

I. INTRODUCTION

Apparently not content with a Recommended Decision that would provide a \$316,000,000 rate increase and allow the merger of FirstEnergy Corp. (FirstEnergy”) and GPU, Inc. (“GPU”) subject only to modest conditions that are largely prophylactic or intended to ensure realization of benefits that Applicants¹ themselves have promised, the Applicants have filed lengthy objections to Judge Gesoff’s Recommended Decision. The central theme of Applicants’ objections is that the merger conditions recommended by Judge Gesoff either (i) apply to merger detriments that were not proven on the record; or (ii) exceed the Commission’s authority. *See generally* Applicants’ Exceptions at 1-6. The Applicants’ exceptions to the modest merger conditions recommended by Judge Gesoff are plainly inconsistent with the applicable law and should be denied.

Indeed, contrary to Applicants’ contentions, even with the conditions recommended by the Judge, the proposed merger falls far short of satisfying the substantial affirmative benefits test under Pennsylvania law. As Citizen Power also explained in its own Exceptions, the Applicants failed to satisfy their separate burden under 66 Pa. C.S. § 2811(e) to show that the merger was not likely to result in anticompetitive conduct. For these reasons, the merger should be denied. If, however, the Commission chooses to exercise its discretion to condition the merger such that it satisfies the relevant legal standards, it must, at a minimum, adopt the conditions recommended by Judge Gesoff and the additional conditions supported in the Exceptions of Citizen Power. In any case, Applicants’ efforts to remove even the modest conditions recommended by Judge Gesoff must be denied.

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

In particular, the Commission should reject Applicants' objection to the recommended condition that GPU be required to obtain Commission approval prior to withdrawing from PJM. Contrary to Applicants' position, the necessity of such a condition was supported by substantial record evidence and is well within the Commission's merger conditioning authority.

Citizen Power also replies below to two exceptions relating to the PLR Proceeding. First, the Commission should reject out of hand GPUE's continued insistence that it be allowed to implement a deferred tracking mechanism ("DTM") for its PLR losses. Use of such a mechanism would destroy the deal struck in GPUE's Restructuring Settlement and would remove GPUE's incentive to mitigate its power supply costs. Second, the Commission must not be persuaded by the argument advanced by MAPSA and The New Power Company that CDS prices should be allowed to increase with wholesale market rates. To do so would not spur competition but would simply expose retail customers to the excessive prices that are being produced in the PJM market that the Presiding Judge found to be not workably competitive.

Finally, Citizen Power cannot support the Settlement Stipulation proposed by Applicants because it includes a deferral mechanism and because it fails to address several of the major problems of the proposed merger that Citizen Power strongly believes the Commission must ameliorate in order for the merger to be found to be in the public interest.

II. REPLY TO EXCEPTIONS

A. Reply To Applicants' Introduction To Exceptions Regarding Merger Conditions

The central theme of Applicants' opposition to the merger conditions recommended by Judge Gesoff is set forth in the introduction to their Exceptions. *See* Applicants' Exceptions at 1-6. There, Applicants argue generally that Judge Gesoff failed to apply the proper legal standards governing the imposition of merger conditions, leading him to recommend conditions

that (i) apply to merger detriments that were not proven on the record; or that (ii) exceed the Commission's authority. *See id.* at 3-6. Applicants' Exceptions to the Presiding Judge's recommended conditions should be rejected. While the Recommended Decision may contain numerous flaws, excessive use of the Commission's conditioning authority is certainly not one of them.

The Applicants have no inherent right to merge. Rather, 66 Pa. C.S. § 1102(a)(3) requires public utilities or affiliated interests of public utilities to first obtain a certificate of public convenience under 66 Pa. C.S. § 1103(a). Section 1103(a) provides that an application for a certificate may be granted "only if the Commission shall find or determine that the granting of such certificate is necessary or proper for the service, accommodation, convenience, or safety of the public."² Interpreting this standard in the merger context, the Supreme Court of Pennsylvania has held that a proponent 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). In determining whether a proposed merger will provide substantial affirmative benefit, 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). If a merger applicant fails to satisfy the public interest standard, the merger as proposed must be denied. However, under Section 1103(a), the Commission *may* choose to cure the deficiencies by applying conditions. The alternative to applying such conditions is denial of the proposed merger. In short, then, a merger condition imposed by the Commission does not

require Applicants to do anything. Instead, they are given a choice: agree to the conditions the Commission determines to be necessary for it to approve the merger or refuse to accept those conditions, upon which the merger will be denied.

As an initial matter, the Applicants inexplicably object to Judge Gesoff's ruling that the Applicants were required to prove "substantial" merger benefits and to his conclusion that conditions could be attached in order to support a finding that substantial benefits outweighed merger risks. *See* Applicants' Exceptions at 2. They assert that "[t]here is no legal basis for this additional burden being thrust upon the Applicants." *Id.* Contrary to Applicants' claim, the *City of York* and *Middletown Township* cases described above prescribe precisely the standard articulated by the Judge.

At bottom, Applicants' objections to *any* merger conditions rest on the assertion that they have satisfied their burden of proof. Judge Gesoff correctly rules, however, that an unconditioned merger would not provide the public with substantial affirmative benefits. *See* R.D. at 39. The two primary benefits Applicants themselves claimed were that the merger would mitigate the costs and risks of GPUE's provision of PLR service and that service quality might improve. *See* Applicants Reb. St. 1 at 11. As to these two claims, Judge Gesoff credited the merger as providing a mere \$4 million PLR cost benefit, R.D. at 40-45,³ but found that service quality conditions were required largely just to *preserve* service quality. *See* R.D. at 60 (explaining that the "SQI is designed to ensure that the merger does not result in a deterioration in safety, reliability or customer service.").

² Of course, Applicants are also required to meet the standard under Section 2811(e) of the Competition Act. As Citizen Power explained in its Exceptions, Applicants failed to meet this standard, and the Judge's finding to the contrary was error. *See* Citizen Power Exceptions at 4-9.

³ As Citizen Power noted, even this finding was overly generous to the Applicants, as they had only claimed PLR benefits of *up to* \$4 million and were unable to demonstrate any more than that the benefit was somewhere between *zero* and \$4 million. *See* Citizen Power Exceptions at 12-14.

While Citizen Power agrees that conditions should not attach where there is no deficiency to be remedied by the condition, this is not the situation here. Contrary to Applicants' position, the record contained substantial evidence that the merger, as proposed, lacked substantial affirmative benefits and posed numerous risks, thus requiring the additional conditions imposed by the Judge.

In this regard, Applicants assert that Judge Gesoff adopted conditions that had not been shown to be necessary by a preponderance of the evidence. Applicants' Exceptions at 2. In making this argument, Applicants cite to the Judge's observation that some of the merger risks are speculative. *See id.* at 2 (citing R.D. at 34). As a fair reading of the cited portion of the Recommended Decision shows, Judge Gesoff was simply making the unremarkable observation that a merger review is necessarily a forward-looking analysis that involves some degree of prognostication. *See* R.D. at 34. The fact that some of the merger risks for which Judge Gesoff adopted prophylactic conditions are not certain to materialize does not mean that the *existence* of these risks is not supported by substantial evidence, or that the Judge erred in recommending a condition to protect against the risk.

Applicants further contend that several of the recommended conditions are beyond the Commission's statutory authority to impose. *See, e.g.,* Applicants' Exceptions at 3-4. Conditions that Applicants cite as exceeding the Commission's authority include the requirement for Commission approval for GPU withdrawal from PJM, waiver of SEC preemption arguments, and conditions that purportedly "interfere in the internal management" of the Applicants. *Id.* Applicants' arguments in this regard are not well-taken.

First, the courts have held that where a regulatory agency has the power to *deny* a certificate as inconsistent with the public interest, the agency also has the power to condition the

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

Second, even if Applicants were correct, if there is substantial evidence of a merger detriment, but the appropriate condition to prevent the harm is beyond the Commission’s authority, then the solution is not to simply drop the condition but to *deny the merger*. *See, e.g., City of Pittsburgh v. Federal Power Comm’n*, 237 F.2d 741, 751, n.28 (D.C. Cir. 1956) (observing that “[t]he existence of a more desirable alternative is one of the factors which enters into determination of whether a particular proposal would serve the public convenience and necessity. That the Commission has no authority to command the alternative does not mean it cannot reject the proposal.”).

Third, Applicants’ are wrong in arguing that certain conditions are beyond the Commission’s authority because they would purportedly interfere with Applicants’ internal management decisions. Applicants’ Exceptions at 4-6. In this regard, with one exception, none of the case cited by Applicants in support of their argument involved a merger. The one case cited by Applicants that did involve a merger, *Northern Pennsylvania Power Company v. Pennsylvania Public Utility Commission*, 5 A.2d 133 (Pa. 1939) does not preclude the conditions objected to by Applicants. The *Northern Pennsylvania Power* decision predates and was superseded by the Court’s decision in *City of York*. Further, the nub of the holding in *Northern*

Pennsylvania Power was that the Commission could not deny a merger where the applicants had shown by substantial evidence that the merger was not adverse to the public interest. *See id.* In a merger where, as here, there is substantial evidence that the merger itself will adversely impact issues that might ordinarily be internal concerns, the Commission clearly has authority to reject or add conditions to ensure that the merger does not result in such detriments adversely affecting the public interest.

In sum, the Commission should not be persuaded by the recurring theme of Applicants' Exceptions that Judge Gesoff applied too broadly the merger condition standards under Pennsylvania utility law. Judge Gesoff properly applied conditions to the merger that were prophylactic or intended to ensure realization of benefits that Applicants themselves have promised. The Applicants' objections to these conditions simply reflect the misplaced notion that Applicants could meet their burden of proof absent such conditions. The record does not support such a finding. Indeed, it is Citizen Power's position that Judge Gesoff did not go far enough in conditioning the merger.

B. Reply To Applicants' Exception Number 11, Concerning The Recommended Condition That Applicants Obtain Commission Approval Prior To Withdrawal From PJM

Applicants claim that requiring them to obtain Commission approval before withdrawing GPUE transmission facilities from the operational control of PJM is "beyond the scope of the Commission's jurisdiction and is therefore unlawful." Applicants' Exceptions at 27. Applicants are mistaken.

As explained above, Applicants have no inherent right to merge, and the Commission may reject a merger if it determines the merger will not benefit, or does harm to, the public interest. The ability to reject a merger clearly carries with it the ability to condition a proposal so as to remove an offending provision. In this case, Judge Gesoff correctly determined that

removal of GPUE transmission from PJM may harm Pennsylvania markets and customers. *See* R.D. at 49. By recommending a condition requiring the merged company to seek prior approval before leaving PJM, he offers Applicants a choice: accept the condition or forego the merger. No one is forcing Applicants to make either choice.

Applicants' claims about FERC's exclusive jurisdiction over terms and conditions of transmission service are irrelevant. The Commission has separate jurisdiction over the terms and conditions under which it will approve the merger, and the concomitant right to set any conditions it believes are necessary in order to grant approval to a merger. Since the merger creates a particular danger that GPU may remove its transmission from PJM, a concern that would be absent or vastly more unlikely without the merger, the Commission has a right to condition its approval of the merger by limiting the merged company's PJM exit rights, based on its responsibility to protect Pennsylvania ratepayers, irrespective of any finding by FERC, in its role overseeing wholesale markets, as to those rights. The Commission, in fact, has imposed similar conditions in other cases.⁴

Applicants also seek a concession from the Commission that, if the Commission imposes the PJM withdrawal condition, they should still be able to challenge the condition's legality at some unspecified time, while accepting the condition now and foregoing any court challenge. *See* Applicants' Exceptions at 31. This is plainly unacceptable. Acceding to Applicants' attempt to limit this condition would undermine the purpose of imposing the condition in the first place. Applicants must choose now between accepting the PJM withdrawal condition as part of the merger or rejecting it and either dropping the merger or challenging the legality of the condition

⁴ *See, e.g., Duquense Light* [CITE] (approving settlement under which utility was required to obtain prior Commission approval to join the Alliance RTO). *See also* [CITE].

in court. Under no circumstances can the Applicants be allowed to accept the merger now and later challenge the legality of a condition, should it need to be enforced.

C. Reply To Applicants' PLR Exception Number 1 Concerning Rejection Of The Deferral Mechanism

Applicants, while lauding Judge Gesoff for recommending immediate rate cap relief, take exception to his rejection of the proposed DTM alone or along with a rate increase. Applicants' Exceptions at 32-33. As proposed by GPUE, the DTM would "defer the net difference between [Met-Ed and Pennelec] retail charges for generation service and their market cost of supply. This net cumulative amount would be deferred together with carrying costs for ultimate recovery as directed by the Commission." *See Applicants' Main Brief at 99.* The Commission should summarily reject GPUE's continued request for a DTM.

Implementing the DTM would guarantee GPUE recovery of all its PLR costs and destroy the bargain struck in the Restructuring Settlement, which called for rate protection for customers in return for utilities' collection of stranded costs and opportunities to eventually charge market prices. *See, e.g., OCA Main Brief at 105-108.* Even more troublesome, implementing the DTM would provide GPUE with dollar-for-dollar recovery of its power supply costs, and thereby eliminate any incentive for GPUE to seek alternative suppliers or in any way mitigate its power supply costs. Removing incentives of suppliers to minimize purchase costs is last thing the Commission should do in this time of high and rising wholesale market prices.

D. Reply To New Power Company Exception Number 1 And MAPSA Exception B

The New Power Company ("New Power") and the Mid-Atlantic Power Supply Association ("MAPSA") both raised exceptions to the Recommended Decision, arguing, in effect, that Judge Gesoff should have done more to encourage retail competition by modifying aspects of the CDS program. *See New Power Exceptions at 2-3; MAPSA Exceptions at 4.* New

Power recommends, for instance, that the Commission “eliminate the provisions in GPU’s Restructuring Settlement that automatically eliminate bids that exceed the generation rate cap.” New Power Exceptions at 3. Similarly, MAPSA suggests that “the Commission could direct that CDS prices be tied to the market.” MAPSA Exceptions at 4.

These proposals both argue, in essence, that allowing competitive retail prices to increase consistent with the increase in wholesale market prices will ultimately spur retail competition. In this regard, New Power explains:

[I]t is imperative for the development of a competitive retail market in electricity for the Commission to remove price controls that insulate customers from the real world prices of generation. The current rate cap restriction on CDS bids is an insurmountable obstacle for alternative generation suppliers because it compels EGSs to compete against an artificially low price which bears no relationship to actual market price for generation. Under GPU’s current CDS bidding process, NewPower would be forced to offer customers a discounted price for generation that is too low to create an incentive for NewPower to enter the GPU market.

New Power Exceptions at 3. Similarly, MAPSA asserts that “[a]n immediate positive impact on competition would require generation rates that actually reflect market prices.” MAPSA Exceptions at 2.

The fundamental problem with this reasoning is that it confuses mere *market* prices with *competitive* market prices. As Judge Gesoff found in this case, the wholesale PJM market is not competitive, which means that prices reflect some exercise of market power. R.D. at 126.

Raising retail rates to reflect these wholesale prices would not increase “competition,” (as New Power and MAPSA claim) but would simply ratify the exercise of market power. It is bad enough that Judge Gesoff has seen fit to recommend a vast, unjustified rate increase for GPUE, this error should not be compounded by ratifying the exercise of the very market power that this Commission should seek to limit if workable competition is to develop.

III. REPLY TO PROPOSED SETTLEMENT STIPULATION

Along with their Exceptions, Applicants filed a proposed Settlement Stipulation, explaining that it “is a proposed alternative [to Applicants’ Exceptions] that has been negotiated in order to permit the proceedings to be settled.” Applicants’ Exceptions at 31. Applicants assert that, as of the filing of their Exceptions, only the Met-Ed Industrial Users Group and the Pennelec Industrial Customer Alliance had agreed to the Settlement Stipulation. *Id.* at 31-32. By letter dated May 9, 2001, the Secretary of the Commission directed parties as part of their replies to exceptions “to indicate whether they accept or reject the proposed Settlement Stipulation.” *See* May 9, 2001 Letter from James J. McNulty to all parties of record.

While as a general principle Citizen Power favors negotiated settlements over protracted litigation, Citizen Power cannot support the Settlement Stipulation as proposed.

Perhaps the central provision of the Settlement Stipulation is paragraph 2, which would allow Met-Ed and Pennelec “to defer for ratemaking and accounting purposes the difference between their charges to retail customers for provider of last resort (POLR) service and their actual cost of supply” from January 1, 2001 through December 31, 2005. Citizen Power believes that this proposal is simply outrageous. As numerous parties explained in the PLR Proceeding, implementing such a deferral mechanism to guarantee GPUE recovery of all its PLR costs, subject only to a potential write-off in 2010, totally destroys the bargain struck in the Restructuring Settlement. Even more troublesome, the proposed deferral mechanism, by providing GPUE with dollar-for-dollar recovery of its power supply costs would reduce the incentive for GPUE to mitigate its costs. This is the last thing the Commission should do in this time of high wholesale market prices.

Further, as Citizen Power's exceptions in this proceeding have indicated, two of its principal concerns with respect to the merger relate to (i) competitive harm and (ii) adverse effect on Pennsylvania air quality FirstEnergy's Ohio generation plants. The Settlement Stipulation does not even address Citizen Power's concerns on these issues.

The Stipulation does not contain any provisions intended to address Citizen Power's position that Applicants have failed to satisfy their burden of proof under 66 Pa. C.S. § 2811(e) to show that the merger will not have an adverse effect on retail competition. While the Recommended Decision failed to accept Citizen Power's arguments on this point, Citizen Power feels strongly that this is an issue that must be reversed by the Commission, or, if necessary, on appeal.

The Stipulation also ignores Citizen Power's and other parties' concerns about the adverse effect the merger is likely to have on Pennsylvania air quality, and the remedies Citizen Power and others have proposed to ameliorate that problem. Paragraph 7 of the Settlement Stipulation at least ostensibly offers environmental benefits, proposing \$5 million over the next five years in incremental spending on renewable energy projects. However, as structured, the Settlement would defer for three years the implementation of the 0.01 cent/kWh sustainable energy program charge that is slated to commence January 1, 2005 under Section H.5 of GPUE's restructuring settlement. It is not apparent to Citizen Power that this tradeoff results in any net increase in renewables funding, let alone approaching the substantial environmental conditions that Citizen Power strongly believes are justified to shield Pennsylvanians from the potential adverse environmental effects of the merger. Accordingly, Citizen Power cannot support the Settlement Stipulation as proposed.

IV. CONCLUSION

The Commission should deny the Exceptions filed by Applicants, New Power and MAPSA in this proceeding, as set forth herein. As Citizen Power has explained on brief and in its exceptions, the proposed merger, even with the additional conditions recommended by the Presiding Judge does not satisfy the relevant statutory standards under Pennsylvania law and should be rejected, or, at a minimum, approved subject to Judge Gesoff's recommended conditions and the additional conditions identified in Citizen Power's Exceptions. Clearly, however, Applicants' efforts to remove even the modest conditions recommended by Judge Gesoff must be denied. Further, the Commission should reject the proposals that would worsen the Presiding Judge's already untenable recommendation with respect to PLR issues. Finally, Citizen Power hereby states that it cannot support the Settlement Stipulation as proposed.

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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