be delivered to GPUE in off-peak periods." *Id.* Mr. Kaiser made clear at the hearing that even this estimate is far from precise. Mr. Kaiser acknowledged that the number "could be 3 [million]. It could be 2. We don't know the exact number." Tr. at 1038.

Moreover, the 4,000,000 MWh estimate is so heavily qualified that it cannot be given any serious weight. Mr. Kaiser testified that achieving this level of supply would depend upon a number of variables, including improving plant maintenance off-peak, improving coal costs, the general competitiveness in PJM, and the locational marginal price ("LMP") at the PJM interface. *See* Tr. at 1039-40; *see also* OCA St. 1 at RLC-2, p. 5.

Further, the Applicants' roughly estimated that the cost reduction from delivering 4,000,000 MWh of off-peak power to GPUE is only "*up to* 4 million dollars savings." Tr. at 1049 (emphasis added). FirstEnergy already delivers capacity and energy into the GPU system. The two, three or four million MWH estimate – Applicants apparently can be no more precise – reflects *total* deliveries to GPU, including current sales. Tr. at 1049. There is no record evidence, in other words, as to what *incremental* energy, if any, will be available to GPU. Without that evidence, however, it is impossible to conclude that there would be *any* energy cost savings, much less $4,000,000. Applicants acknowledge that GPUE will not buy from FirstEnergy unless its supplies are cheaper than alternatives. Tr. 1080. As discussed below, there is no reason to believe that additional energy sold by FirstEnergy to GPU would be any cheaper than (i) off-peak energy sold by third parties; or (ii) off-peak energy sold by FirstEnergy absent a merger.

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however, the fact is that such rules exist, and blaming the ISO does not constitute proof that GPUE customers will benefit from the merger.

- **The Record Does Not Support A Finding That There Would Be Any On-Peak Supply Benefit To GPU Resulting From The Merger**

The Applicants are even more circumspect in their statements concerning FirstEnergy's ability to provide on-peak supply to GPUE. As noted, FirstEnergy is currently "short" on on-peak capacity, and thus, has none to sell to GPUE during FirstEnergy's peak load periods. *See* Tr. at 1041, 1108-09. Thus, FirstEnergy would only be able to provide on-peak power to GPUE during periods when demand peaks in PJM and FirstEnergy's market area are not coincident. *See* Applicants Reb. St. 5 at 6-7. Mr. Kaiser estimated that "on peak, our generating units on average can provide 350 MW of POLR support through delivery of energy." *Id.* With the exception of the Seneca plant and western PJM contract cited by Mr. Kaiser, however, such sales would be subject to the same transmission capability restraints discussed above. *See id.* at 7. In this regard, Mr. Kaiser does not elaborate on the degree to which energy from Seneca or the PJM contract could be expected to be available to serve GPUE during GPUE peak load periods. More fundamentally, the Applicants present no quantification of the potential cost savings, if any, to GPUE customers from these speculative on-peak deliveries.

When Applicants discuss how the merger could improve long-range supply for GPUE, the story becomes even more speculative. *See generally* Applicants Reb. St. 5 at 7-9. Mr. Kaiser identifies a number of possibilities, such as building new generation in PJM, building new transmission lines, and contracting for supply in PJM. *Id.* at 7-8. No specifics are provided concerning any of these "options," much less an explanation why these bare possibilities are *merger* benefits and cannot be realized otherwise. Such speculation can not possibly constitute substantial evidence that GPUE customers will benefit from the proposed merger.

c. Even Accepting, *Arguendo*, The Ability Of FirstEnergy Generation To Mitigate GPUE PLR Supply Costs, This Cannot Be Considered A Merger Benefit

(i) Applicants Have Not Explained Why The Merger Would Change GPUE's Supply Alternatives

A common theme of the Applicants' case is to seize on any potential improvement in GPUE operations and claim it as a "merger benefit," regardless of whether such improvements are a consequence of the merger. The Applicants' claims regarding PLR supply options fit this mold. Simply put, the options described by Applicants for mitigating GPUE's PLR costs, if they are available at all, could be implemented regardless of whether the merger goes forward. Thus, even accepting, *arguendo*, that the supply options cited by the Applicants are feasible, they cannot be viewed as merger benefits.

The record shows that GPUE can and does currently purchase power from FirstEnergy to supply its PLR obligations. *See* Tr. at 925, 1035-36, 1049-50, 1079. Mr. Kaiser agreed that FirstEnergy's marketing subsidiary could make off-peak sales to GPUE today. Tr. at 1079. Further, Mr. Frame acknowledged that FirstEnergy's incentives to lower its costs and prices to compete for GPUE customers remains the same before and after the merger. Citizen Power Cross-Exam. Exh. 1; Tr. 602, 604, 608. Similarly, nothing currently prevents FirstEnergy from constructing new generating plants or contracting for power in PJM. Further, FirstEnergy could presently seek to increase transmission capability to PJM. Thus, the merger will not improve the FirstEnergy supply options currently available to GPU.

When the merger was announced, Applicants held two days of meetings with Wall Street analysts. *See* Tr. at 1160; Citizen Power Cross-Exam. Exh. 3. Transcripts show that the analysts several times sought an explanation of how a merger would increase existing supply options or

reduce GPU costs, but the Applicants were unable to provide an adequate explanation.[3] *See* Citizen Power Cross-Exam. Exh. 3, 8/8/00 tr. pp.10-14, 18-19, 24-26; 8/9/00 tr. pp. 16-19, 21.

(ii) If, As Applicants' Economist Claims, FirstEnergy Has No Market Power In Any PJM Markets, There Is No Benefit To GPU From Purchasing FirstEnergy Supplies

For FirstEnergy supplies to provide a merger-related benefit to GPUE, and, ultimately, the public, the Applicants must prove (i) that FirstEnergy can actually provide a supply option not otherwise available, or if available, one that would cost more to obtain elsewhere and (ii) that this option is made possible by the merger. But by the account of their own witnesses, Applicants cannot satisfy either prong of this test.

According to Applicant witness Rodney Frame, the PJM wholesale markets (including the GPUE service territories) into which FirstEnergy sells power are competitive, *i.e.*, they are "characterized by the absence of market power." Applicants St. 4 at 9; Tr. at 593, 609. This conclusion, if correct, has several significant consequences. In a competitive market, as Mr. Frame acknowledged, all sellers are "price takers," that is, they must accept the market price for their products. Tr. at 598-99. From the buyer's perspective, this means that it makes no difference who supplies it – the products and services are fungible.

As Citizen Power explained earlier, FirstEnergy is short on capacity, so it is not even a competitor in the PJM markets for on-peak capacity. Tr. at 595-96, 1041, 1108-09. FirstEnergy is only a player in the off peak capacity market. *See generally* Tr. at 595-96. And, since FirstEnergy lacks market power, by definition it lacks any advantage over other suppliers of off

[3] A representative question stated: "Right now, GPU can buy power in the off-peak market isn't that correct? And you guys can sell into the wholesale off-peak market? I guess what we're trying to figure out or what some of the questions seem to be aimed at is what exactly is the synergy, if you guys are able to currently sell into the off-peak market, you know, to the wholesale market and they're able to buy in the wholesale market, where is the synergy that's associated with that? If right now it seems like you guys are able to do this without the [merger] transaction." Citizen Power Cross-Exam. Exh. 3, 8/8/00 tr. at 24.

peak energy. In the PJM spot market where GPUE buys energy, FirstEnergy, like other suppliers, sells its capacity into an exchange. Tr. at 604-05. The buyer pays the exact same price regardless of supplier. Tr. at 605-06. The conclusion is the same in the bilateral contract market for energy. In that market, there is no reason to believe that GPUE could receive a better price from FirstEnergy than from other suppliers, since, as Mr. Frame acknowledged, none have market power and must therefore be price takers. Tr. at 598-99.

The only effect of the merger identified by Applicants that would conceivably improve upon the status quo is the indication that GPUE would be sold power at cost-based rates following the merger. *See* Tr. at 1050. In theory, providing power to GPUE at cost-based rates could benefit customers, provided that FirstEnergy's costs do not exceed market prices. However, there is no record evidence from which the Presiding Judge or the Commission could conclude that benefits of FirstEnergy cost-based rates will actually accrue to GPUE customers. In this connection, Mr. Kaiser testified that no effort had been made to quantify the incremental savings that would accrue to GPUE as result of buying FirstEnergy power at cost-based rates. Tr. at 1050. Accordingly, there is no record evidence to support the contention that charging cost-based rates would result in any incremental savings to GPUE customers.

Further, to the extent that Applicants might contend that sales to GPUE, as an affiliate, must be made at cost under Section 13(b) of the Public Utilities Holding Company Act, 15 U.S.C. 79m,[4] the Federal Energy Regulatory Commission ("FERC") has consistently observed that this section applies to intra-affiliate transactions involving *non-power* goods and services. *See, e.g., Ohio Edison Co.*, 94 FERC ¶ 61,291, slip op. at 13 (March 15, 2001). Moreover, the Applicants have not cited any binding commitment to sell any power to GPUE at any particular

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[4] Applicants have not, to Citizen Power's knowledge, made such a contention.

rate as part of the merger. In this regard, one must question what incentive FirstEnergy would have to sell to GPUE at a cost-based cap if it could receive a higher price on the market.[5] Indeed, additional record evidence casts doubt on FirstEnergy's intention to sell to GPUE if more attractive price options exist. During the aforementioned conference call with Wall Street analysts, Mr. Peter Burg, Chairman and CEO of FirstEnergy, was specifically posed a hypothetical choice between selling to GPU "versus other opportunities at higher prices elsewhere . . . ." Citizen Power Cross-Exam. Exh. 3, 8/9/00 tr. p. 21. Mr. Burg responded

> Well, I mean obviously you have to take all of those factors into consideration, and we will do that. We'll look at the economic trade-offs and consider what's the best for the bottom line going forward.

Id.; *see also* OCA St. 1 at 37. Mr. Burg's response makes perfect economic sense. There is no incentive for the merged company to provide power to GPUE at below-market rates when its could sell into any market at a higher price. On the contrary, such conduct would be adverse to the interests of shareholders.

(iii) A Reduction In Competitive Risk To FirstEnergy Is A Benefit To FirstEnergy, Not A Public Benefit

Mr. Kaiser's testimony supports a finding that the effect of the merger vis-à-vis sales from FirstEnergy to GPUE is to benefit FirstEnergy, while leaving GPUE at the status quo. Mr. Kaiser explained that the merger allows FirstEnergy to "avoid the risk of a firm sale into PJM . . . ." Applicants Reb. St. 5 at 5; *see also* Tr. at 1079-80. Mr. Kaiser explained that although FirstEnergy can and does currently sell power to GPUE for its PLR load, FirstEnergy runs a risk "whether or not our plants are available, whether or not their cost is low enough to beat the LMP,

[5] Assuming FirstEnergy sold energy to GPUE at less than market prices, the merged company would be worse off unless its shareholders were able to retain the entire cost savings, with no benefit shared with GPUE customers. Of course, in that instance, the lower priced power would provide no merger benefits to the public.

if they aren't, then we would buy from the market just as GPU would to cover the cost of that contract with GPU and potentially we would lose money in the transaction." Tr. at 1079-80. Merging with GPU simply removes the risk of entering into a firm contract with GPUE, who, as Mr. Kaiser notes will have to buy from the market either way:

> With the merger, GPU has to buy from the market either way. If we can provide it cheaper, they can save money. If we can't provide it cheaper, they can buy it from the market. So it takes the risk out of the transaction for us.

Tr. at 1080. Thus, FirstEnergy could sell to GPUE regardless of the merger. The only difference caused by the merger is that a current risk to *FirstEnergy* is eliminated. GPUE still faces the same market price risk it faces today.

3. Transmission Asset/RTO/ISO Issues

Citizen Power is not specifically addressing issues relating to these issues in its Main Brief. Citizen Power notes, however, that numerous parties, including OTS, OCA, and PJM have raised significant concerns that the proposed merger raises the troublesome prospect that GPU might not remain a member of PJM after the merger is completed. *See, e.g.*, OCA St. 1 at 31; MEIUG/PICA St. 1 at 32; PJM St. 2 at 9-14; OTS St. 2 at 3-6; PFII St. 1 at 14. Citizen Power shares these concerns.

4. Reliability/Customer Service Issues

The Applicants contend that the other "primary benefit" of the proposed merger will be improvements in reliability and customer service. *See generally*, Applicants St. 1 at 8-9; Applicants St. 3 at 4-7; Applicants Reb. St. 1 at 4-7, 11; Applicants Reb. St. 3; Applicants Reb. St. 6. Consistent with their *modus operandi*, however, the Applicants' discussion of these issues is vague and noncommittal. The Applicants do not offer anything by way of a commitment to assure Pennsylvania customers that the merger will improve reliability and/or customer service.

In this regard, Mr. Chesser agreed that in order to provide improved reliability, GPUE will have to do better than it has done historically. Tr. at 520. While this may be an obvious point, it is important to note that much of the Applicants' evidence on customer service and reliability issues describes FirstEnergy's methods, without providing any proof that implementation of such practices by the merged company would constitute an improvement over GPUE's historical methods or over what GPUE could do absent the merger. *See, e.g.,* OCA St. 1-S at 8.

Applicants assert that the merger will benefit the public interest by allowing the combined company to implement oft-cited but ill-defined "best practices." *See, e.g.,* Applicants St. 3 at 3; Applicants Reb. St. 1 at 5; Applicants Reb. St. 3 at 3. According to Applicants' own testimony, the best practices of the two companies are yet to be identified. *See* Applicants Reb. St. 1 at 5 (noting that "[t]hese practices are being identified by merger transition teams . . . ."); *see also* OCA St. 1 at 18. Accordingly, there is no evidence that any such best practices will be identified and/or implemented by the combined company such that Pennsylvania customers will benefit.

Even if one accepts the premise that FirstEnergy and GPUE will one day identify and implement best practices, it should not be considered a merger benefit. Mr. Chesser, CEO of GPUE, testified that GPU Energy currently makes efforts on a day-to-day basis to identify best practices. Tr. at 542. Mr. Roche's testimony also shows that their are numerous ways other than a merger to identify industry best practices, including employees, trade journals, and industry peers. Tr 980-81. These observations are consistent with Mr. LaCapra's testimony that "one could question the prudence of GPU's management if it has failed to routinely query neighboring utilities in an ongoing effort to learn of the best approaches to the businesses of electricity distribution and customer service." OCA St. 1-S at 8. The Commission itself is a source of best

practices. Mr. Roche explained that the Commission takes advantage of best practices when it establishes requirements and regulations. Tr. at 978. Mr. Roche agreed that the Commission has authority to order GPU and other utilities to implement best practices. Tr. at 978.

It cannot be seriously disputed that GPUE currently possesses the resources to implement best practices. Even without the merger, GPU is an enormous company, with a capitalization in excess of $10 billion. OCA St. 1-S at 7. Mr. Chesser testified that he believes that GPUE management and employees can hold their own with any one in the utility industry, Tr. at 540-41, and agreed that GPUE management and employees could implement a best practice once they identify and understand the practice. Tr. at 543-44. In sum, as Mr. LaCapra observes, a company of such size and resources should already be expected to provide a level of service consistent with the best that the electric industry has to offer. OCA St. 1-S at 8.

Applicants also contend that customer service will be improved as a result of the merger because of FirstEnergy's use of a regional management approach. *See, e.g.,* Applicants St. 1 at 10; Applicants St. 3 at 3-4; Applicants Reb. St. 1 at 4-5; Applicants Reb. St. 3 at 4-8. However, as the Applicants, acknowledge, GPU had already moved to a regional management approach prior to the merger agreement. *See* Tr. at 516, 544; Applicants Reb. St. 3 at 8. Accordingly, Applicants cannot claim that a regional management structure is a benefit of the merger. Rather, the crux of Applicants' position is that FirstEnergy will help GPU "fine tune" its regional structure and minimize the "growing pains" associated with the approach. Applicants Reb. St. at 8. Vague assertions that FirstEnergy will help develop a management approach that GPU has already implemented do not amount to substantial evidence of benefit.

Moreover, any benefit derived from FirstEnergy rendering guidance on the regional management approach is likely to be more than offset by the fact that, by the Applicants own

admission, the attention and resources of upper-level management of the merged company may be diverted away from operational matters to issues relating to integrating the two merging companies. *See* OCA St. 1 at 26 (quoting Applicants Joint Proxy Statement).[6] In the longer term, GPUE will become a smaller fish in a larger pool of FirstEnergy subsidiaries competing for the attention of upper-level management and corporate resources. In this respect, the Board of Directors of the merged company will consist of ten members of FirstEnergy's current Board, but will only include six members from GPU's current Board. Applicants St. 2 at 3. Thus the GPUE companies' importance will potentially be diluted as they transition from being a very large segment of an independent company to a smaller part of a much bigger entity. These detriments more than offset any assistance in "fine tuning" GPU's existing regional management structure.

The only other customer service and reliability issues on which Applicants attempt to go beyond mere generalizations are (i) major storm outages; (ii) momentary interruptions; (iii) call center operations; and (iv) linemen training. *See generally* Applicants Reb. St. 3. Mr. Cary describes FirstEnergy's efforts in these areas and asserts, without making any commitments, that such programs will translate to improvements in GPUE reliability and customer service. *See id.* at 9-20, 23-29. While FirstEnergy may have implemented certain constructive practices in its service territories, the Applicants offer nothing by way of proof that use of FirstEnergy's methods will improve upon the existing practices of GPUE. In this regard, Mr. LaCapra accurately observes that, while Mr. Cary describes certain FirstEnergy customer service and

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[6] During the course of the hearing, GPUE's CEO, Mr. Chesser, asserted that, while GPU was able to implement the best practices of FirstEnergy, the merger would allow more intimate discussions, leading to faster implementation. Tr. 542-44. This claim, of course, is at odds with the Applicants' acknowledgement (discussed above) that management's attention is more likely to be diverted to corporate integration. In any event, Mr. Chesser's vague claim seems decidedly *post hoc*, as he acknowledged that GPU made no study of benefits to ratepayers before deciding to merge. Tr. 529.

reliability programs, Mr. Roche of GPUE rejects any criticism of GPUE's current level of service. *See* OCA St. 1-S at 8.

With reference to storm outage management and call center operations, Mr. Roche testified that GPUE has in the last few years implemented a new outage management system and made improvements to its call center operations. *See* Applicants Reb. St. 6 at 4, 12. Mr. Roche's testimony was that, in making these improvements, GPUE has taken some significant steps towards improving reliability and customer service. Tr. at 974-75. Thus, even accepting Mr. Cary's testimony regarding the *bona fides* of FirstEnergy's outage procedures and call center operations, there is no evidence from which the Presiding Judge or the Commission could conclude that such approaches would constitute an improvement over GPUE's recent implementation of enhancements in the same areas.

The same conclusion is warranted regarding FirstEnergy's Power Systems Institute ("PSI") program for training linemen. *See* Applicants Reb. St. 26-28. From Mr. Cary's testimony, it appears that the PSI program is a commendable training program. However, the Applicants have not provided any testimony regarding the procedures GPUE currently uses to recruit and train linemen. Absent such evidence, it is not possible to conclude that the PSI program would represent an improvement to the existing level of service provided by GPUE.

5. Rate and Regulatory Issues

The Applicants have not committed to any reduction in customer rates as a result of the merger. *See* Applicants Reb. St. 1 at 11. Further, the evidence pertaining to potential merger savings (the most likely source of customer benefit from a cost standpoint) is woefully deficient. Finally, the Applicants provide inadequate assurances regarding recovery of the acquisition premium and fail to insulate customers from the transaction costs of the merger. Accordingly,

the record does not contain substantial evidence from which it could be concluded that the merger will result in pecuniary benefit to the customers of GPU.

a. Savings (Rate Issues)

In order to gauge the effect of a merger on corporate costs, it is typical for the merging companies to perform a detailed analysis of the potential merger savings for regulatory as well as internal purposes. *See* MEIUG/PICA St. 1 at 11. Remarkably, the Applicants have not performed such an analysis of the efficiency savings that could potentially accrue as a result of the merger. *See* Applicants St. 1 at 11. Mr. Kollen testified that, in his experience, the failure to perform such a study was "highly unusual." MEIUG/PICA St. 1 at 11. The failure of the Applicants to perform a merger savings analysis or commit to any savings achieved leaves the record devoid of substantial evidence to show that customers will ever receive any pecuniary benefit from the merger.

The only merger savings "analysis" performed by the Applicants was to assume an across-the-board five percent reduction in non-generation O&M expenses, *see* Applicants Reb. St. 2 at 7-8, which Applicants estimate will produce for the combined company $150 million in savings annually. *Id.* Applicants state that they derived this percentage by looking at savings announced in other utility mergers, *id.*, but produced no evidence demonstrating that the other mergers were comparable to a merger between GPU and FirstEnergy. Thus, the estimate advanced by the Applicants in this proceeding is not grounded in any analysis of reducing particular cost items.

The Commission has previously found that sharing of merger savings between customers and shareholders can be an affirmative benefit militating in favor of approving a utility merger. *See DQE, Inc.*, PaPUC Docket No. A-110150, F.0015 (April 30, 1998). In fact, in their presentation to Wall Street analysts, Applicants all but conceded that some sharing would be

required, acknowledging that 50-50 sharing would be reasonable to assume. *See* MEIUG/PICA St. 1 at 14-16; Citizen Power Cross-Exam. Exh. 3, 8/9/00 tr. at 9. Here, because there has been no commitment to share any portion of merger savings with customers, Applicants Reb. St. 1 at 11, cost savings cannot be considered a benefit of the merger.

The Applicants' contention that merger savings will be reflected in rates as they are adjusted in the future does not change this conclusion. Applicants Reb. St. 1 at 11. First, by failing to perform a detailed analysis of cost savings opportunities, there is no record evidence upon which to base a finding that any cost savings will ever be achieved. In this connection, when asked if there was any guarantee that merger-related savings will exist at the time of the next base rate case, Mr. Marsh bluntly stated:

> There's no guarantee that any merger synergies will be achieved at all. That's something that management has to make happen. But, no, there are no guarantees that they'll exist at any point in time.

Tr. at 1157.

Even assuming cost savings are achieved, the Applicants' decision not to perform a detailed synergies study prior to seeking merger approval leaves the Commission and other interested parties at a disadvantage in efforts to gauge the level of savings that is likely to result from the merger and/or the level of sharing between shareholders and customers that might be appropriate. *See, e.g.*, MEIUG/PICA St. 1 at 11-12; OCA St. 1 at 36. As Mr. Kollen observes, the Applicants' $150 million merger savings estimate "seeks to establish a cap on the savings available to share with ratepayers simply by making an assumption, which the Companies have not chosen to support through any type of study." *Id.* In fact, it is quite possible that actual merger savings could exceed the $150 million estimated by Applicants. Mr. LaCapra testified that merger savings projections typically range from five to fifteen percent, with the greatest

savings achieved in mergers where, as here, utilities with adjoining service areas merge. OCA St. 1 at 25.

The Applicants are circumspect, to say the least, as to whether customers would ever see any such savings. In this regard, the Applicants explained in a data response that their analysis is not meant to "imply that the 5% [cost savings] figure is appropriate to apply to each of the components individually." Applicants Reb. St. 2 at Exh. RHM-1. Similarly, Mr. Alexander noted vaguely that "savings would be attributed to each particular FirstEnergy entity, *as appropriate*." Applicants St. 1 at 11. Further, pursuant to the restructuring settlement, MetEd and Pennelec will not file a rate case before 2004 at the earliest. If the companies' T&D costs have not risen enough to offset merger cost savings, they will have no reason to file for increased rates. They can retain all merger savings. *See* OCA St. 1 at 36. Thus, the record contains no evidence to support a finding that GPUE customers would see any merger cost savings from the merger regardless of the level of savings achieved.

The prospects of GPUE customers benefiting from merger cost savings are further diminished by the fact that Applicants "commitment" with respect to merger related costs is that no such costs "*in excess of merger related* savings . . . will become part of GPU Energy's cost of service for ratemaking purposes." Joint Application at 10. Consequently, merger-related savings, if any, will apparently be reduced and could potentially be neutralized by merger related costs and amortization of the acquisition premium. In this regard, the failure to quantify expected merger-related savings is important because, as Mr. Kollen explained, "the Companies' approach makes it much simpler for them to assert in future ratemaking proceedings that they have achieved significant savings as the predicate to recover the acquisition premium and costs of the merger." MEIUG/PICA St. 1 at 12.

b. Acquisition Premium

The shareholders of GPU are slated to receive a substantial premium for their shares in merging with FirstEnergy. *See* OCA St. 1 at 24. The proposed purchase price represents a premium of over $1 billion above-book value. OCA St. 1 at 24 (citing Applicants' response to OCA-XI-3 at 12). Of this premium, Mr. LaCapra estimated that approximately $580 million represents a payment above the market value of GPU shares. *Id.* The above-market premium paid by FirstEnergy will be retained by GPU shareholders. Tr. at 1155-56; OCA St. 1 at 24. FirstEnergy will capitalize the acquisition premium as goodwill, which may be recognized on the balance sheets of GPU subsidiaries once the companies merge. *See* MEIUG/PICA St. 1 at 20. As Applicants proposal now stands, the acquisition premium provides no potential benefit to Pennsylvania customers, but presents several significant risks to customers.

Applicants assert that FirstEnergy "will not seek to recover this cost from its utility customers." Applicants Reb. St. 2 at 6. This commitment, of course, simply maintains the status quo and does nothing to support a finding that the merger will result in affirmative benefits to Pennsylvania customers. More importantly, the Applicants' pledge not to seek recovery of the acquisition premium in utility rates is significantly qualified by their position that merger savings, if any, will only be passed to customers net of costs to achieve the merger savings. *See* Applicants Reb. St. 2 at 9; MEIUG/PICA St. 1 at 21. In other words, the Applicants have improperly failed to foreclose the possibility that FirstEnergy will indirectly recover acquisition premium costs as an offset to merger savings that would otherwise flow to customers. *See id.*

c. Costs to Achieve

As explained above, the Applicants' position regarding costs to achieve the merger represents a significant qualification on their already nebulous claims regarding the potential cost savings benefits of the merger for Pennsylvania customers. The Joint Application states that

“[n]o merger-related costs *in excess of merger related savings* (that is, transaction costs, severance payments, etc.) will become part of GPU Energy’s cost of service for ratemaking purposes.” Joint Application at 10 (emphasis added). Mr. Marsh further explained the Applicants’ position:

> If rates are reset to include the benefits of merger savings, then all of the investments made to obtain those savings as well as any other costs that would be incurred to improve service should be recognized as a legitimate cost of providing service for customers.

Applicants Reb. St. 2 at 9. The significance of Applicants position is that merger-related savings, if any, will be reduced, and potentially neutralized, by merger related costs. Significantly, the Applicants have not provided a succinct definition of what they consider the “costs to achieve” the merger, let alone an estimate of such costs. Thus, even if the Presiding Judge or the Commission were to believe that the merger provides the prospect of some synergy cost savings to Pennsylvania customers, the fact that Applicants intend to offset undefined and unquantified costs undermines any conclusion that customers will benefit from actual savings achieved.

d. Nuclear/Fossil Cost Issues

If it had been shown that use of FirstEnergy generation could reduce the cost of power to GPUE PLR customers, merging with a company owning such generation could potentially be viewed as a benefit. As explained above, however, the Applicants have not made a plausible showing that FirstEnergy’s generation resources will materially assist GPU in meeting its remaining power supply obligations in a way that serves the public interest. Conversely, the record shows that merging with a company that remains heavily invested in generation, particularly nuclear plants, presents substantial risks to GPU. Thus, GPU customers are left with

the worst of both worlds: they will derive little or no benefit from merged company generation, but will be exposed to the costs and risks associated with such generation.

Credit rating agencies viewed favorably GPU's decision to exit the generation business. *See* OCA St. 1 at 28 (citing OCA-VI-6(a)). This is consistent with the testimony of GPU CEO Fred Hafer that GPU considered the regulated wires business to be a more stable, predictable business than generation ownership, which is subject to market forces. *See* Tr. at 1518. Mr. Hafer explained that:

> GPU made a strategic decision not to enter into [the deregulated generation] market because of the risks and uncertainties that were associated with it, and to pursue instead what we had believed to be the more secure, predictable, regulated market in which it believed it could excel.

Id.

The proposed merger would catapult GPU right back into the generation business with its attendant risks while providing little or no benefit to GPUE customers. Indeed, the Joint Proxy Statement describing the proposed merger warned that GPU shareholders will be exposed to risks relating to the ownership of electric generation plants. *See* OCA St. 1 at 28. The financial risk to GPU became evident immediately following the announcement of the merger when the major credit rating agencies, Standard & Poor's, Moody's, and Fitch all swiftly put GPU on a credit ratings watch with negative implications. *See* Tr. at 642-44; MetEd/Pennelec St. 2-PLR at 9-10, Exh. TGH-2; OCA St. 1 at 27. Notably absent from the announcements regarding the ratings watch for GPU is any mention that FirstEnergy would likely be able to assist GPU with its PLR obligations. *See* MetEd/Pennelec St. 2-PLR at Exh. TGH-2 and TGH-3. GPU remains on ratings watch for all three major agencies. Tr. at 644-45. In this regard, Mr. Howson noted that Moody's recently revised its position to include "in their downgrade watch the risks associated with the PLR proceeding." Tr. at 645. Significantly, Moody's did not even address

the prospect that GPU's exposure might be reduced by the ability to use FirstEnergy generation to mitigate GPU PLR costs. *See* MetEd/Pennelec St. 2-PLR at Exh. TGH-3. Thus, according to the major credit rating agencies, the merger represents a negative for GPU that is not offset by the affiliation with FirstEnergy generating resources.

The practical effect of the credit rating agencies' view is that the cost of capital could be increased for GPU and its subsidiaries. As Mr. Marsh explained, "what the ultimate credit ratings turn out to be would have an impact on the cost of capital and access to the markets" for a company on credit ratings watch. Tr. at 1159. Thus, by becoming part of a company with substantial investments in generation, GPU is likely to face increased credit costs without deriving meaningful benefits from the generation.

The prospect that GPU and its subsidiaries could face increased costs and risks associated with FirstEnergy generation is not idle speculation. Mr. LaCapra explained that roughly thirty percent of FirstEnergy's generation capacity is from nuclear fueled units. OCA St. 1 at 28-29. This is cause for concern because "[n]uclear units represent significant regulatory and operational risks including extended outages, liability and decommissioning costs." *Id.* FirstEnergy's fossil plants also face significant costs. FirstEnergy's Sammis plant is the target of an enforcement action under the Clean Air Act brought by the Department of Justice on behalf of the Environmental Protection Agency in which the government is seeking hundreds of millions of dollars in fines as well as an order requiring the plant to comply with new source performance standards. *See* Citizen Power Cross-Exam. Exh. No. 4 at 25-26; OCA St. 1 at 29; PFII St. 1 at 9-11; Tr. at 1207-08. Even though the DOJ/EPA suit remains pending, its presence, like any other contingent liability, has an effect on the financial health of the Company. Significant costs and

risks could adversely affect the credit quality of the entire combined company. *See* OCA St. 1 at 29.

Thus, the financial risk to the merged company, and ultimately, its rates and its ability to compete in the marketplace is potentially severe.

e. Jurisdictional Issues

The only jurisdictional issue addressed by Citizen Power is discussed in the next section, "Corporate Structure Issues." Citizen Power reserves the right to address such issues further in its reply brief or in briefs on or opposing exceptions.

6. Corporate Structure Issues

The Applicants state that, following the merger, FirstEnergy will become a registered public utility holding company under the Public Utility Holding Company Act of 1935. Applicants St. 1 at 6. Further, the Applicants contend that a benefit of the merger will be the ability to "eliminate certain duplicative activities and allow for more efficient use of [the Applicants'] combined staffing, particularly at the corporate and administrative levels." *Id.* at 9. According to Mr. LaCapra, the OCA made substantial efforts to gain a better understanding of the plans regarding the post-merger structure of the combined company and, in particular, the support services. The Applicants' responses indicated a lack of any detailed plans. *See* OCA St. 1 at 16-17, 27-28.

As Mr. LaCapra explains, the lack of detailed plans for the post-merger structure of the company creates uncertainty relating to, among other things, the cost allocations between the subsidiaries of the merged company. *See* OCA St. 1 at 27. The Applicants have notably not agreed to waive the defense that a Securities & Exchange Commission ("SEC") determination with respect to corporate overhead issues preempts a Commission determination on this issue,

i.e., the *Ohio Power* defense.[7] Thus, absent waiver of the *Ohio Power* defense, there is a danger that the merger will adversely affect the Commission's ability to regulate the shared services costs allocated to GPUE.

7. Financial Arrangement Issues

Citizen Power is not addressing this issue in its Main Brief. Citizen Power reserves the right to address such issues in its reply brief or in briefs on or opposing exceptions.

8. Community Issues

Applicants contend that the merger will have a positive impact on the communities in which GPUE currently serves. *See* Applicants St. 1 at 11; Applicants St. 2 at 5; Applicants St. 3 at 8. As with almost all of Applicants' claims, however, the Applicants' testimony is largely vague and non-specific. Where the Applicants do make something resembling a concrete proposal, it is clear that the merged company would, at best, maintain the status quo with respect to its commitment to the Pennsylvania communities it serves. Moreover, there is substantial contrary evidence showing that the merger is likely to have an adverse impact on the Pennsylvania communities served by GPUE and Penn Power. *See* Section 8.c, below.

a. Charitable Contributions

The Applicants have committed to maintain GPUE's charitable contributions at existing levels for three years, and thereafter at levels comparable to its Ohio utilities. Applicants Reb. St. 1 at 14. Thus, for the first three years, this commitment merely requires the merged company to maintain the status quo. Following the initial three period, communities served by GPUE cannot be sure that they will receive so much as a dime in charitable contributions. In this regard, Mr. Alexander was noncommittal concerning the amount of charitable giving in Pennsylvania communities following the initial three year commitment. He asserted that he did

[7] *Ohio Power Co. v. FERC*, 954 F.2d 779 (D.C. Cir.), *cert. denied*, 498 U.S. 73 (1992).

not consider charitable giving a “numbers game,” Tr. at 1193, and explained the Applicants’ proposal this way:

> I’m going to – organization will try to balance charitable as [sic] giving across all of its service territories. That charitable giving could be up, it could be down depending a lot on our financial condition of the company. You can only give if the company is doing well. If the company is not doing well, it won’t be able to support, not only in Pennsylvania but in Ohio.
>
> What we’re really saying is that through the foundation and through our efforts of trying to stay as close as we can to all of our communities, I’m going to try to treat them as fairly as we can and consistently across all of our service territories.

Tr. at 1194-95.

No where in Mr. Alexander’s answer is there a commitment to maintain charitable giving at existing levels. To the contrary, Mr. Alexander warns that charitable giving could cease depending on the finances of the company, and, at best, promises to treat the communities served by the merged company fairly and consistently across the company’s territory. While charitable giving may be voluntary, the Applicants’ commitment to maintain the status quo for three years with no assurance beyond that time cannot reasonably be considered a benefit of the merger.

b. Pennsylvania Economic Development

This issue is addressed in section IV.C.8.c, immediately below.

c. Pennsylvania Presence

Because GPU is already headquartered in another state, Pennsylvania does not have to address the potential loss of corporate headquarters to a neighboring state. Nonetheless, the Commission should be concerned by the fact that three utilities operating in the Commonwealth will now be part of a much larger corporate entity. The merged company will be headquartered in Akron, Ohio, and will have utility operations across three different states. The Board of Directors of the merged company will consist of ten members of FirstEnergy’s current Board,

but will only include six members from GPU's current Board. Applicants St. 2 at 3. Necessarily, GPUE and PennPower will be competing for the attention of upper level management, the Board and the resources of a much larger company.

Further, Mr. LaCapra notes that GPUE has been recognized for its efforts to develop commercial enterprise in Pennsylvania. OCA St. 1 at 51. The Applicants have stated that the future of GPUE's economic development programs are being reviewed. *Id.* There should be at least some concern that FirstEnergy management will favor economic development in its traditional home state of Ohio at the expense of Pennsylvania. *See id.*

d. Employee Issues

Citizen Power is not addressing these issues in its Main Brief. Citizen Power reserves the right to address such issues in its reply brief or in briefs on or opposing exceptions.

9. NUG Issues

Citizen Power is not addressing these issues in its Main Brief. Citizen Power reserves the right to address such issues in its reply brief or in briefs on or opposing exceptions.

10. Environmental Issues

Glaringly absent from the Applicants' initial filing was any discussion of the impact the merger would have on environmental concerns. There can be no serious dispute that the Commission is required to consider the potential environmental effects of a merger in determining whether the merger "is necessary or proper for the service, accommodation, convenience, or safety of the public" under 66 Pa. C.S. § 1103(a). *See, e.g., L&H Trucking Co., Inc.*, Docket No. A-102463, 1982 Pa. PUC LEXIS 162 *9-10 (January 8, 1982) (holding that the environmental impact of issuing a certificate to a regulated company is relevant to the Commission's determination of whether issuance of the certificate is in the public interest). The

Applicants have patently failed to satisfy their burden to show that the merger will not have an adverse effect on the environment and on the health of the citizens of the Commonwealth.

The record shows that air quality in Pennsylvania would be harmed as a *direct result* of the merger if the Applicants' petition were to be approved. In addition to the direct environmental harm that would be caused by the merger, the evidence raises substantial questions concerning FirstEnergy's environmental compliance record and shows that FirstEnergy could face serious financial consequences arising from its environmental record. These environmental problems with the merger are serious enough that the Presiding Judge and the Commission should find that it is not in the public interest to authorize the merger between GPU and FirstEnergy.

As proposed, the merger would have a direct adverse effect on the environment. As part of its case, FirstEnergy has stated that it intends to run certain of its coal-fired plants at a higher capacity factor in order to attempt to deliver more power into PJM to supply GPUE's PLR requirements. *See, e.g.*, Applicants Reb. St. 5 at 5; Tr. at 1081-1083; Citizen Power Cross-Exam Exh. 3, 8/8/2000 tr. at 11-12, 24. Mr. Kaiser testified that the plants that would be run more extensively would be FirstEnergy's Mansfield plant and Sammis Station Units 6 and 7. Tr. at 1079-80. Mr. Kaiser acknowledged that running these plants at a higher capacity factor would result in greater nitrogen oxide and sulfur dioxide emissions from the plants. Tr. at 1082, 1114.

Although, as explained above, the likely mitigation of PLR costs from such increased use of FirstEnergy plants is negligible, the fact is that FirstEnergy intends to increase the capacity factor of its coal plants as a result of the merger and thereby increase emissions. Sammis Station is one of FirstEnergy's most environmentally damaging plants. Collectively, Sammis' seven units emitted 120,619 tons of sulfur dioxide and 32,008.2 tons of nitrogen oxide in 2000. CAC

Cross-Exam Exh. 4 at 5; *see also* Tr. at 1118-19. Current emissions from Sammis Units 6 and 7 are roughly five to six times the new source performance standards for sulfur dioxide. Tr. at 1118-19. An analysis by Mr. Rohrbach found that, for 1998, Sammis represented 43% to 61% of FirstEnergy's total emissions of sulfur dioxide, nitrogen oxide and carbon dioxide, and that Sammis' nitrogen oxide emissions were the equivalent of 30% of the emissions level of all major utilities in Pennsylvania *combined*. PFII St. 1 at 5. In this connection, the DOJ states in its Amended Complaint against FirstEnergy that:

> As a result of Defendants' operation of the Sammis power plant following these unlawful modifications and the absence of appropriate controls, massive amounts of sulfur dioxide, nitrogen oxides, and particulate matter have been, and are still being, released into the atmosphere, aggravating air pollution locally and far downwind from this plant.

Citizen Power Cross-Exam. Exh. 4 at 2.

The pollution created by Sammis and other FirstEnergy plants affects Pennsylvania air quality. Mr. Kaiser agreed that emissions from plants in Ohio can be carried into Pennsylvania. Tr. at 1083-84. The EPA has previously determined that Ohio power plants contribute significantly to air quality problems in Pennsylvania. *See* PFII St. 1 at 7; *see also Finding of Significant Contribution and Rulemaking for Certain States in the Ozone Transport Assessment Group Region for Purposes of Reducing Regional Transport of Ozone*, 63 Fed. Reg. 57356 at 57394-95 (October 27, 1998). Mr. Rohrbach also cited modeling evidence showing that pollution from Ohio power plants has air quality consequences in Pennsylvania. PFII St. 1 at 8. In this connection, Mr. Rohrbach explained that Sammis is located in Stratton, Ohio, on the West Virginia-Ohio border less than twenty miles from the Pennsylvania border, and that Sammis has especially tall chimneys that have the effect of increasing the dispersion of pollution. *Id.* at 8-9.

It bears emphasis that the problem of pollution from plants to the west and south of Pennsylvania was a distinct public interest concern recognized by the Pennsylvania General Assembly in passing the Competition Act. Included in the Act's Declaration of Policy was a finding that:

> Under federal and state clean air laws and regulations, electricity generators located in states to the west and south of this Commonwealth are not subject to requirements as stringent as those which apply to generators and other "persons" as defined in section 3 of the act of January 8, 1960 (1959 P.L.2119, No.787), known as the air pollution control act, operating in this Commonwealth and that different regions within this Commonwealth are subject to varying air emission requirements. Under some scenarios, competition among electricity generators located in different states and different regions within this Commonwealth could make it more difficult for areas in this Commonwealth to demonstrate attainment with federal and state air quality standards. Since this result may be caused by the disparate requirements imposed by federal and state law on generators and other "persons" as defined in section 3 of the air pollution control act in this Commonwealth and generators located in other states, the general assembly supports changes to federal clean air laws and regulations that will protect Pennsylvania's environment and ensure that electricity generators and other "persons" as defined in section 3 of the air pollution control act located in this Commonwealth are not placed at an undue competitive disadvantage. The Commission will consult with the Department of Environmental Protection regarding this issue during the transition to retail competition.

66 Pa. C.S. § 2802(21). Thus, FirstEnergy's stated intention to run its coal-fired plants at a greater capacity factor in an effort to sell lower-cost power into Pennsylvania raises the very concerns expressed by the General Assembly, and for which the General Assembly sought remedies.

This foregoing evidence clearly supports a conclusion that FirstEnergy's stated intention to run Mansfield and Sammis at greater capacity factors as a result of the merger will adversely affect the air quality in Pennsylvania, in contravention of the public interest. This conclusion is

in no way rebutted by Mr. Kaiser's contention, first offered at the hearing, that increased emissions from Sammis and Mansfield would be offset by reduced emissions from other plants. Tr. at 1083-84. According to Mr. Kaiser, his conclusion was based on a FirstEnergy analysis of the effect on air quality of increasing emissions from Sammis and Mansfield, *see* Tr. at 1083-84. While Applicants have refused to include the analysis in the record,[8] it is nonetheless clear from Mr. Kaiser's testimony at the hearing that the study does not support his conclusion. As Mr. Kaiser acknowledged, FirstEnergy's analysis compared the potential increased emissions from Sammis and Mansfield to the *average emissions* of GPU's former plants, the western PJM utilities, Virginia Power, and ECAR plants. Tr. at 1114. Thus, the record indicates that the FirstEnergy analysis referenced by Mr. Kaiser compared apples to oranges. It compared the potential emissions from *specific* FirstEnergy plants to the *average* emissions from other companies and control areas. *Id.* By definition, there can only be a full offset of increased emissions from Sammis and Mansfield if emissions at other plants are reduced by at least the same amount. If, however, one only knows the *average* emissions of a group of plants based on their former use without knowing which plants actually will be backed down (and to what extent), if Sammis and Mansfield are run more extensively, there is no basis to measure the future impact. Thus FirstEnergy's unfiled "study" cannot serve as the basis to conclude that running the Sammis and Mansfield plants at a higher capacity factor will not adversely affect Pennsylvania air quality. Accordingly, Mr. Kaiser's claim that running Mansfield and Sammis more extensively will not increase pollution in Pennsylvania is not entitled to any weight.

As previously discussed, FirstEnergy subsidiaries Ohio Edison and Penn Power are currently defendants in a civil action brought by the DOJ on behalf of the EPA alleging that

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[8] Citizen Power submits that a negative inference may be drawn from Applicants' refusal to agree to place the analysis in the record. Presumably, if the study fully supported Mr. Kaiser's testimony, Applicants would not object

FirstEnergy repeatedly and over an extended period of time violated the Clean Air Act and the Ohio State Implementation Plan ("SIP") at FirstEnergy's Sammis Station. *See* Citizen Power Cross-Exam. Exh. No. 4. Prior to the suit being filed, the EPA issued a notice of violation to FirstEnergy. *See* Citizen Power Cross-Exam. Exh. 2; Tr. at 1084-87. The DOJ suit alleges that the Sammis plant has been modified numerous times "without first obtaining appropriate permits authorizing this construction and without installing the appropriate pollution control technology to control their emissions of nitrogen oxides, sulfur dioxide, and particulate matter, as the Act and the Ohio SIP require." *Id.* at 2. The DOJ seeks an order permanently enjoining FirstEnergy from operating the Sammis plant, except in accordance with applicable regulatory requirements. The government also seeks, *inter alia*, an order that FirstEnergy install the best available control technology on the Sammis station for each pollutant regulated under the Clean Air Act. *Id.* at 25.

The government also seeks large financial penalties against FirstEnergy. The suit alleges four separate continuing violations of the Clean Air Act, and notes that for each violation the defendants could be liable for "civil penalties of up to $25,000 per day for each violation prior to January 30 1997, and $27,500 per day for each such violation after January 30, 1997." *See id.* at 21-23, 25-26. The Amended Complaint alleges violations going back as far as 1984. *Id.* Thus, even a conservative estimate of FirstEnergy's potential exposure could reach into the hundreds of millions of dollars.

The pendency of the DOJ lawsuit must be considered a significant risk to the public interest of Pennsylvania in evaluating the proposed merger. While FirstEnergy has denied the DOJ's contentions, the existence of serious allegations of environmental wrongdoing by the federal government casts a shadow over FirstEnergy that bears on its fitness to acquire

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to the analysis being in the record.

Pennsylvania utilities. *Cf. National Broadcasting Co. v. United States*, 319 U.S. 190, 222-23 (1942) (holding that the FCC was entitled, in making a public interest finding, to consider behavior that it found to be anticompetitive, even though the behavior had never resulted in a conviction for violation of antitrust laws). If the potential consequences of the alleged misconduct are not considered by the Commission and the serious allegations are later proven true, it will be too late to prevent the merger or attach conditions to protect against the risk of such misconduct.

Moreover, if the allegations against FirstEnergy are proven, FirstEnergy faces several hundred million dollars in fines. The payment of such fines, even though not likely recoverable from ratepayers, could weaken the merged company financially and thereby increase its cost of raising capital. These increased capital costs would then likely be reflected in higher rates, and impair FirstEnergy's ability to compete in retail markets.

Also of concern should be the potential costs of modifying Sammis Station to comply with the Clean Air Act, should the allegations be upheld. Mr. Kaiser acknowledged that current emissions from Sammis Units 6 and 7 are roughly five to six times the NSPS for sulfur dioxide. Tr. at 1118-19. Suits similar to the one involving Sammis have been settled by other utilities, which generally agreed to significantly reduce emissions. *See* PFII St. 1 at 10-11. As noted, in settling a related suit, Cinergy agreed to spend $1.4 billion to clean up pollution from its coal-fired plants. OCA St. 1 at 29.

Thus, there is clear evidence that the merger will have a direct adverse effect on Pennsylvania air quality as a result of FirstEnergy's increased output from its plants, particularly Sammis Station. Moreover, the pending DOJ lawsuit in which FirstEnergy has been accused of serious environmental violations and faces enormous fines and remedial expenses must be

considered a significant risk in Commission's evaluation of whether it is in the public interest to authorize FirstEnergy to acquire GPU and its public utility subsidiaries. These environmental problems with the merger are serious enough that the Presiding Judge and the Commission should find that it is not in the public interest to authorize the merger between GPU and FirstEnergy unless and until these problems are resolved.

11. Other

Citizen Power is not addressing other issues in its Main Brief. Citizen Power reserves the right to address such issues in its reply brief or in briefs on or opposing exceptions.

D. Competitive Issues Under Section 2811(e)

1. Applicants Have Not Met Their Burden Under Section 2811(e)

The Competition Act requires the Commission to investigate 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) (emphasis added). If the Commission finds that the merger is likely to adversely affect the development of the competitive retail market, the Commission may not approve the 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.* The Applicants acknowledge that they must satisfy the requirements of Section 2811(e). *See* Joint Application at 5.

The Applicants have clearly failed to carry their burden under Section 2811(e). The Applicants' direct case relied on the testimony of Mr. Rodney Frame concerning *wholesale* electric markets from the Applicants' FERC merger application. *See* Applicants St. 4 at 4-11 (relying on Applicants Exh. APP-300). As discussed below, Mr. Frame's testimony fails to

prove that the merger is unlikely to result in anticompetitive conduct in Pennsylvania *retail* markets. Because Applicants have failed to satisfy their burden to show that the merger satisfies the requirements of section 2811(e), the merger may not be approved as proposed. As explained above, Applicants' failure to meet their burden on this and other issues warrants a finding that the merger should be rejected. Specifically, the Commission should decline to exercise its conditioning authority under Section 2811 to salvage Applicants' deficient proposal.

Mr. Frame admits that he did not examine, or even define the relevant Pennsylvania retail electricity markets in his analysis of the proposed merger's effect on competition. Tr. at 621. Instead, he argues that a study of the retail market is irrelevant. Tr. at 621. The essence of Mr. Frame's position is this: To be sure, the merger of FirstEnergy and GPU will result in the loss of one retail supplier, but that is not a problem if the wholesale market is competitive and there are also plenty of retail suppliers. Applicants St. 4 at 8-10. Since the PJM wholesale markets are competitive, Tr. at 597, 599, and since there are fifty companies licensed to provide retail electric service in Pennsylvania already, the loss of FirstEnergy as a retail competitor of GPUE's marketing affiliate will not adversely affect competition. *Id.* at 10; Tr. at 616-620. Mr. Frame's analysis fails in two critical respects.

First, as Mr. Frame testified, even if there were many retail suppliers, if the wholesale market were not workably competitive, consumers would be disadvantaged. Tr. at 598; Applicants St. 1 at 12-13; Applicants St. 4 at 8-9. While Mr. Frame claims that the PJM markets are workably competitive, he acknowledged, correctly, that other Applicant witnesses take exactly the opposite position. *See* Tr. at 611-12. Indeed, according to Mr. Mascari, his review of the same PJM markets led him to conclude "that market power exists and is being exercised opportunistically." MetEd/Pennelec St. 1-PLR at 19; Applicants Reb. St. 5 at 14. This is not a

case where the Applicants have made a claim supported by evidence, but rebutted by other parties. Instead, Applicants have made diametrically opposite claims. Mr. Frame's conclusions about the impact in retail markets are predicated on the existence of a competitive wholesale market in PJM. If the Applicants cannot decide whether market power exists in the PJM market, they cannot satisfy their burden of proof that the merger will have no adverse impact on consumers.

Second, even accepting Mr. Frame's conclusion that PJM *wholesale* markets are characterized by the absence of market power, the Applicants have failed to carry the burden to show that the merger will not adversely affect competitive *retail* markets. This is important because, 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; Tr. at 617. Such retail sellers could simply capture any cost reductions in the wholesale markets for themselves. Mr. Frame acknowledged this point. He explained in his testimony that, even assuming the existence of a competitive wholesale market, the merger could have a potential adverse effect on retail prices. *See* Applicants St. 4 at 10.

Mr. Frame noted that a horizontal merger will always remove a participant from the market and characterized the relevant question as whether the loss of a market participant will reduce retail competition by "too much." *Id.* Mr. Frame testified further that the loss of one competitive retail supplier could potentially be the basis for market power concerns. Tr. at 617.

In this case, the merger would mean that FirstEnergy Services and GPU Advanced Resources, the Applicants' respective marketing affiliates, would no longer be competitors. *See* Tr. at 573. Thus, according to Mr. Frame's own testimony, it is necessary to decide whether the

loss of competition between FirstEnergy and GPU retail suppliers reduces retail competition by "too much."

Mr. Frame's answer to this important question is as follows:

> While it is not clear how retail electricity markets ultimately will evolve in Pennsylvania, 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. For this reason, I do not believe that the merger of FirstEnergy and GPU will adversely affect electricity competition at the retail level in Pennsylvania.

Applicants St. 4 at 10. 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 GPUE's service territory. Tr. at 618-19. Further, Mr. Frame acknowledged 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 GPUE service territory. Tr. at 572, 619. Apparently, Mr. Frame did nothing more than reference a list of names, without making any effort to determine whether the listed "suppliers" have or would ever provide retail supply in the GPUE service territory. Without inquiring as to the number of retail suppliers actually in the market, Mr. Frame had no basis to determine whether the loss of FirstEnergy as a retail competitor was significant or not. Thus, Applicants have 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."

Finally, the inconsistency of Mr. Frame's analysis is underscored by his position with respect to price caps. Mr. Frame asserts that existing price caps protect customers from the exercise of market power. Applicants St. 4 at 11. Generation price caps, however, will end by 2010. *See* OCA St. 1 at 36. When asked whether consumers would be protected against market power if price caps were removed, Mr. Frame acknowledged that he did not perform an analysis

of the effect on retail ratepayers if the price cap were removed on prices in the retail markets served by the GPU distribution subsidiaries. *See* Tr. at 627-33. Logically, if there were no retail market power concerns, a price cap would be superfluous. Yet, Mr. Frame believed a cap to be an "important protection." Tr. at 632.

Based on the foregoing Mr. Frame's conclusions regarding the merger's effect on retail competition must be rejected. Because Mr. Frame is the only witness for the Applicants to address the competitive effects of the merger, the record does not contain evidence from which the Presiding Judge or the Commission could find that Applicants have carried their burden under Section 2811(e). Accordingly, the merger should be rejected.

2. Because Applicants Have Not Met Their Burden Under Section 2811(e), The Commission May Not Approve The Merger Absent Conditions To Limit The Effects Of Market Power

It is Citizen Power's position that, because Applicants have failed to satisfy their burden under Section 2811(e), authorization for the merger should be denied. Citizen Power recognizes, however, that, in lieu of rejecting the merger, the Commission could attach conditions "as it finds necessary to preserve the benefits of a properly functioning and workable competitive retail electricity market." 66 Pa. C.S. § 2811(e)(2).

If the Commission chooses to attach conditions to the merger to address Applicants' failure to meet their burden under Section 2811(e), the Commission should, at a minimum, require GPUE to retain the existing generation price caps beyond the current expiration date unless and until the Merged Company submits a study for Commission review and approval demonstrating that workable competition in the relevant retail geographic and product markets exists and is sufficient to restrain prices. Such a condition would mitigate the impact on customers from anticompetitive conduct pending a Commission finding that the retail market is workably competitive.

E. Proposed Merger Conditions and Recommendations

1. Introduction

The foregoing discussion clearly establishes that, weighing the risks and benefits of the merger on all affected parties, Applicants have failed to demonstrate that the proposed merger will affirmatively benefit the public interest in any substantial way. To the contrary, the record shows that the proposed merger poses both clear potential adverse effects and numerous risks to GPUE customers and Pennsylvania citizens. Consequently, the Commission may not approve the merger without imposing conditions that will provide substantial public benefits. Citizen Power describes below the conditions that are necessary to meet this standard.

First, a word in response to Applicants' suggestion that certain of the merger conditions proposed by intervenors are outside the Commission's authority or would be inconsistent with the 1998 GPUE Restructuring Settlement. *See, e.g.*, Applicants Reb. St. 4 at 3 (concerning RTO membership); Applicants Reb. St. 8 at 9, 19-20 (concerning rate caps). The Applicants have no "right" to merge. Under Pennsylvania law, they must prove to the Commission's satisfaction that the merger will affirmatively promote the service, accommodation, convenience, or safety of the public in some substantial way." *City of York v. Pennsylvania Pub. Util. Comm'n*, 449 Pa. 136, 141, 295 A.2d 825, 828 (1972); *see also DQE, Inc.*, PaPUC Docket No. A-110150, F.0015 (April 30, 1998). If the Commission finds that this standard has not been met it must reject the merger as proposed. However, under the Public Utility Code, the Commission may exercise its discretion to "impose such conditions as it may deem to be just and reasonable" in exercising its authority to grant an application for a certificate authorizing a merger. *See DQE, Inc.*, PaPUC Docket No. A-110150, F.0015 (April 30, 1998) (citing 66 Pa. C.S. § 1103(a)); *see also* 66 Pa. C.S. § 2811(e)(2) (allowing the Commission to approve a merger "upon such terms and

conditions as it finds necessary to preserve the benefits of a properly functioning and workable competitive retail electricity market.").

Thus, the Commission may use its conditioning authority to ensure that the merger, as conditioned, would meet relevant public interest standards. In this regard, many of the conditions proposed by the various witnesses in this proceeding have clearly been advanced simply in an effort to provide assurance that the purported benefits of the merger cited by the Applicants (*e.g.*, PLR cost mitigation, customer service reliability improvements) are actually realized. The Applicants are under no obligation to accept the conditions imposed by the Commission. If the Applicants believe that meeting the Pennsylvania public interest standard is too onerous, they are free to withdraw their Application.

2. POLR/Generation Issues

Citizen Power is not addressing any conditions relating to these issues in its Main Brief. Citizen Power reserves the right to address such issues in its reply brief or in briefs on or opposing exceptions.

3. PJM Issues

a. GPU Membership in PJM

Citizen Power endorses the condition proposed by numerous witnesses that GPU commit to retain GPU's membership in PJM, for the various reasons provided by the witnesses. *See* OTS St. 2 at 4-6; OCA St. 1 at 48-49; OCA St. 1-S at 17-18; MEIUG/PICA St. 1 at 32; PFII St. 1 at 14; PJM St. 1 at 27; PJM St. 2 at 22; PJM St. 3 at 12.

b. FirstEnergy Membership in PJM

Citizen Power is not addressing any conditions relating to these issues in its Main Brief. Citizen Power reserves the right to address such issues in its reply brief or in briefs on or opposing exceptions.

c. Other PJM/Transmission Issues

Citizen Power is not addressing any additional conditions relating to these issues in its Main Brief. Citizen Power reserves the right to address such issues in its reply brief or in briefs on or opposing exceptions.

4. Service/Reliability Issues

Meaningful improvements in reliability and customer service could potentially serve as merger benefits to offset some of the adverse impacts of the merger. As discussed at length above, however, the record does not support the Applicants' claim that a merger, as proposed, would result in improved customer service and reliability. In order to ensure that Pennsylvania customers of the merged company benefit from improved reliability and customer service as Applicants have pledged, Citizen Power supports the recommendations of OCA Witness Alexander concerning issues (a), (b), and (c) below. *See* OCA St. 2; OCA St. 2-S.

a. Reliability

See section IV.E.4 above.

b. Call Center/Customer Service

See section IV.E.4 above.

c. Service Quality Index

See section IV.E.4 above.

d. Linemen Training Program

Citizen Power is not addressing any conditions relating to this issue in its Main Brief. Citizen Power reserves the right to address such issue in its reply brief or in briefs on or opposing exceptions.

5. Rate Issues

a. Rate Caps

See Section IV.D.2 above.

b. Merger Savings

Citizen Power does not believe that the proposed merger should be approved absent a commitment ensuring that GPUE customers will receive some pecuniary benefit as a result of the merger. Accordingly, Citizen Power supports a condition that would require GPUE to flow back to customers a guaranteed portion of merger savings based on the level of savings estimated by Applicants in this proceeding. The Commission has previously found that sharing of merger savings between customers and shareholders can be an affirmative benefit militating in favor of approving a utility merger. *See DQE, Inc.*, PaPUC Docket No. A-110150, F.0015 (April 30, 1998).

The Applicants have advanced an estimate of $150 million in annual savings for the combined company. Applicants St. 1 at 11; Applicants Reb. St. 2 at 7-8. As explained above, however, this estimate is not grounded in any analysis of reducing particular cost items. Moreover, the Applicants' decision not to perform a detailed synergies study prior to seeking merger approval leaves the Commission and other interested parties at a disadvantage in efforts to gauge the level of savings that is likely to result from the merger and the level of sharing between shareholders and customers that might be appropriate. *See, e.g.*, MEIUG/PICA St. 1 at 11-12; OCA St. 1 at 36. As noted, it is quite possible that actual merger savings could exceed the $150 million estimated by Applicants. *See* OCA St. 1at 25.

Because Applicants have failed to perform a detailed cost savings analysis or otherwise provide substantial evidence that customers will benefit from merger savings, the Applicants should guarantee some cost reduction for GPUE customers. Specifically, Applicants should be

required to flow back to customers five percent of the O&M expenses of MetEd, Penn Power and Pennelec. Such an approach is reasonable because it will guarantee customers savings based on the level of savings cited in the Joint Application, and will allow GPUE to retain savings achieved in excess of estimated savings. The Applicants should guarantee this level of cost savings without any offset for costs to achieve or acquisition premium amortization. Following approval of the merger, GPUE should be required to make a filing, subject to Commission review and approval, calculating the five percent O&M cost savings and proposing an appropriate mechanism to flow the savings to customers. Interested parties would have the right to intervene and propose modifications to GPUE's proposal or to propose different methods. The Commission would decide between any competing proposals.

Several other considerations support a conclusion that such a an approach is reasonable. First, Applicants have testified that obtaining synergy savings is not a primary purpose of the merger. Applicants St. 1 at 12. Accordingly, the Applicants should not be adversely affected by sharing a reasonable amount of savings with customers. Second, in discussions with Wall Street analysts, Mr. Marsh specifically stated that the Applicants had assumed some level of sharing for modeling purposes, and confirmed that it would be reasonable for the analysts to do so in analyzing the merger. *See* MEIUG/PICA St. 1 at 14-16; MEIUG/PICA St. 1-S at 6; Citizen Power Cross-Exam. Exh. 3, 8/9/00 tr. at 9. Finally, the sharing of savings would not disturb the bargain struck in GPUE's restructuring settlement because a merger and attendant cost savings were not even taken into account in agreeing to the T&D rate cap level established by the restructuring settlement. Tr. at 776-78. Indeed, absent sharing of savings, GPUE would retain savings that were not anticipated at the time of the settlement. *Id.*

c. Acquisition Premium/Merger Costs

As explained above, FirstEnergy proposes to pay GPUE shareholders a substantial premium over the market value of their shares as an incentive to merge with FirstEnergy. *See generally* OCA St. 1 at 24. The "acquisition premium" raises two distinct set of issues that should be addressed through two separate conditions.

First, the merger should be conditioned on the Applicants making a commitment that the acquisition premium paid by FirstEnergy is not passed on to its customers in any way. Although Applicants have stated that FirstEnergy "will not seek to recover this cost from its utility customers," Applicants Reb. St. 2 at 6, the Applicants should strengthen this pledge by clarifying that they will not recover the acquisition premium "indirectly" from customers by offsetting amortization of the acquisition premium against cost savings that would otherwise benefit customers.

Second, the acquisition premium represents an above-market payment to GPU shareholders for the remaining assets of the company at the same time that GPUE customers are compensating GPU shareholders through the CTC for allegedly unrecoverable stranded costs. However, in effect, FirstEnergy is purchasing the remaining assets of GPU's operating companies, including their stranded cost regulatory assets at an above-market price. This above-market premium represents a true market valuation of those assets. Thus, as Mr. Kollen observed:

> If the regulated or formerly regulated assets which GPU is recovering through the CTC are worth more than net book value, then the acquisition premium, at least in part, should be considered a "market" recovery of GPU's stranded costs above and beyond that already afforded by the Commission. As such, the acquisition premium is not a cost to be recovered but rather an offset to costs otherwise recoverable, including potentially the additional costs associated with GPU's POLR obligations.

MEIUG/PICA St. 1 at 22-23.

Accordingly, Citizen Power submits that Applicants must credit the portion of the acquisition premium attributable to MetEd and Pennelec against customer rates in order to offset the remaining stranded cost balances of MetEd and Pennelec. Toward this end, Citizen Power recommends that, following closing of the merger, GPUE should be required to make a filing with the Commission accounting for the acquisition premium paid by FirstEnergy to GPU shareholders and the portion of which is attributable to MetEd and Pennelec. In the same filing, GPUE would propose an appropriate mechanism to flow the allocated portion of the acquisition premium to customers. Interested parties would have the right to intervene and contest GPUE's calculation of the acquisition premium and to propose modifications to GPUE's proposal to credit ratepayers or to propose different methods. The Commission would decide between any competing proposals.

d. Nuclear/Fossil Rate and Regulatory Related Issues

Citizen Power is not addressing any conditions relating to these issues in its Main Brief. Citizen Power reserves the right to address such issues in its reply brief or in briefs on or opposing exceptions.

e. Other

Citizen Power is not addressing any conditions relating to these issues in its Main Brief. Citizen Power reserves the right to address such issues in its reply brief or in briefs on or opposing exceptions.

6. Inter-Company Issues

a. Financial/Credit Restrictions

Citizen Power is not addressing any conditions relating to these issues in its Main Brief. Citizen Power reserves the right to address such issues in its reply brief or in briefs on or opposing exceptions.

b. Affiliate Issues (Accounting, Allocation)

The only issue Citizen Power addresses regarding this topic is discussed in the following section.

c. Jurisdictional Issues

In order to ensure that the Commission will have adequate authority to prevent the unfair allocation of corporate overhead costs to GPUE customers, a condition of the merger should be that Applicants commit to waive any *Ohio Power* defense. *See* OCA St. 1 at 55.

d. Codes of Conduct

Citizen Power supports the conditions proposed by OCA on this issue, for the reasons set forth in Ms. Alexander's testimony. OCA St. 2 at 31-33.

e. Pension Funds

Citizen Power is not addressing any conditions relating to these issues in its Main Brief. Citizen Power reserves the right to address such issues in its reply brief or in briefs on or opposing exceptions.

f. Access to Books and Records

Citizen Power supports the conditions proposed by OCA on this issue, for the reasons set forth in Mr. LaCapra's testimony. OCA St. 1 at 56.

7. Community Support Issues

a. Charitable Contributions

Citizen Power supports the condition proposed by OCA that GPU commit to continue at least its current level of charitable contributions within Pennsylvania, adjusted for inflation, for at least a ten-year period. *See* OCA St. 1 at 56.

b. LIURP/CAP Issues

Applicants' proposal would not improve existing services to low-income energy users, GPUE's most vulnerable customer group. The Commission has rightly concluded that, in the transition to competitive markets, additional protections for low income households are needed to preserve universal service and to make essential energy affordable. Thus, it has implemented programs like the Customer Assistance Program and Low Income Usage Reduction Program to assist low-income customers. In this regard, GPUE has committed to certain spending levels in these programs as part of its restructuring settlement. OCA St. 2 at 29-31. The merger proposed in this case, however, poses additional risks to ratepayers – risks, *inter alia*, of environmental degradation and diminished retail competition. Just as low income households have been the most vulnerable to the risks of restructuring, so too are they the most vulnerable to the added risks posed by the merger. Citizen Power submits that, as a condition of any merger approval, low-income customers should receive significant added benefits to offset these risks. Specifically, Citizen Power proposes that the Commission determine an appropriate increment to be added to each of the annual universal spending levels established for MetEd and Pennelec in their restructuring settlement. *See* Applicants Reb. St. 8 at 7; OCA St. 2 at 30. Further, a proportionate increase should be applied to PennPower's annual universal service program spending levels.

Contrary to Mr. D'Angelo's arguments in response to Ms. Alexander, Applicants Reb. St. 8 at 8-9, such a proposal is not inconsistent with the GPUE restructuring settlement, nor does it unfairly force GPUE to increase spending for these programs without providing for increased revenue in rates. The restructuring settlement simply establishes the status quo for universal service programs. Under Pennsylvania law, a merger must affirmatively benefit the public, *i.e.*, provide benefits above and beyond the status quo. A reasonable increase in universal service funding would assure that GPUE's most vulnerable customers affirmatively benefit from the merger. Securing important benefits for low-income customers by conditioning the merger on a reasonable increase in spending for universal service programs would not place an undue financial burden on GPUE.

c. Pennsylvania Presence

Citizen Power supports the condition proposed by OCA that GPU agree to retain a headquarters in Pennsylvania and maintain an appropriate level of management employees at this headquarters. *See* OCA St. 1 at 56.

d. Economic Development Programs

Citizen Power supports the conditions proposed by OCA on this issue, for the reasons set forth in Mr. LaCapra's testimony. OCA St. 1 at 51.

e. Employee Issues

Citizen Power is not addressing any conditions relating to these issues in its Main Brief. Citizen Power reserves the right to address such issues in its reply brief or in briefs on or opposing exceptions.

8. Environmental Issues

As Citizen Power has explained, the environmental concerns raised by the proposed merger are so substantial that the merger should not be allowed to proceed, even with conditions

attached. As the Commission itself has noted in the context of market power problems, when substantial concerns exist about a proposed merger, it is preferable to implement a structural remedy such as denying or delaying a merger, rather than relying on behavioral limitations to be enforced in post-merger review. *See, e.g.*, *See DQE, Inc.*, PaPUC Docket No. A-110150, F.0015 (April 30, 1998) (delaying proposed merger pending applicants' joining a FERC-approved fully-functional ISO). Similarly, a condition denying approval of the merger is appropriate here.

If, however, the Commission finds that the merger should be approved, the Commission should, at a minimum, place the following environmental conditions on the merger. First, because the merger as proposed would have a direct adverse effect on Pennsylvania air quality, the Commission should require FirstEnergy to install the best available control technology (BACT) at all its coal-fired units on a specific timetable. Specifically, this would include: (i) within six months of Commission approval of the merger, preparing a BACT analysis for upgrading each particulate control device, submitting such analysis to the appropriate permitting authorities, and implementing the upgraded controls as required by the permitting authorities; (ii) installing selected catalytic reduction systems in all plants for nitrogen oxide reduction to achieve BACT on an annual basis by 2004; (iii) installing scrubbers in all plants to achieve a 95% reduction of sulfur dioxide emissions by 2005.

Second, the Commission should condition the merger upon FirstEnergy settling the DOJ/EPA environmental lawsuit relating to the Sammis plant. The fact that FirstEnergy has been accused of serious environmental violations and faces enormous fines and remedial expenses must be considered a significant risk in the Commission's evaluation of whether it is in the public interest to authorize FirstEnergy to acquire GPU and its public utility subsidiaries. Further, the Commission should specify that, whatever the terms of the settlement with DOJ,

GPUE customers are to be insulated from the costs of any fines, penalties, remedial measures or cost of capital increases resulting from the resolution of the lawsuit.

a. Demand Side Issues

Citizen Power supports the demand-side management conditions proposed by the Clean Air Council and the PennFuture Individual Intervenors in this proceeding, for the reasons set forth in the testimony of Mr. Altman and Mr. Rohrbach, respectively. *See* CAC St. 1 at 9; PFII St. 1 at 3, 20-23.

b. Renewable Energy Issues

As explained above, FirstEnergy is a significant contributor to air pollution in both Ohio and Pennsylvania. In order to ensure that Pennsylvanians benefit from the merger through improved air quality, the merger should be conditioned upon Applicants committing to the development of renewable energy resources that will, over time, replace some fossil plants in FirstEnergy's existing operating companies' service territories.

Specifically, Applicants should establish a Sustainable Development Fund, similar in arrangement and in proportionate size to the four funds already established in Pennsylvania, in the PennPower service territory. Further, Citizen Power supports the position of the PennFuture Individual Intervenors that the Commission should condition the merger upon the Applicants providing $50 million to implement a statewide sustainable development fund to support renewable energy in Pennsylvania. *See* PFII St. 1 at 12-13. Citizen Power also generally supports the uses of the fund (although not necessarily in the same precise allocations) proposed by Mr. Rohrbach. *Id.*

In order to further address the coal plant emissions in the merged company's operating territories, Applicants should be required to develop at least two 10-15 MW wind farms in the merged company's operating territories. *See, e.g.,* CAC St. 1 at 5-6; PFII St. 1 at 13 (discussing

benefits of wind as an energy resource). Similarly, the merged company should be required to invest a total of $2 million in photovoltaic roof top installations in the merged company's operating territories. *See* CAC St. 1 at 6-7 (discussing benefits of solar power as an energy resource).

c. Existing Generation Capacity Issues

Citizen Power is not addressing any conditions relating to these issues in its Main Brief. Citizen Power reserves the right to address such issues in its reply brief or in briefs on or opposing exceptions.

d. Other Environmental Issues

Citizen Power is not addressing any conditions relating to other environmental issues in its Main Brief. Citizen Power reserves the right to address such issues in its reply brief or in briefs on or opposing exceptions.

9. Other Recommendations

Citizen Power is not making any additional recommendations at this time.

F. Merger Conclusion

The Applicants have failed to carry their burden to show either (i) that the merger will affirmatively benefit the public interest in some substantial way; or (ii) that the merger is not 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). To the contrary, the record demonstrates that the merger, as proposed, poses adverse impacts and numerous risks to the public interest. Consequently, the Commission should reject the merger as proposed. If the Commission in its discretion approves the merger, it should do so only upon imposing the conditions discussed above.

1. Proposed Ordering Paragraphs

Consistent with the foregoing, Citizen Power respectfully proposes the following ordering paragraphs and requests that they be adopted by the Presiding Judge. First, consistent with Citizen Power's position that authorization for the merger should be denied, Citizen Power proposes the following:

- Applicants have not met their burden under Pennsylvania law to show that the proposed merger will affirmatively benefit the public interest in some substantial way. ACCORDINGLY, IT IS HEREBY ORDERED that the Applicants' Joint Application for a certificate of public convenience pursuant to 66 Pa. C.S. Section 1102(a)(3) shall be and hereby is DENIED.

- Applicants have not met their burden under 66 Pa. C.S. Section 2811(e) to show that the merger is not "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." ACCORDINGLY, IT IS HEREBY ORDERED that the Applicants' Joint Application for a certificate of public convenience pursuant to 66 Pa. C.S. Section 1102(a)(3) shall be and hereby is DENIED.

If the Presiding Judge finds, contrary to the position of Citizen Power, that the merger should not be denied outright, Citizen Power proposes that the Presiding Judge condition the merger consistent with the following ordering paragraphs.

- IT IS HEREBY ORDERED that the Applicants' Joint Application for a certificate of public convenience pursuant to 66 Pa. C.S. Section 1102(a)(3) shall be and hereby is GRANTED subject to the following conditions:

  (a) MetEd and Pennelec shall remain subject to the existing generation price caps beyond the current expiration date unless and until the merged company submits a study for commission review and approval demonstrating that workable competition in the relevant retail geographic and product markets exists and is sufficient to restrain prices.

  (b) Applicants shall make a binding commitment that GPU transmission assets shall not be transferred out of the control of the PJM Office of the Interconnection as long as PJM remains a viable regional transmission organization.

(c) Applicants shall install the best available control technology (BACT) at all coal-fired units owned by any affiliate or subsidiary of the merged company. Specifically, Applicants shall: (i) within six months of Commission approval of the merger, prepare a BACT analysis for upgrading each particulate control device, submit such analysis to the appropriate permitting authorities, and implement the upgraded controls as required by the permitting authorities; (ii) install selected catalytic reduction systems in all plants for nitrogen oxide reduction to achieve BACT on an annual basis by 2004; and (iii) install scrubbers in all plants to achieve a 95% reduction of sulfur dioxide emissions by 2005.

(d) FirstEnergy shall settle the pending DOJ/EPA environmental lawsuit relating to the Sammis plant.

(e) Applicants shall establish a Sustainable Development Fund, similar in arrangement and in proportionate size to the four funds already established in Pennsylvania, in the PennPower service territory.

(f) Applicants shall develop at least two 10-15 MW wind farms in the merged company's operating territories.

(g) Applicants shall invest a total of $2 million in photovoltaic roof top installations in the merged company's operating territories.

(h) Applicants shall agree that GPUE and PennPower shall implement demand-side response programs that shall include, but shall not be limited to: (i) providing customers the option of participating in voluntary appliance control device programs; (ii) installation of advanced customer meters that allow the operating company to register time of use reductions by the customer; (iii) implementing rate incentives for commercial customers that agree to an independent energy audit and adopt significant aspects of the audit's recommendations; and (iv) implementing an appliance rebate program for residential customers to retire inefficient household appliances.

(i) Applicants shall provide $50 million to implement a statewide sustainable development fund to support renewable energy in Pennsylvania.

(j) Applicants shall agree to be subject to the Service Quality Index as proposed by the OCA in this proceeding, as described herein.

(k) MetEd, Pennelec and PennPower shall credit to their customers five percent of their O&M expenses. To implement this condition, GPUE and PennPower shall, within a reasonable time, but not more than three months following merger approval, make a filing subject to Commission review and approval calculating the five percent O&M

cost savings and proposing an appropriate mechanism to flow the savings to customers. Interested parties shall have the right to intervene and propose modifications to such proposal or to propose different methodologies.

(l) Applicants shall agree that the acquisition premium paid by FirstEnergy to GPU shareholders is not passed on to utility customers in any way, including, specifically that the acquisition premium shall not be recovered "indirectly" from customers by offsetting amortization of the acquisition premium against cost savings that would otherwise benefit customers.

(m) The acquisition premium received by GPU and attributable to MetEd and Pennelec shall be credited against MetEd and Pennelec customers stranded cost payments. To implement this condition, GPUE shall within a reasonable time, but not more than three months following merger closing, make a filing subject to Commission review and approval calculating the amount of the acquisition premium attributable to MetEd and Pennelec and proposing an appropriate mechanism to flow the savings to customers. Interested parties shall have the right to intervene and propose modifications to such proposal or to propose different methodologies.

(n) Applicants shall waive the *Ohio Power* defense for purposes of all Commission proceedings.

(o) The current GPUE code of conduct shall be applicable to the activities of FirstEnergy in Pennsylvania.

(p) Applicants shall commit to provide, upon request, to the Commission, the OCA, and other parties properly requesting access to the books, records, officials and staff of affiliated companies involved in business activities not regulated by the Pennsylvania PUC to the extent necessary for the Pennsylvania PUC to perform its regulatory oversight responsibility of GPU. Further, Applicants shall commit to accept service in Pennsylvania of any requests made pursuant to the foregoing and shall agree to produce any such requested books, records and personnel in the Commonwealth of Pennsylvania.

(q) Applicants shall commit to maintain GPU charitable contributions within Pennsylvania at least at current levels, adjusted for inflation, for at least a ten-year period.

(r) A reasonable increment, to be determined by the Commission, shall be added to each of the annual universal spending levels established for MetEd and Pennelec in their restructuring settlement. In addition,

an equivalent increase shall be made to the annual universal service program spending levels of PennPower.

(s) Applicants shall agree that GPU shall retain a headquarters in Pennsylvania and maintain an appropriate level of management employees at this headquarters.

(t) Applicants shall agree that GPU's current Pennsylvania economic development programs and initiatives are not diminished.

V. POLR PETITION PROCEEDING–DOCKET NOS. P-00001861 AND P-00001861

A. Introduction

Citizen Power does not address matters at issue in the PLR Proceeding in its Main Brief except to the extent that such issues are relevant to the Merger Proceeding. Any such issues are addressed in Section IV.

B. Legal Standard For Company Requests (Rate Cap and Deferral)

Citizen Power does not address matters at issue in the PLR Proceeding except to the extent that such issues are relevant to the Merger Proceeding. Any such issues are addressed in Section IV.

C. Purchased Power Outside Of The Control Issues

Citizen Power does not address matters at issue in the PLR Proceeding except to the extent that such issues are relevant to the Merger Proceeding. Any such issues are addressed in Section IV.

1. Introduction

2. GPU's Procurement Practices

3. Energy Costs

4. Other Issues

D. Fair Rate of Return Issues

Citizen Power does not address matters at issue in the PLR Proceeding except to the extent that such issues are relevant to the Merger Proceeding. Any such issues are addressed in Section IV.

1. Introduction

2. Revenue Analysis/Earnings Analysis

3. Rate of Return/Cost of Capital

4. Fair Rate of Return Considerations

E. Proposed Resolutions of the POLR Issues

Citizen Power does not address matters at issue in the PLR Proceeding except to the extent that such issues are relevant to the Merger Proceeding. Any such issues are addressed in Section IV.

1. Introduction

2. PLR Deferral Mechanism

a. Rate Design

b. Customer Impact

3. Rate Increase–With and Without Additional Deferral

4. Rate Adjustment Without Rate Increase

F. Competitive Issues

Citizen Power does not address matters at issue in the PLR Proceeding except to the extent that such issues are relevant to the Merger Proceeding. Any such issues are addressed in Section IV.

G. Financial and Credit Quality Issues

Citizen Power does not address matters at issue in the PLR Proceeding except to the extent that such issues are relevant to the Merger Proceeding. Any such issues are addressed in Section IV.

H. NUG Issues

Citizen Power does not address matters at issue in the PLR Proceeding except to the extent that such issues are relevant to the Merger Proceeding. Any such issues are addressed in Section IV.

I. Other Issues

Citizen Power does not address matters at issue in the PLR Proceeding except to the extent that such issues are relevant to the Merger Proceeding. Any such issues are addressed in Section IV.

J. Conclusion

Citizen Power does not address matters at issue in the PLR Proceeding except to the extent that such issues are relevant to the Merger Proceeding. Any such issues are addressed in Section IV.

1. Proposed Ordering Paragraphs

VI. CONCLUSION

Based on the foregoing, Citizen Power submits that the Joint Application for a certificate of public convenience should be denied. If, however, it is decided that the Joint Application should be approved, appropriate conditions should be attached, set forth herein.

Respectfully submitted,

CITIZEN POWER, INC.

By:____________________________

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