

**COMMONWEALTH OF PENNSYLVANIA
BEFORE THE
PUBLIC UTILITY COMMISSION**

Joint Application for Approval of the)	Docket Nos. A-110300F.0095
Merger of GPU, Inc.)	A-110400F.0040
with FirstEnergy Corp.)	

Petition of Metropolitan Edison)	Docket Nos. P-00001860
Company and Pennsylvania Electric)	P-00001861
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)	

REPLY 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 Post-Hearing Reply Brief in the captioned proceedings.

I. INTRODUCTION

Applicants¹ concede, as they must, that they bear the burden under Pennsylvania law to demonstrate that their proposed merger will provide substantial net public benefits and will not harm competition in relevant retail markets. Applicants fail to meet these standards. The deficiencies in Applicants’ evidentiary showing are discussed at length in Citizen Power’s Main Brief and will not be repeated here.

¹ As used herein, “Applicants” refers collectively to FirstEnergy Corp. (“FirstEnergy”), GPU, Inc. (“GPU”), Metropolitan Edison Company (“MetEd”) and Pennsylvania Electric Company (“Penelec”). MetEd and Penelec are collectively referred to herein as “GPUE.”

Instead, Citizen Power's Reply Brief will focus principally on several of Applicants' key claims, that, when shown to be insufficiently supported, require the merger to be rejected. Specifically, Citizen Power will principally focus on Applicants' contentions: (i) that identifying claimed benefits that it admits were not quantified or the subject of any study or analysis satisfies the substantial benefits test; (ii) that the merger will be environmentally benign; and (iii) that Applicants have met their burden to show that the merger will not harm competition in relevant retail markets.

II. STATEMENT OF THE CASE AND PROCEDURAL HISTORY

Please refer to Citizen Power's Main Brief at pages 3-4.

III. SUMMARY OF ARGUMENT

Although they concede the burden to demonstrate that their merger will produce substantial public benefits, Applicants' Main Brief consists of nothing more than a description of claimed but unsubstantiated benefits. Applicants have never conducted a study or analysis of the public benefits, if any, that the merger would create and, without such an analysis, the record contains nothing more than Applicants' word that there will be benefits of some unspecified magnitude.

Further, even if the merger application demonstrated that the merger would provide an affirmative benefit in some aspect of utility operations (which it does not), the Commission would still be obligated to weigh such benefit against potentially offsetting detriments. With no evidence of quantifiable public benefit, and ample evidence of the merger's potential competitive, financial and environmental risks to GPUE customers and Pennsylvania citizens, the balance tips decidedly against Applicants.

Applicants have not negated concerns that the proposed merger will harm Pennsylvania air quality if, as they contend they will, Applicants run FirstEnergy's existing fossil plants at a

higher capacity factor in an effort to serve GPUE customers. Remarkably, Applicants try to portray use of FirstEnergy plants to serve GPUE load as an environmental *benefit* of the merger. Applicants' position relies, however, on assertions by Applicants' witness regarding an emissions analysis that is not in the record and that was shown by the witness' own description to be of no probative value whatsoever.

Applicants have also failed to meet their burden under 66 Pa. C.S. § 2811(e) to show that the merger is not likely to result in anticompetitive or discriminatory conduct, including the unlawful exercise of market power. Applicants' witness Mr. Rodney Frame only performed a study of the merger's effect on *wholesale* markets, not the retail markets that are the subject of this proceeding. In this regard, Applicants themselves made conflicting claims concerning whether the PJM markets are workably competitive.

But even accepting Mr. Frame's conclusion that the relevant *wholesale* markets are workably competitive, it does not follow, and Applicants did not prove, that retail customers will not be harmed by the loss of a retail competitor as a result of the merger. In this regard, Mr. Frame's contention that retail customers are protected by the existence of more than fifty alternative suppliers was undermined by his admission at the hearing that he had not investigated how many suppliers, if any, are actually offering retail service in GPUE's service territory. Further, Applicants merely assert, but offer no factual support, that a combination of low barriers to entry and many potential new suppliers will restrain prices in the absence of actual competitors. Finally, generation price caps may provide protection, but such protection is temporary, and Applicants offered no information regarding how retail prices would be restrained once those caps are lifted. Moreover, Applicants have requested in this proceeding that the caps be increased because wholesale prices have risen.

Applicants have thus failed to meet their burden under Section 2811(e) of the Competition Act. Because the language of Section 2811(e) is mandatory, the Commission has no discretion to waive Applicants' failure of proof. Accordingly, the merger as proposed may not be approved by the Commission.

Finally, Applicants challenge the attachment of *any* conditions to the merger proposal, arguing that the Commission may only apply conditions that are necessary to remedy some deficiency in the merger proposal. This argument is a red herring. As Citizen Power explained in its Main Brief, Applicants *have* presented a deficient proposal. Accordingly, Citizen Power and other parties proposed conditions that would ensure that the merger would satisfy statutory standards. Thus, far from being "wish lists," as alleged by Applicants, the conditions proposed by Citizen Power are intended precisely to accomplish the purposes that the Applicants themselves acknowledge are the proper function of merger conditions.

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

A. Introduction/Merger Proposal

B. Applicable Legal Standards

There is no dispute that Applicants must satisfy the legal standard set forth in 66 Pa. C.S. Section 1102(a)(3), as interpreted by the Pennsylvania Supreme Court in *City of York v. Pennsylvania Pub. Util. Comm'n*, 449 Pa. 136, 295 A.2d 825, (1972). Compare, e.g., Citizen Power M.B. at 10-12; Applicants M.B. at 9-10. Specifically, Applicants are required to show that "the merger will *affirmatively promote* the service, accommodation, convenience, or safety

of the public in some *substantial* way.” *City of York*, 449 Pa. at 141, 295 A.2d at 828 (emphasis added); *see also DQE, Inc.*, PaPUC Docket No. A-110150, F.0015 (April 30, 1998).²

Applicants discuss *York* and several previous Commission merger decisions and conclude that “evidence of improved financial strength, the potential for operational improvements through combined expertise and future cost savings have consistently been found by the Commission to be proof that a merger provides affirmative public benefits.” Applicants M.B. at 11. Even assuming, *arguendo*, that Applicants have correctly analyzed the Commission’s standards, Applicants are required to demonstrate that their case meets these standards by adducing substantial *evidence* in support of their claims. *See, e.g., Burlison v. Pennsylvania Pub. Util. Comm’n*, 501 Pa. 433, 437, 461 A.2d 1234, 1236 (1983). As discussed herein and in Citizen Power’s Main Brief, Applicants have offered no credible evidence that any of the purported merger benefits identified by Applicants will ever be realized, much less that these unquantified benefits would be *substantial*.

Moreover, Applicants’ discussion of merger standards fails to acknowledge an important aspect of the affirmative benefit test. Namely, the test requires the Commission 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). Accordingly, even if Applicants had been successful in demonstrating the existence of some merger benefit, any such benefits would have to be weighed against the clear record evidence of

² Applicants also recognize their burden to demonstrate that the merger is unlikely 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” under 66 Pa. C.S. § 2811(e)(2). *See* Applicants M.B. at 16.

merger detriments, *i.e.*, the environmental impact, harm to competition, and increased financial risk discussed at length in Citizen Power's Main Brief.

In addition to discussing the merger standards themselves, Applicants devote a substantial portion of their brief to explaining their understanding of the circumstances under which the Commission can place conditions on utility mergers. *See* Applicants M.B. at 11-15, 40-42. It is axiomatic that the Commission's conditioning power gives it broad authority to fashion appropriate remedies to ensure that a proposed merger will be in the public interest. *See, e.g., Bell Atlantic Corp.*, PaPUC Docket No. A 310200F002 (PaPUC November 4, 1999) (citing *Rheems Water Co. v. Pennsylvania Pub. Util. Comm'n*, 620 A.2d 609 (Pa. Commw. Ct. 1993)). The Applicants acknowledge the Commission's authority, but assert that, in the merger context, the Commission may only apply conditions that are demonstrated to be necessary to remedy some deficiency in the merger proposal. *See* Applicants M.B. at 41.

Citizen Power generally agrees that merger conditions cannot be attached where there is no deficiency to be remedied by the condition. This is not the situation in this case, however, because, as explained herein and in Citizen Power's Main Brief, there are numerous deficiencies in Applicants' merger proposal, that, at a minimum, must be remedied through conditions before the merger is allowed to proceed.

C. Demonstration of Benefits of the Merger As Proposed

1. Introduction

Citizen Power's Main Brief explained in detail why Applicants' evidence fails to prove that the proposed merger of GPU and FirstEnergy will affirmatively benefit the public interest at all, let alone in a substantial way. *See generally* Citizen Power Main Brief at 12-47. In this regard, Applicants' Main Brief presents nothing new, and simply describes alleged merger

benefits that they admitted were not the product of any study or analysis, and that they, therefore, never attempted to quantify. *See* Tr. at 529.

Take, for instance, Applicants' enumeration of the merger's purported benefits on pages 17-18 of their Main Brief. Many of the listed items are, in fact, boons to shareholders that do not benefit customers or the public in any way. Further, Applicants in several instances try to style the absence of "adverse impact" as a merger benefit. By definition, the fact that the merger will not make things worse does not constitute an affirmative benefit. Thus, Applicants' summary of the general benefits of the merger is a fair synopsis of what this proposed merger offers the public interest – nothing but vague, abstract benefit claims without any commitment of real, substantial affirmative benefit to the public interest.

Because they cannot reliably quantify *any* benefit, it is no surprise that Applicants now contend that they "need not" quantify merger benefits. Applicants M.B. at 40. It is telling, moreover, that Applicants apparently decided to merge without first conducting any analysis of potential merger benefits. Tr. at 529. In these circumstances, Applicants' benefit claims should be seen for what they are – *post hoc* creations designed to provide statutory "filler" for their merger application.

Applicants' failure to prove substantial benefits is brought into sharp relief by the benefits that the Commission has recognized in the merger cases cited in Applicants' Main Brief. For instance, in the *DQE* case relied upon by Applicants, the merging companies proposed to flow significant generation-related and distribution-related savings back to customers. *See DQE, Inc.*, PaPUC Docket No. A-110150, F.0015 (April 30, 1998). Significantly, the Commission did not simply accept the applicants' offer to share merger savings as an unexpected bonus, but rather, the Commission analyzed the savings estimates and adopted the higher savings figures

calculated by OCA as the appropriate amounts to flow to customers. *Id.* In *Bell Atlantic Corp.*, PaPUC Docket No. A 310200F002 (PaPUC November 4, 1999), the Commission's finding of affirmative public benefit was based largely on the concessions made by the applicants in a memorandum of understanding with the Office of Attorney General that provided for, *inter alia*, extension of existing rate caps, reductions to some rates, elimination of certain customer charges, and capital investment commitments. *Id.* Applicants have not demonstrated any affirmative benefit, let alone the types of substantial benefits recognized by the Commission in these cases.³

Applicants' Main Brief does not describe any evidence of substantial merger benefits that was not addressed and refuted in Citizen Power's Main Brief. Nonetheless, on several issues it is necessary to briefly respond to arguments made by Applicants that overstate the record or ignore important conflicting evidence or arguments. In particular, Citizen Power responds below to Applicants' position on environmental issues and on competitive issues.

- 2. PLR Service Issues**
- 3. Transmission Asset/RTO/ISO Issues**
- 4. Reliability/Customer Service Issues**
- 5. Rate and Regulatory Issues**
 - a. Savings (Rate Issues)**
 - b. Acquisition Premium**
 - c. Costs to Achieve**
 - d. Nuclear/Fossil Cost Issues**
 - e. Jurisdictional Issues**

³ This case is thus distinguishable from *PG Energy, Inc.* cited by Applicants. *See* Applicants M.B. at 11. There, the Commission found that applicants had satisfied their burden under *York* to show affirmative benefits. *PG Energy, Inc.*, PaPUC Docket A120011F0002 (September 15, 1999). Here, although Applicants allege some of the same types of benefits that the Commission accepted in *PG Energy*, Applicants have not shown by substantial evidence that any of these purported benefits will be realized.

6. **Corporate Structure Issues**
7. **Financial Arrangement Issues**
8. **Community Issues**
 - a. **Charitable Contributions**
 - b. **Pennsylvania Economic Development**
 - c. **Pennsylvania Presence**
 - d. **Employee Issues**
9. **NUG Issues**
10. **Environmental Issues**
 - a. **Applicants Have Not Adduced Credible Evidence Refuting The Evidence That Increased Use Of FirstEnergy Plants Would Harm Pennsylvania Air Quality**

As Citizen Power explained in its Main Brief, a significant problem with the proposed merger is the harm to Pennsylvania air quality that will result if, as they contend they will, Applicants run certain of FirstEnergy's existing coal plants at a higher capacity factor in an effort to serve Pennsylvania customers. *See* Citizen Power M.B. at 40-44; *see also* CAC M.B. at 19-20. This and other environmental problems posed by the merger are so grave that the Presiding Judge and the Commission should find that it is not in the public interest to authorize the merger as proposed. *See* Citizen Power Main Brief at 40-41.

In their Main Brief, Applicants do not, because they cannot, dispute that there will be increased pollutants emitted by Sammis Station and the Mansfield Plant upon implementation of Applicants' stated plan to increase sales to GPUE by running these plants at a higher capacity factor. *See* Applicants M.B. at 34-35; *see also* Citizen Power M.B. at 41. Remarkably, however, Applicants characterize the increased use of Sammis and Mansfield to serve GPUE load as an environmental *benefit* of the merger. Applicants M.B. at 34-35. Applicants contend that "[a]n

increase in GPU Energy purchases from Mansfield and Sammis, combined with a corresponding reduction in purchases from Western Pennsylvania PJM plants, would produce a net *decrease* in emissions.” Applicants M.B. at 35 (citing Tr. at 1083) (emphasis in original). The record does not support Applicants’ position.

Applicants’ contention regarding the merger’s effect on Pennsylvania air quality relies on assertions made by Applicants’ witness Robert Kaiser. Mr. Kaiser’s testimony, in turn, was ostensibly based on an emissions analysis performed by FirstEnergy. Tr. at 1083-84. There are at least two problems with Applicants’ reliance on Mr. Kaiser’s testimony. First, the analysis on which Mr. Kaiser’s testimony purportedly relies is not in the record, and, in fact, the Applicants specifically opposed its introduction into the record. Second, Mr. Kaiser’s own testimony regarding the emissions analysis shows that it cannot rebut the evidence that Pennsylvanians will be adversely affected by increased emissions from Sammis and Mansfield if, as they contend they will, Applicants increase the capacity factor of the Mansfield and Sammis plants.

Mr. Kaiser’s testimony regarding the effect on total emissions from running Sammis and Mansfield at a higher capacity factor is based on a study that Applicants chose not to put in the record. Rather, Mr. Kaiser volunteered for the first time on cross-examination that such an analysis had been performed. Tr. at 1083-84. The record shows that the analysis was performed in the Fall of 2000. Tr. 1088. Thus, at a minimum, the analysis was available to Applicants when they filed their rebuttal testimony in this proceeding. Applicants’ apparent decision not to discuss the study in their testimony is curious, especially given that Mr. Altman of the Clean Air Council had specifically identified pollution from coal plants carried from Ohio into Pennsylvania as a concern in evaluating the merger. *See* CAC St. 1 at 4. Instead of introducing the study, however, Applicants simply referenced it on the stand. The result is that the study

itself is not in the record and, thus, Mr. Kaiser's testimony regarding the study's conclusions constitutes improper hearsay evidence. While Mr. Kaiser may be characterized as an expert witness ordinarily entitled to rely on extrajudicial information in forming opinions, by simply reciting the purported results of the analysis Mr. Kaiser was acting merely as a conduit for extrajudicial evidence, and was not relying on information to develop an independent expert opinion. Accordingly, his testimony regarding the study is hearsay evidence and should not be afforded any weight. *See, e.g., Primavera v. Celotex Corp.*, 415 Pa.Super 41, 52, 608 A.2d 515, 521 (Pa. Super. Ct. 1992).

Applicants could have avoided or cured this problem by placing the analysis in the record. Applicants, however, did not choose to do so, and, in fact, opposed Citizen Power's efforts to enter the study into the record. *See* Joint Applicants' Reply to Citizen Power's Motion for Admission of an Exhibit (March 27, 2001). It stands to reason that if Applicants believed the study fully supported their position that emissions into western Pennsylvania will be reduced as a consequence of the merger, they would have sought to include the analysis in the record. In this regard, Pennsylvania courts have long held that if a party fails to call a witness or other evidence within his or her control, the fact finder may be permitted to draw an adverse inference. *See Piwoz v. Iannacone*, 406 Pa. 588, 596, 178 A.2d 707, 711 (1962); *Kovach v. Solomon*, 732 A.2d 1, 8 (Pa. Super. Ct. 1999). Accordingly, in this instance, an inference may be drawn from Applicants' initial failure and later resistance to putting the analysis into the record that the analysis is not fully supportive of their claim that emissions in Pennsylvania will be reduced as a consequence of the merger.

Even accepting, *arguendo*, that testimony regarding the unfiled FirstEnergy analysis can be considered probative evidence, Mr. Kaiser's own testimony discredited the analysis as

evidence that emissions into Pennsylvania will be reduced by greater utilization of Sammis and Mansfield. In this regard, Mr. Kaiser acknowledged that the study 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. As Citizen Power explained in its Main Brief, one cannot evaluate the net increase or decrease in emissions simply by the comparing the potential emissions from *specific* FirstEnergy plants to the *average* emissions from other companies and control areas. *See* Citizen Power Main Brief at 43-44. 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.

Accordingly, Mr. Kaiser's testimony regarding the FirstEnergy emissions analysis and its purported conclusions cannot be afforded any weight, and, thus, there is nothing in the record to rebut the evidence that running the Mansfield and Sammis Plants at a higher capacity factor will increase harmful emissions which will be carried downwind into Pennsylvania to the detriment of the citizens of the Commonwealth. *See* Citizen Power M.B. at 41-43.

The environmental problems posed by the merger warrant denial of Applicants' request for a certificate of public convenience. If, however, the Commission chooses to approve the merger subject to conditions, Citizen Power enumerated specific measures necessary to remedy the harm. In particular, Citizen Power proposed a number of conditions to remedy the environmental problems with the merger. Included in these conditions are: (i) steps to be taken by FirstEnergy to remedy pollution from its existing coal plants so as to prevent deterioration of

Pennsylvania air quality following the merger; and (ii) a requirement that FirstEnergy settle the DOJ environmental lawsuit. *See* Citizen Power M.B. at 62-63.

b. Applicants Provide No Basis For Rejecting A Condition That FirstEnergy Settle The DOJ Environmental Suit

On brief, Applicants challenge the necessity of placing conditions on the merger to insulate GPUE customers against the risks posed by the civil action brought by the Department of Justice (“DOJ”) against FirstEnergy. *See* Applicants M.B. at 67; *see also* Citizen Power M.B. at 44-46, 62-63. As explained in Citizen Power’s Main Brief, the DOJ’s suit was brought on behalf of the Environmental Protection Agency (“EPA”), and alleges that FirstEnergy subsidiaries 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, resulting in massive amounts of pollution being released into the atmosphere, aggravating air pollution near the Sammis plant and far downwind. *See* Citizen Power Main Brief at 44-46; Citizen Power Cross-Exam. Exh. No. 4 at 2. The suit seeks hundreds of millions of dollars in fines and injunctive relief requiring FirstEnergy to install the best available pollution control technology at the plant. *See id.*

FirstEnergy argues that the merger should not be conditioned on resolving the DOJ suit because (i) the merger is unrelated to the DOJ litigation; (ii) the DOJ litigation is still unresolved; (iii) the substantive allegations in the DOJ lawsuit have been hotly contested; (iv) there have been no adverse findings in the DOJ lawsuit; and (v) the Commission is not equipped and does not have the jurisdiction to assess the merits of the competing claims in the lawsuit. Applicants M.B. at 67. These arguments simply do not provide grounds for the Commission to approve the merger without first requiring that FirstEnergy settle the DOJ suit.

First, the argument that the suit is “unrelated” to the merger is specious. If, as Applicants contend they will, the merged company increases the capacity factor of its Sammis plant following the merger, the result will be more pollution from Sammis. One of the main purposes of the DOJ suit is to address this very pollution.

Second, due to the litigation, FirstEnergy faces the risk of several hundred million dollars in fines, as well as potential remedial costs, which tends to increase the merged company’s cost of capital and impair its ability to compete in retail markets. *See* Citizen Power M.B. at 45-46. These risks cast a shadow over FirstEnergy that bears on its fitness to acquire Pennsylvania utilities.

That FirstEnergy has denied the DOJ’s allegations is beside the point. The risk that the suit may result in adverse consequences to FirstEnergy and GPU exists, regardless of the denials. Moreover, 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 or mitigate both the environmental effects and the financial harms resulting from the verdict.

Third, while it is true that the court hearing the DOJ suit has yet to make any adverse findings, it bears emphasis that, as a prerequisite to filing the suit, the EPA issued a notice of violation to FirstEnergy. *See* Citizen Power Cross-Exam Exh. 2. Thus, the agency charged with enforcing federal environmental laws has specifically made adverse findings with respect to the operation of Sammis Station.

Finally, and contrary to Applicants’ suggestion, Citizen Power is not asking the Presiding Judge or the Commission to “assess the merits of the competing environmental claims” at issue in the DOJ suit. Applicants M.B. at 67. Citizen Power’s position is simply that the existence of a suit by the federal government seeking significant fines and remedial measures raises

substantial questions, both environmental and economic, regarding FirstEnergy's fitness as a merger partner. Accordingly, the Commission should not permit the merger to go forward absent some certainty that these risks are resolved. The way to accomplish this is for FirstEnergy to settle the DOJ suit as a condition of the merger.

11. Other

D. Competitive Issues Under Section 2811(e)

The Competition Act requires that 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 makes such a finding, the Commission “shall not approve such proposed merger” 66 Pa. C.S. § 2811(e). Applicants thus have the burden to show that their proposal is not likely to adversely affect retail competition. They have failed to meet that burden. Because the language of Section 2811(e) is mandatory, the Commission has no discretion to waive Applicants' failure of proof. Accordingly, the merger may not be approved by the Commission as proposed.

Relying on Mr. Frame's testimony, Applicants claim in their Main Brief that the proposed merger meets the Section 2811(e) statutory standards. The merger will, they claim, “have no adverse impact on retail electricity markets in which Pennsylvania customers purchase electricity and will not prevent retail electricity customers from obtaining the benefits of a properly functioning and workably competitive retail electricity market.” Applicants M.B. at 37. This assertion is not supported by the record, however, because, as he admitted at hearing, Mr. Frame neither defined nor studied the relevant retail markets. Tr. at 621. He further admitted that he did not know the extent of current retail competition in GPUE's service territory, Tr. at

572, 619, and so he had no basis on which to evaluate the incremental effect of the merger on that competition.

Mr. Frame readily admitted that he “did not seek to define particular retail markets” because, he said, it was “not necessary for the task at hand.” Tr. at 621. It is axiomatic, however, that without defining the relevant markets, there is no basis to evaluate the extent of competition that could be affected by the merger.

Mr. Frame only analyzed competition in *wholesale* markets in the region. *See Applicants St. 4 at 8-9.* In their Main Brief, the Applicants attempt to rely on the results of Mr. Frame’s wholesale market analysis to meet their burden under Section 2811(e). *See Applicants M.B. at 37-38.* Their argument fails. Applicants’ presented conflicting evidence on the competitiveness of PJM wholesale markets. *See Citizen Power M.B. at 48-49.* While Mr. Frame claims that PJM markets are workably competitive, Mr. Mascari reached the opposite conclusion about the same markets. *See id.* Specifically, Mr. Mascari concluded that “market power exists and is being exercised opportunistically.” MetEd/Pennelec St. 1-PLR at 19; *see also Applicants’ Reb. St. 5 at 14.* Applicants’ conflicting positions undermine any reliance on their claim that competitive wholesale markets protect retail customers from the exercise of market power at the retail level.

Moreover, the fact that FERC agreed with Mr. Frame’s wholesale market analysis in approving the merger, a fact Applicants emphasize in their Brief, has no bearing on the market determination the Commission must make here, and, thus, Applicants’ attempt to use FERC’s approval to buttress its case here should be rejected. *See Applicants M.B. at 38-39 (citing Order Authorizing Merger in Ohio Edison Co., 94 FERC ¶ 61,291).* In assessing the competitive effects of a proposed merger, FERC has a distinctly different job than the one facing the Commission in this case. FERC evaluates the effect of the merger on wholesale competition, but

only wholesale markets. Under its policy standards, FERC will not examine the effect of a merger on retail competition unless an affected state commission lacks jurisdiction to do so, and specifically requests FERC to perform such a review. *See, e.g. Ohio Edison Co.*, 94 FERC ¶ 61,291 (March 15, 2001). That is not the case here. To the contrary, in approving the FirstEnergy-GPU merger, FERC specifically disavowed any responsibility to examine the merger's effect on retail competition:

We reject Intervenors' argument that the Commission should analyze the effect of the merger on retail competition in New Jersey, Pennsylvania and Ohio. As we stated in Order No. 592 [footnote omitted], we will examine the effects of a proposed merger on retail competition in cases where the affected state commissions lack jurisdiction and request the Commission to do so. None have asked us to do so in this case.

Ohio Edison, 94 FERC ¶ 61,291, slip op. at 8 (March 15, 2001). Here, the Commission is required under Pennsylvania statutes to evaluate the effect of the merger on retail competition, and only it can do that job. FERC's conclusion has no bearing on the relevant analysis in this case.

Even if wholesale markets are perfectly competitive, however, it does not follow that retail customers will be protected. If a retail market has few suppliers such that they could exert market power over prices, those suppliers could simply capture the benefits of competitive wholesale rates, while maintaining retail rates above competitive levels. *See Citizen Power M.B.* at 49. Mr. Frame acknowledged this point. He explained that, even assuming the existence of competitive wholesale markets, the merger could still have an adverse effect on retail prices Applicants St. 4 at 10; Tr. at 624.

In their Main Brief, Applicants acknowledge that the merger between FirstEnergy and GPU will result in the loss of a retail market participant. Applicants M.B. at 37. Applicants assert, however, that there will be no adverse effect on competition because "there are over

50 electricity retailers licensed by the Commission,” and “the loss of one independent supplier is not important when so many others remain available to participate in the market.” Applicants M.B. at 37, 38. The claim that there are more than 50 licensed suppliers was made by Mr. Frame in his prefiled testimony, but it is curious to find it cited in Applicants’ Main Brief given that Mr. Frame acknowledged at the hearing that only about half that number have been licensed to sell electricity in GPUE’s service territory. Tr. at 618-19.

Further, Applicants fail to acknowledge Mr. Frame’s concession that he had no idea how many of these 25 or so licensed sellers, if any, now supply, or have ever supplied GPUE customers. Tr. at 572, 619. Indeed, without investigating this question, Mr. Frame has no way of knowing how many of these purported suppliers have since abandoned Pennsylvania retail markets or even gone out of business altogether. *See* Tr. at 619. “I don’t know how many were still selling,” Mr. Frame testified, “and it just doesn’t matter.” Tr. at 619-620. It does matter. Mr. Frame’s failure to inquire as to the number of retail suppliers actually in the market leaves him with no basis to determine whether the loss of a retail competitor as a result of the merger reduces retail competition by “too much.” *See* Citizen Power M.B. at 49-50.

Rather than evaluating actual retail competition, Mr. Frame, at various points in this proceeding, identified two other factors that he contended would protect consumers from any and all potential market power abuses: price caps on retail sales by GPUE, Applicants St. 4 at 11, and the potential market entry of additional suppliers. *See* Tr. at 617, 620. Significantly, in discussing these purported limits on market power abuses, Mr. Frame made no attempt to discuss what is supposed to be the relevant question, *i.e.*, the incremental effect of the merger on retail competition, because, as he acknowledged, he made no attempt to assess the current state of *retail* markets as a basis for such a evaluation. *See* Tr. at 619. Instead, Mr. Frame claims that

the factors he identified will protect consumers from any possible effect of the merger, even if retail markets were so highly concentrated as to contain only one supplier. *See* Tr. at 620, 624. But neither price caps nor the potential entry of other suppliers offer the protection Mr. Frame claims.

Generation price caps are slated to end at a date certain. When asked whether, to what extent, or by what mechanism retail customers would be protected when the caps on GPU affiliates' prices ended, Mr. Frame acknowledged that he made no study of those questions. *See* Tr. at 627-33.

While price caps will end, the merger, if approved, will remain. Accordingly, the Commission should reject Applicants' efforts to rely on a temporary restraint to the exercise of their potential market power in seeking approval for the merger. If the price caps are such an important protection – so important that they relieve Applicants of the need to evaluate current retail market competitiveness or likely merger effects – then surely Mr. Frame should have explained what will happen when they are removed. However, Mr. Frame made no such analysis and offered no explanation. *See* Tr. at 627-33.

Moreover, Applicants' reliance on the effectiveness of caps placed on the prices charged by GPUE is at odds with Applicants' request in the companion PLR case. In that case, Applicants are seeking to raise the caps. Thus, even if price cap protection was as viable in the abstract as Mr. Frame argues, its benefit to GPUE ratepayers is in doubt, given the volatile uncertainty in both wholesale and retail markets, and regardless of whether Applicants obtain the relief that they have requested in the PLR proceeding.

In addition to price caps, Applicants suggest that potential entry by new suppliers may be sufficient to limit the exercise of market power: “even in a highly concentrated market, without

many active alternative suppliers, if there are low barriers to entry and many potential participants, the market may still be considered competitive.” Applicants M.B. at 38. Mr. Frame expressed this point on cross examination: “A market can have perfectly competitive results, and there can be only one supplier in the market, so long as when that supplier stubs his toe, others can quickly jump in.” Tr. at 617. In other words, Mr. Frame contends that those customers who buy from a monopolist may still see “perfectly competitive” prices (reflecting the complete absence of market power) because of the pressure exerted by the potential entry of other suppliers, which would swiftly and surely occur should that monopolist try to exert its market power to raise prices above competitive levels.

First, it is important to note that Applicants’ assertion that a highly concentrated market without many active alternative suppliers *may* be considered competitive if there are low barriers to entry and many potential participants is simply made in the abstract. *See* Applicants M.B. at 38. Applicants’ carefully crafted observation never even makes the claim that *Pennsylvania retail markets* are characterized by low barriers to entry and many potential participants. Applicants are not, in fact, even making an argument, but merely expressing a possibility, which cannot be given any analytical weight.

Second, even if Applicants had made such a claim, they would be required to show that GPUE retail markets are characterized “by low barriers to entry” and “many potential participants” that could not only enter the market “quickly,” but were able and likely to do so. *Id.*; *see also* Tr. 617. Applicants offered no such evidence. Thus, any finding that the existence of other suppliers will restrain the abuse of market power in the GPUE market is precluded by the fact that Applicants have provided no evidence on which to base such a finding. Mr. Frame was unable to offer any such evidence, because, as Citizen Power has shown, he made no

attempt to ascertain either the suppliers currently serving, or those potentially capable of serving GPUE customers. Tr. at 572, 619-20. Absent such a showing, there can be no conclusion that “potential participants” would realistically be able to enter GPUE markets so as to restrain Applicants’ market power should the merger be approved.

The record is thus left with a case that does not include either a retail market study by Applicants showing that the merger will not harm competition, or any other substantial evidence on which to base a conclusion that customers will be shielded from the exercise of market power by the Applicants, were the merger to be approved. Accordingly, Applicants have failed to carry their burden to show that the merger will not harm retail competition in the relevant markets. This failure of proof is dispositive. Thus, the merger cannot be approved as proposed by Applicants.

E. Proposed Merger Conditions and Recommendations

1. Introduction

As explained above, Applicants contend that the Commission may only apply conditions that are demonstrated to be necessary to remedy some deficiency in the merger proposal. *See* Applicants M.B. at 41. Not surprisingly, Applicants assert that the Commission need not attach *any* conditions to the proposed merger. Applicants M.B. at 41. Applicants’ position that the conditions proposed by the parties in this case are unnecessary is grounded, however, in the flawed premise that Applicants have met their statutory burdens. They have not. Accordingly, if the merger is to be approved at all, the Commission must attach conditions to ensure that the statutory standards are satisfied. Thus, even applying Applicants’ own definition of when it is appropriate to attach merger conditions, the conditions proposed by Citizen Power in this proceeding are proper.

For instance, Citizen Power demonstrated in its Main Brief that if one accepts Applicants' own claims, the merger as proposed would result in increased emission of pollution from FirstEnergy plants into Pennsylvania. Citizen Power M.B. at 41-44. To remedy this adverse effect of the merger, Citizen Power proposed several conditions to minimize pollution from FirstEnergy plants. *Id.* at 61-64.

Moreover, many of the conditions proposed or supported by Citizen Power, *e.g.*, service quality standards, are proposed simply to ensure that customers actually receive the benefits that Applicants themselves have identified but have failed to prove.

Applicants devote particular attention to the argument that sharing of merger savings is not a prerequisite for merger approval. *See* Applicants M.B. at 15-16. While it is true that sharing of savings is not mandatory for merger approval, the Commission has clearly recognized sharing of merger savings between customers and shareholders as 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 this proceeding, where Applicants have failed to demonstrate any affirmative benefits resulting from the merger, sharing of savings is an appropriate condition that could contribute to a finding that the merger will result in substantial affirmative benefits. Such a condition is especially appropriate because the Applicants themselves cite the potential for merger savings as a benefit of the merger, without making any commitment that such savings will ever accrue to the benefit of customers. *See* Applicants M.B. at 27-28; *see also* Citizen Power M.B. at 31-32.

Moreover, as Applicants acknowledge, Applicants M.B. at 14, the Commission has found that sharing of merger cost savings may be an important mitigation condition where the proposed merger raises anti-competitive concerns and involves two horizontal competitors that are actual

or potential competitors in the same relevant markets. *See Bell Atlantic Corp.*, PaPUC Docket No. A 310200F002 (PaPUC November 4, 1999). This is the precisely the situation here. As Citizen Power has described herein and in its Main Brief, Applicants have failed to show that the elimination of a competitive supplier through the merger will not have and adverse effect on retail competition. Thus, for this reason alone, sharing of the merger savings would be appropriate.

In sum, Citizen Power generally agrees that merger conditions cannot be attached where there is no deficiency to be remedied by the condition. This is not the situation in this case, however, because there are numerous deficiencies in Applicants' merger proposal, that, at a minimum, must be remedied through conditions before the merger is allowed to proceed.

- 2. POLR/Generation Issues**
- 3. PJM Issues**
 - a. GPU Membership in PJM**
 - b. FirstEnergy Membership in PJM**
 - c. Other PJM/Transmission Issues**
- 4. Service/Reliability Issues**
 - a. Reliability**
 - b. Call Center/Customer Service**
 - c. Service Quality Index**
 - d. Linemen Training Program**
- 5. Rate Issues**
 - a. Rate Caps**
 - b. Merger Savings**
 - c. Acquisition Premium/Merger Costs**

- d. **Nuclear/Fossil Rate and Regulatory Related Issues**
- e. **Other**
- 6. **Inter-Company Issues**
 - a. **Financial/Credit Restrictions**
 - b. **Affiliate Issues (Accounting, Allocation)**
 - c. **Jurisdictional Issues**
 - d. **Codes of Conduct**
 - e. **Pension Funds**
 - f. **Access to Books and Records**
- 7. **Community Support Issues**
 - a. **Charitable Contributions**
 - b. **LIURP/CAP Issues**
 - c. **Pennsylvania Presence**
 - d. **Economic Development Programs**
 - e. **Employee Issues**
- 8. **Environmental Issues**

Please refer to Section IV.C.10 of Citizen Power's Reply Brief.

- a. **Demand Side Issues**
- b. **Renewable Energy Issues**
- c. **Existing Generation Capacity Issues**
- d. **Other Environmental Issues**
- 9. **Other Recommendations**
- F. **Merger Conclusion**
 - 1. **Proposed Ordering Paragraphs**

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

- A. Introduction**
- B. Legal Standard For Company Requests (Rate Cap and Deferral)**
- C. Purchased Power Outside Of The Control Issues**
 - 1. Introduction**
 - 2. GPU's Procurement Practices**
 - 3. Energy Costs**
 - 4. Other Issues**
- D. Fair Rate of Return Issues**
 - 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**
 - 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**
- G. Financial and Credit Quality Issues**
- H. NUG Issues**
- I. Other Issues**
- J. Conclusion**

1. Proposed Ordering Paragraphs

VI. CONCLUSION

Based on the foregoing, Citizen Power submits that nothing in the Main Brief of Applicants should dissuade the Commission from finding that the Joint Application for a certificate of public convenience should be denied. Further, if it is decided that the Joint Application should be approved, the Applicants have not shown why the Commission should not attach the conditions proposed by Citizen Power in its Main Brief.

Respectfully submitted,

CITIZEN POWER, INC.

By: _____

Harvey L. Reiter
John E. McCaffrey
MORRISON & HECKER L.L.P.
1150 18th Street, N.W.
Suite 800
Washington, DC 20036
(202) 785-9100 (phone)
(202) 785-9163 (fax)

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