STATE OF NEW JERSEY
BOARD OF PUBLIC UTILITIES
OFFICE OF ADMINISTRATIVE LAW

I/M/O THE JOINT PETITION OF	)	**OAL Docket No:** PUCOT01585-01N
FIRST ENERGY CORP. AND JERSEY	)	**BPU Docket No:** EM00110870
CENTRAL POWER & LIGHT	)	
COMPANY, d/b/a GPU ENERGY, FOR	)	
APPROVAL OF A CHANGE IN	)	
OWNERSHIP AND ACQUISITION OF	)	
CONTROL OF A NEW JERSEY PUBLIC	)	
UTILITY AND OTHER RELIEF	)	

INITIAL BRIEF OF THE DIVISION OF THE RATEPAYER ADVOCATE

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I. Statement of the Case and Procedural History

INTRODUCTION

On August 8, 2000, FirstEnergy Corporation ("FirstEnergy") and GPU, Inc. ("GPU"), executed an "Agreement and Plan of Merger" ("Merger Agreement"). FirstEnergy is the parent company of several Ohio and Pennsylvania electric and natural gas utilities. GPU, Inc. is the parent of several electric distribution utilities, including Jersey Central Power and Light Company ("JCP&L"), a public utility of the State of New Jersey, subject to the jurisdiction of the New Jersey Board of Public Utilities ("Board").[1] If all the necessary regulatory approvals are granted and the merger closes, GPU and JCP&L will be merged into FirstEnergy. JCP&L would be a subsidiary of FirstEnergy, with the corporate headquarters located in Akron, Ohio.

The proposed merger is significant to the State of New Jersey for several reasons. It is the third proposed acquisition of a New Jersey electric utility by an out-of-state utility.[2] If this merger is consummated, three of New Jersey's four investor-owned electric utilities would be owned and controlled by out-of-state corporations. The proposed merger also comes at a time when the electric power industry is still struggling with the implementation of both wholesale and retail competition. In 1996, the Federal Energy Regulatory Commission ("FERC") issued Order 888, mandating that all electric utilities file non-discriminatory open-access transmission tariffs, paving the way for both increased wholesale and retail competition. In early 1999, the Electric Discount and Energy Competition

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[1] Collectively, FirstEnergy and JCP&L are referred to as "Joint Petitioners."

[2] Atlantic City Electric Company was acquired by Delmarva, to form Conectiv, in early 1998. Rockland Electric Company was acquired by Consolidated Edison in 1999. Recently, Potomac Electric Power Company, a Washington, D.C. corporation, announced that it would merge with Conectiv.

Act ("EDECA") was signed into law by Governor Whitman, initiating retail competition for all electricity and natural gas customers in New Jersey. Indeed, as the electric industry moves from strict command-and-control regulation to an increasingly competitive framework, there have been a large number of mergers involving electric utilities. The perceived need to increase corporate size to compete in (or control) the restructured marketplace may be one of the driving forces in the FirstEnergy/GPU merger.

The proposed merger is extremely important to JCP&L's customers as well. As the Legislature recognized when it enacted the EDECA, New Jersey's electric rates are among the highest in the nation. Moreover, retail competition is currently stalled in New Jersey, as well as throughout the nation. Fewer than 1.5% of this State's customers are current served by non-utility suppliers. JCP&L's switching figures are the lowest in the State.[3] More disturbingly, with high wholesale electricity prices continuing, very few suppliers are able to compete with the basic generation service ("BGS") rates of the incumbent utility. Residential customers in JCP&L's service territory currently have **no** suppliers offering electricity below the BGS rate. Consequently, a proposed merger, with its obvious removal of at least one potential competitor in the New Jersey market place, must receive the highest level of regulatory scrutiny at this juncture.

For these reasons, JCP&L's customers must receive the benefit of all cost reductions that result from the merger. The Division of the Ratepayer Advocate ("Ratepayer Advocate") has made several proposals in this case to ensure that JCP&L's customers receive and retain the full benefit of merger-related cost savings.

By contrast, apart from the promise of cost reductions, the proposed merger has potential pitfalls

[3] As of the BPU's May 7, 2001 report, statewide only 49,114 customers were being served by alternative suppliers, out of a total of 3.5 million customers. For GPU, only 2,845 out of 992,533 customers are currently served by alternative suppliers (i.e., 0.29%).

for JCP&L's customers, its employees, and the economy of the State. Under the proposal, JCP&L will likely reduce its corporate presence in New Jersey, and the utility will be operated out of the FirstEnergy corporate headquarters in Ohio. While certain field personnel will remain in New Jersey, in essence, the State is losing one of its major electric utilities to Ohio. Notably, there has yet to be a determination as to how many GPU/JCP&L employees (or New Jersey residents) will lose their jobs if the merger is finalized. It is likely that, in addition to losing a utility, New Jersey will lose a significant number of jobs as a result of the merger. Yet, the merger application contains no proposal that addresses these vital issues. The Ratepayer Advocate has proposed a pro-rata workforce reduction plan that will help protect the jobs of JCP&L's New Jersey residents and the economy of this State.

Similarly, the merger proposal contains no protections for JCP&L's customer service personnel or facilities. Nor does the merger proposal adequately address the reliability issues that have plagued JCP&L's distribution system for many years. Although the merger is likely to lead to additional problems for the substantial number of low-income customers in JCP&L's service territory, the Joint Petition contains no provisions for ensuring that service affordability, reliability, and quality will be maintained following the merger. The Ratepayer Advocate has proposed certain programs that should be implemented as a condition of merger approval to ensure that all of JCP&L's customers receive safe and adequate service at just and reasonable rates if the merger is approved.

Finally, as the Board continues to implement electric industry competition in the State, there is a compelling need to ensure that all customers have the benefit of robust competition, with no incumbent electric provider enjoying an unfair advantage or market power. Yet the merger petition contains no meaningful analysis of the proposed merger's impact on retail competition in either the JCP&L service territory or the State. Finally, the proposed merger may be a stepping stone for FirstEnergy to remove

GPU's transmission facilities outside the control of the PJM ISO, possibly into the newly-formed Alliance RTO. This could have negative consequences with respect to service reliability and retail rates in New Jersey.

In response, the Ratepayer Advocate has proposed several safeguards that the Board should adopt as a condition of merger approval to ensure that all of JCP&L's customers receive the benefit of meaningful retail competition. For all these reasons, in its review of this matter the Board must ensure not only that JCP&L's customers, the *public* that the public utility serves, receive the benefits of this merger, but also that these positive gains are not subsumed by interceding disadvantages.

PROCEDURAL HISTORY

On or about November 9, 2000, the Joint Petitioners filed a joint petition ("Joint Petition") with the Board, seeking approval by the Board of the change in control and transfer of stock of JCP&L, which will be affected by the proposed merger of JCP&L's parent, GPU, with and into FirstEnergy. Board Staff and the Ratepayer Advocate subsequently commenced to propound discovery on the Joint Petitioners.

The matter was originally transmitted to the Office of Administrative Law ("OAL") on November 13, 2000 as a contested case. By letter dated November 16, 2000, the Board asked the OAL to return the Joint Petition, noting that the earlier transmittal was premature and that the papers would be transmitted anew when deemed appropriate.

The matter was subsequently re-transmitted to the OAL as a contested case on December 28, 2000. In its transmittal cover letter, the Board asked that the ALJ only "make a record and issue a decision only making findings of fact." On January 18, 2001, the Ratepayer Advocate filed a motion with the Board seeking to amend the instructions found in the Board's re-transmittal of the Joint Petition so that the ALJ will issue a full Initial Decision with not only findings of fact, but with conclusions of law and a recommended decision to the Board. Although the Board never specifically ruled on that motion, by letter dated February 5, 2001, the Board sent yet another clarifying transmittal letter to the OAL, stating that it now agreed that the ALJ should issue a full initial decision, with both findings of fact and conclusions of law. The Board also stated that it would retain issues related to compliance with its May 1, 2000 Order in Docket No. EA99070485 as well as those issues related to post-August 1, 2003 rates.

On February 28, 2001, the Honorable Louis McAfoos, ALJ (t/a), presided over a pre-hearing conference.[4] The following parties were granted intervenor status in the case: PECO Energy Company; Independent Energy Producers of New Jersey; National Energy Marketers Association ("NEMA")[5]; New Jersey Business Users; NewPower Company; Mid-Atlantic Power Supply Association; Co-Steel, Inc.; Shell Energy Services Company; and PJM Interconnection, LLC. New Jersey Natural Gas Company was granted participant status. Later, Enron was granted intervenor status, and PSEG Power was granted participant status.

At the prehearing conference, dates for the completion of discovery, and the filing of written direct, rebuttal, and surrebuttal testimony were established. Plenary hearings were scheduled for consecutive days from April 30 through May 4, 2001, and from May 7 through May 11, 2001. On April 16, 2001, the Ratepayer Advocate and other intervenors filed their direct testimony. Ms. Barbara Alexander, Messrs. Bruce Biewald/David Schlissel, David Peterson and James Rothschild submitted testimony on behalf of the Ratepayer Advocate. On April 23, 2001, the Joint Petitioners filed their rebuttal testimony. On April 30, 2001 the intervenors filed their surrebuttal testimonies. Hearings commenced on April 30 and ended on May 8, 2001.

During the final plenary hearing, the parties established the briefing schedule. Initial briefs are scheduled to be filed May 25, 2001 and reply briefs are due on June 4, 2001.

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[4] A written pre-hearing Order was issued on March 28, 2001.

[5] NEMA later withdrew from this matter.

II. Standard of Review

<u>POINT I</u>

THE PROPER STANDARD OF REVIEW OF THE PROPOSED MERGER IS THE "OF POSITIVE BENEFIT TO THE PUBLIC INTEREST" TEST.

The proposed merger of JCP&L into FirstEnergy will have an unprecedented impact on the management and control of JCP&L. GPU, Inc., the parent of JCP&L, will be merged into a newly-structured, registered public utility holding company. If the necessary approvals are granted, FirstEnergy will acquire all of the outstanding stock shares of GPU, Inc. Subject to certain conditions, GPU's shareholders will elect to either receive cash ($36.50 per share) for their outstanding shares of stock, FirstEnergy stock, or a combination of both cash and FirstEnergy stock. GPU's Board of Directors will be disbanded, and it would be able to select only six of the sixteen members of the newly-constituted FirstEnergy Board. FirstEnergy will be headquartered in Ohio, and JCP&L's headquarters in Morristown, New Jersey will likely close or be reduced in size. Thus, New Jersey will lose the corporate presence of one of its four investor-owned electric utilities.

It is unclear whether any members of JCP&L's senior management staff will have positions with FirstEnergy, although GPU's current Chairman will be Chairman of FirstEnergy for a couple of years until he retires. *P*-3, p. 3. It is possible that a number of JCP&L's lower-level New Jersey employees will lose their jobs. Significantly, FirstEnergy plans to consolidate the senior management activities in Akron, Ohio. In addition, the GPU Service Company, which currently provides administrative, accounting, and various other services to JCP&L will be disbanded, and replaced by a new FirstEnergy service company operating in Ohio. Accordingly, the merger, as proposed, will significantly affect the

management structure of JCP&L and the various units which purchase and distribute power, as well as those which provide customer service, engineering, and billing functions. Virtually no aspect of JCP&L's operations will remain untouched by the proposed merger.

In sum, the proposed merger will affect the internal structure of an electric utility which serves approximately one million customers in New Jersey. The merger will have a significant impact on New Jersey's economy, as well as the manner in which service is provided to JCP&L's New Jersey customers.

The Board has broad and sweeping powers over all aspects of public utilities subject to its jurisdiction. *See N.J.S.A.* 48:2-13; *Township of Deptford v. Woodbury Town Sewerage Corporation*, 54 *N.J.* 418 (1969); *In re Public Service Electric and Gas Company*, 35 *N.J.* 358, 371 (1961). The powers of the Board extend to transfers of utility stock and control. A New Jersey public utility is required by statute to obtain authorization from the Board prior to transferring any shares of its capital stock to another utility. *N.J.S.A.* 48:3-10. Here, JCP&L seeks approval of its proposal to transfer utility stock and control to FirstEnergy.

Furthermore, under its statutory mandate, the Board is required to "evaluate the impact of the acquisition on competition, on the rates of ratepayers affected by the acquisition of control, on the employees of the affected public utility or utilities, and on the provision of safe and adequate service at just and reasonable rates." *N.J.S.A.* 48:2-51.1. Ultimately, the Board must determine whether the proposed merger is in the public interest. Historically, the Board has used either one of two standards to determine if a proposed merger is in the public interest: the "positive benefits" standard, or the "no harm" standard.

The "positive benefits" test, also known as the "best interest of the public" or "of positive benefit

to the public interest" test, has its origins in merger or "takeover" cases "affecting the internal structure of existing New Jersey utilities." *See I/M/O Public Service Electric and Gas Company for Authorization Pursuant to N.J.S.A. 48:3-10*, BPU Docket No. EM8507774 (Order Authorizing Transfer of Capital Stock and Approval of Merger, January 17, 1986, at p. 7); *See also I/M/O New Jersey Resources Corporation and New Jersey Natural Gas Company v. NUI Corporation and Elizabethtown Gas Company*, BPU Docket No. 8312-1093 (Decision and Order on Motions for Emergent Relief, January 31, 1984) ("*New Jersey Resources*"); *Re: New Jersey Natural Gas Company*, 80 PUR 3d 337, 339 (1969)("*New Jersey Natural*"). Under the "positive benefits"standard, the Board required the petitioners to demonstrate that benefits would accrue to ratepayers from the proposed transfer of control.

Generally, in the past the Board had applied the "no adverse impact" test in cases where the proposed stock transfer did not significantly affect the internal structure of a utility, principally those cases involving the transfer of utility stock to a holding company. *See I/M/O Atlantic City Electric Company*, BPU Docket No. EM8608886 (January 5, 1987); *I/M/O PSE&G for Authorization Pursuant to N.J.S.A. 48:3-10*, BPU Docket No. EM8507774 (January 17, 1986); *I/M/O Elizabethtown Water Company*, BPU Docket No. WM8502238 (August 9, 1985); *I/M/O Elizabethtown Gas Company*, BPU Docket No. 6913-1007 (April 17, 1969); *I/M/O Hackensack Water Company*, Docket No. 833-195 (July 12, 1983); *See*, *Re: Mount Laurel Water Corp.*, BPU Docket 627-460 (1962); *Re: General Water Corp.*, BPU Docket No. 629-631 (1963); and *Re: Elizabethtown Water Co.*, BPU Docket No. 6212-809 (1963), as cited in *New Jersey Natural*, *supra*, at 339.

More recent merger cases represent somewhat of a departure from the standard articulated in past transfer of control cases. In recent merger cases involving electric utilities, the Board has

articulated the "no adverse impact" standard as the basis for its findings, even when the proposed merger affected the internal structure of an existing New Jersey utility. *See I/M/O Atlantic City Electric Company and Conectiv, Inc., for Approval of a Change in Ownership and Control*, BPU Docket No. EM97020103 (Order, January 7, 1998) ("*Conectiv Merger Order*"); *I/M/O Orange and Rockland Utilities, Inc. for Approval of the Agreement and Plan of Merger and Transfer of Control*, BPU Docket No. EM98070433 (Order, April 1, 1999) ("*Rockland Merger Order*"). In the *Conectiv Merger Order*, the Board clarified its position, noting that it was not bound as a matter of policy to use the "positive benefits" test in all circumstances where changes are made in the internal structure of a utility." *Conectiv Merger Order,* p. 5. However, even while articulating the "no harm" standard in both the Conectiv and Rockland merger cases, the Board ordered the merged utilities in those cases to provide significant positive benefits to its ratepayers as a condition of merger approval.

In the Conectiv merger case, the Board ordered the Atlantic City Electric Company ("Atlantic") to flow through 75% of the net estimated merger savings to its customers as a rate decrease implemented at the merger's closing date. *Conectiv Merger Order*, pp. 7-8. The Board also ordered significant protections for Atlantic's employees. *Id.* at 11-12. Similarly, in the Rockland Electric Company ("Rockland")/Consolidated Edison ("Con-Ed") merger case, the Board ordered Rockland to pass through 75% of the net merger savings to its customers and provided for a minimum staffing level for Rockland's New Jersey operations. *Rockland Merger Order*, pp. 17-18. Thus, it is clear that the Board has required a merging electric utility to flow positive benefits to its customers as a prerequisite of merger approval, regardless of what standard of proof it has stated it applied in its review.

Similarly, in two recent telecommunication merger cases, the Board also considered the sharing of merger savings with ratepayers. In its review of the Bell Atlantic merger with GTE, the Board did

not require the petitioners to meet the "positive benefits" standard requiring the development of merger savings and benefits through the evidentiary process before the merger was approved. *I/M/O the Joint Petition of Bell Atlantic Corporation and GTE Corporation for Approval and of Agreement and Plan of Merger*, BPU Docket No. TM98101125 (Order, March 15,1999), p. 8. However, the Board nonetheless directed the merged company to compile merger-related cost and savings data on a going-forward basis, and determined that it would address the issue of ratepayer sharing of merger savings in a future proceeding. *Id.* at 13. Similarly, in the Bell Atlantic/NYNEX merger case, the Board also required the merged company to compile merger-related cost and savings data on an ongoing basis for review in a future proceeding. *I/M/O the Board's Review of the Amended and Restated Agreement and Plan of Merger Dated as of April 21, 1996 By and Between NYNEX Corporation and Bell Atlantic Corporation*, BPU Docket No. TM96070504 (*Order*, May 22, 1997), pp. 21-22.

The proposed merger of GPU into FirstEnergy clearly falls within the category of mergers where the "positive benefits" test should serve as the standard of review. Undoubtedly, as summarized above and as shown in the sections of this brief that follow, the internal structure of JCP&L will be directly and significantly affected by the proposed merger.

Here, the proposed merger is not unlike the merger considered by the Board in the *New Jersey Natural* case, where the Board applied the "positive benefits" test. *New Jersey Natural* involved the request of an existing New Jersey regulated utility, New Jersey Natural Gas Company, to transfer its stock to Brooklyn Union Gas Company, a foreign corporation. In the instant merger, the stock of the existing New Jersey utility, JCP&L, likewise will be transferred to a foreign corporation, FirstEnergy, much as the stock of New Jersey Natural Gas Company was to have been transferred to Brooklyn Union Gas Company in the *New Jersey Natural* case.

The management and control changes contemplated in *New Jersey Natural* were even less onerous than those proposed in the FirstEnergy/GPU merger. For example, the merger considered in *New Jersey Natural* did not upset the continuation of a separate Board of Directors for both the merged subsidiary, New Jersey Natural Gas Company, and the parent, Brooklyn Union Gas Company. But for the addition of two additional members to New Jersey Natural's Board of Directors, it was contemplated that the operations of the continuing company would "continue as they are now." *New Jersey Natural* at 339. In contrast, (as discussed *infra*), the present merger would result in a new Board of Directors for the new parent corporation, dominated by ten FirstEnergy directors and only six GPU-nominated directors.

In the *New Jersey Resources* case, the proposed merger took the form of a hostile takeover of New Jersey Resources Corporation, the parent company of a New Jersey public utility, New Jersey Natural Gas Company, by NUI Corporation, the parent company of another New Jersey public utility, Elizabethtown Gas Company. Not unlike the FirstEnergy/GPU merger at issue, the merger considered in the *New Jersey Resources* case would have drastically altered the management structure of New Jersey Resources Corporation. In the *New Jersey Resources* case, the Board also chose to apply the more stringent "of positive benefit to the public interest" test.

Furthermore, the instant case may be distinguished from the Conectiv and Rockland merger cases. In each of those cases, the Petitioners filed detailed analyses of merger-related savings and costs, as well as studies of the effect on employees. These analyses were subject to further examination in evidentiary hearings, and the Board considered that evidence in its rulings and directed the merged utilities to share the benefits with ratepayers. Here, in contrast, the Joint Petitioners have not provided any detailed quantification of the anticipated merger benefits or costs, or the merger's expected impact

on GPU's employees. The Board is left with only unsupported promises upon which it must make its determination of whether the proposed merger is in the public interest. Absent reliable estimates of both the cost and savings attributable to the proposed merger, the Board might not be able to make the necessary findings.[6] Accordingly, because the Board is without a reliable factual basis upon which it can determine whether the proposed merger will adversely affect ratepayers (due entirely to Joint Petitioners' filing of a wholly-inadequate merger petition and supporting testimony), the Board should apply the more stringent "positive benefits" standard to protect JCP&L's ratepayers and employees.

The instant case may also be distinguished from the Bell Atlantic merger cases. Unlike JCP&L, Bell Atlantic operates under an alternative form of regulation, pursuant to *N.J.S.A.* 48:2-21.15. Pursuant to that statute, Bell Atlantic's rates are regulated under an alternative form of regulation, unlike JCP&L, which is subject to traditional rate base rate of return regulation for its distribution rates. Hence, many of the reasons underlying the application of the "no adverse impact" standard in the Bell Atlantic cases are not present here. Therefore, JCP&L's New Jersey ratepayers should be credited with the benefits of the merger, which are not reflected in the cost structure upon which its current rates are based.

In sum, the present case may be distinguished from those where the Board has applied the "no adverse impact" standard. Furthermore, as demonstrated below and in the record, the proposed merger would have far reaching effects on the internal structure and operations of JCP&L. Moreover, the merger comes at a time when the State's electric industry is in the midst of the transition period in implementing the EDECA. Indeed, Ratepayer Advocate witnesses Peterson, Biewald/Schlissel, Alexander, and Rothschild have shown that the utility's customers will be adversely affected if the

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[6] In considering a request for approval of an acquisition of control of a public utility, the Board is also statutorily required to "accompany its decision ...with a written report detailing the basis for its decision, including findings of fact and conclusions of law." *N.J.S.A.* 48:2-51.1.

merger is approved as proposed by the Petitioners. *See* Exh. *RPA*-23,-24, -25, -26, -43(a), -43(b), -44, -50, and -51. Therefore, the Ratepayer Advocate submits that there is overwhelming support for applying the "of positive benefit to the public interest" test to the proposed merger.

In applying the "of positive benefit to the public interest" standard of review, the Board also developed factors which bear on the public interest in the proposed transaction. For example, in *New Jersey Natural*, the Board enumerated nine factors bearing on the public interest, including the "effect of foreign or absentee ownership," the "impact on service standards," the "promotion of economies," and the "effect on rates." *New Jersey Natural*, at 339.

Similarly, the Board outlined twelve factors which bear on the public interest in *New Jersey Resources*, which included "the advantages of combined control as opposed to local management", "the impact of the planned merger on service standards and the continued provision of safe, adequate and proper service", "the effect of the planned merger on rates to be charged to customers both now and in the future", and "the effect on obligations to employees with respect to pensions and other benefits." *New Jersey Resources*, *supra*, at 7-8.

The Ratepayer Advocate has developed criteria which bear on whether the proposed merger is in the public interest. These criteria were developed through an analysis of the existing standards based on the law governing the Board's evaluation of mergers, from the statutory criteria, and from an evaluation of the facts of the instant case. The pertinent criteria, listed below, were contemplated in the pre-filed direct testimonies of Ratepayer Advocate witnesses Peterson (Exh. *RPA*-23, -24), Biewald/Schlissel (Exh. *RPA*-50, -51), Alexander (Exh. *RPA*-43(a), (b), -44), and Rothschild (Exh. *RPA*-25, -26):

1. Will the merger result in tangible and quantifiable net benefits to the merging

companies that could not be realized in the absence of a merger?

2. Will all classes of JCP&L's ratepayers realize tangible and quantifiable benefits contemporaneous with the merger and does the proposal address the special needs of its low income ratepayers?

3. Does the Merger Agreement contain adequate protection for JCP&L's current employees against unreasonable treatment in the downsizing that will result from the merger?

4. Will JCP&L's accounting processes or the Board's regulatory oversight be unduly complicated by the merger in such a way that effective regulation by the Board is impeded?

5. Will the post-merger holding company be able to inappropriately manipulate the capital structure of JCP&L, resulting in higher costs to customers?

6. Will JCP&L's service quality or service reliability be adversely affected by the merger?

7. Will the merger increase competition in a way that is likely to be beneficial to JCP&L's ratepayers, or will it allow FirstEnergy to discourage competition?

8. Will FirstEnergy be able to remove GPU's transmission assets from the PJM ISO, to the detriment of reliability and rates in New Jersey?

The Ratepayer Advocate submits that the aforementioned criteria should be used to evaluate whether the proposed merger is of "positive benefit to the public interest." Based on those criteria, the merger, as proposed, is not of "positive benefit to the public interest," as demonstrated below. It is clear that based on its prior decisions and the facts of this case, the Board should employ the "positive benefits to the public interest" standard. However, even if the Board decides to use the arguably less stringent "no adverse impact" standard, it is apparent that the factors enumerated above and in the testimony of the Ratepayer Advocate's witnesses would still be appropriate for use by the Board in its evaluation of whether the instant merger is "in the public interest." However, as noted above, given the unique characteristics of this merger and the concurrent unprecedented restructuring of the State's

electric industry, the Ratepayer Advocate submits that the more stringent standard adopted in the *New Jersey Natural* and *New Jersey Resources* merger orders is appropriate for the Board to use in its review of the instant merger: whether the proposed merger is "of positive benefit to the public interest." This more stringent standard should govern whether the proposed merger is "in the public interest."

III. Impact on Competition

POINT II

THE PROPOSED MERGER WILL NEGATIVELY IMPACT ELECTRIC COMPETITION IN NEW JERSEY AND PJM. THEREFORE, THE BOARD SHOULD NOT APPROVE THE MERGER WITHOUT IMPOSING CERTAIN REQUIREMENTS TO MITIGATE MARKET POWER CONCERNS.

As discussed in Point I of this brief, the appropriate standard of review in this case is the "of positive benefits to the public interest" standard. While New Jersey is in the midst of a transition to a fully competitive electric marketplace, the Joint Petitioners should be required to show that the proposed merger has positive effects on retail electric competition in this State, and more specifically, in the JCP&L service territory. Moreover, the proposed merger should not be approved unless the Joint Petitioners can show positive benefits on retail electric competition in the post-transition years.

Contrary to the clear requirements of applying the positive benefits review standard, the Joint Petitioners have mistakenly relied on their belief that the appropriate standard is no "adverse effect on competition." *P-6, p. 3;* Tr. 707:15-16.[7] The Joint Petitioners filed the testimony of their witness, Rodney Frame, to support the erroneous use of this standard of review of competition issues, including market power. Mr. Frame alleged that the proposed merger would have no such "adverse effect on electricity competition in New Jersey." *Id*. The basis for this conclusion was his analysis of the merger's purported effects on **wholesale electricity markets** that was filed with the FERC and attached to his prefiled Direct Testimony. *P-6, Attachment 1.*

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[7] Cites to hearing transcripts are indicated thus: Tr.Page number:line number. Therefore, Tr.707:15-16 denotes transcript page 707, lines 15 through 16.

It is clear that Mr. Frame's analysis is not only irrelevant and useless as a measure of the merger's effects on **retail electricity markets in New Jersey**, but also contains errors that call its credibility into question. Furthermore, even applying the more lenient standard of review, the proposed merger does not pass the test of "no adverse impact" on retail electric competition in New Jersey. The Joint Petitioners' own market power witness has admitted, for the purpose of his analysis, that the proposed merger will eliminate one competitor for retail electric customers in JCP&L's service territory (where there are already precious few competitors) and throughout New Jersey. Furthermore, Mr. Frame's own study's results and methodology show that the proposed merger will have adverse effects on competition.

Mr. Frame's conclusions rely almost entirely on his analysis using the U.S. Department of Justice and Federal Trade Commission 1992 Horizontal Merger Guidelines ("Merger Guidelines"). *P-6, p. 6.* The FERC's Merger Policy Statement is based on those Merger Guidelines. *Id.* The Merger Guidelines "measure merger induced changes in [market] concentration using the Herfindahl-Hirschmann Index or HHI." *P-6, p. 5.* Mr. Frame's study led him to the conclusion that the merger-induced changes in HHI were not significant enough to raise market power concerns related to competition in the wholesale electricity markets within PJM. *P-6, p. 6.*

Mr. Frame also alleged that this conclusion was relevant to the Board's concerns over retail electricity markets in New Jersey. Because he believed that there were no wholesale market concerns, he claimed that no retail market concerns should exist, because prospective retailing parties would be able to procure wholesale electricity for resale to end users. *P-6, pp. 7-8.* His conclusion also relied on his belief that, because the Board had licensed over 25 electricity retailers in New Jersey, this proved that there was enough retail competition for New Jersey customers that the loss of one competitor due to

the merger would not have an adverse effect on retail competition in New Jersey. Mr. Frame also depended heavily on the rate caps imposed by the EDECA until August 1, 2003 to protect JCP&L's ratepayers from increased market power concentration caused by the merger. *P-6, pp. 8-9.* However, despite Mr. Frame's self-serving conclusion that the above factors should mollify market power concerns, the record in this case shows that much more work needs to be done before the Board can safely rely on Mr. Frame's conclusions.

First, it is obvious from Mr. Frame's testimony that he prepared no real analysis of the retail electricity market in New Jersey or in JCP&L's service territory at all. Furthermore, he admitted that even before beginning his analysis, he had already reached the expectation that his clients' proposed merger would not adversely affect retail electricity competition, stating that his analysis "simply reinforces these *a priori* expectations." *P-6, p. 7.* He made no rigorous study of the relevant retail market. He merely tried to bootstrap his wholesale market study that was filed with the FERC into supporting the conclusions he had already reached before beginning the study. The fact that retailers may have opportunity for access to wholesale electricity supplies simply does not support Mr. Frame's conclusion that the merger will not have a negative impact on retail competition in New Jersey.

The availability of wholesale electricity supplies to retailers by itself does not prove there are no market power problems. A market power problem would arise when a wholesale seller of electricity could improperly use market power to raise the price of electricity to an amount that retailers could still afford and then pass through to end users. The mere fact that there are some wholesale supplies available to the retailer does nothing to protect the end users from having to pay improperly increased energy bills caused by market power. The retail customers would still suffer from the market power abuse of the wholesale seller. Mr. Frame's conclusion that available wholesale electricity practically

eliminates market power concerns is hardly the type of analysis that the Board can count on to reach a conclusion that the merger would not adversely affect retail electric competition, let alone a conclusion that the merger would have positive effects on retail electric competition.

Mr. Frame's nearly total reliance on his findings concerning the wholesale electricity markets in relation to the FERC Merger Policy Statement and the Merger Guidelines provides the Board with no assurance that, as the result of the merger, retail electric competition in New Jersey will either receive positive benefits or at least have no adverse effects. Mr. Frame has admitted that the FERC's approval of the merger does not mean the Board should not have market power concerns. Tr. 723:2-6. However, his overall conclusion about retail competition is almost entirely based on his FERC testimony. There are scant few other reasons for his recommendation of the Board's approval of the merger's effect on market power concerns in his testimony.[8]

The FERC Merger Policy Statement says that the agency must "pay close attention to the possible effect of a merger on competitive **bulk power** markets," not retail markets. *FERC Order 592, Docket No. RM96-6-000, (December 18, 1996), p. 2. (Emphasis added.)* The agency will also seek "appropriate ratepayer safeguards" for "wholesale customers," not retail customers. *Id., p. 4.* It is plain that the FERC's concern in its merger reviews is the impact on wholesale or bulk power competition, not retail competition. It is the Board's responsibility as a state regulator to examine the proposed merger's effects on JCP&L retail customers. The Merger Policy Statement goes on to state that:

> With respect to the merger's effect on state regulation, where the state commissions have authority to act on the merger, we intend to rely on the state commissions to exercise their authority to protect state interests. [*Id., p. 5*].

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[8] As will be seen, those other reasons (discussed *infra*) do not support the Joint Petitioners' contention that the merger would have no adverse effects on retail competition in New Jersey.

The FERC has undoubtedly left the state public utility commissions with the obligation to protect their ratepayers' interests in retail competition and does not include that issue in its review. The Board would effectively abdicate its responsibility if it adopts the FERC's benign view of the proposed merger's effects on bulk power markets as a finding that this merger would have no adverse effect on retail electric competition. Indeed the record in this case proves that the FERC has specifically left retail competition issues to the state commissions including the Board. As affirmed in its Order authorizing the proposed merger:

> We reject the 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 592, 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. [Footnote omitted.] [*RPA-49, p. 8*].

Clearly, Mr. Frame's reliance on the fact that his analysis abides by the FERC Merger Guidelines is completely misplaced.

Second, Mr. Frame's confidence in the fact that the Board has licensed over 25 electricity retailers in New Jersey provides no comfort to JCP&L customers who have virtually no alternative to the regulated BGS rates. The mere existence of licensed suppliers has provided precious little benefit to JCP&L's customers who have had few opportunities to switch suppliers. Even the relatively lucky few switching customers are now being returned involuntarily to JCP&L's BGS and, therefore, their days of saving on their electric bills are over, for at least the near term. *RPA-47.*

When preparing his analysis, Mr. Frame reviewed how many retail marketers were licensed in New Jersey, but did not check to see how many marketers were active in JCP&L's service territory. Tr. 666:9 to 667:9. He did not believe it was important to do so given the current BGS rates versus the market price of energy. Tr. 665:15-23, 666:19-24 and 667:10-15. He apparently drew great comfort

from the point that there will still be licensed retailers in New Jersey in the future, whenever market prices are favorable compared to BGS rates. As discussed above, the fact that 25 or more retailers are licensed is hardly relevant when JCP&L customers are not getting competitive offers from any of them. Therefore, JCP&L's customers receive no comfort from Mr. Frame's reliance on the number of licensed suppliers, and the Board should simply disregard this useless fact. Furthermore, as Ratepayer Advocate witnesses Bruce E. Biewald and David A. Schlissel testified, Mr. Frame presented no evidence on how serious and active the remaining electricity retail suppliers are or will be, as compared to the retail supplier that will be eliminated as a result of the proposed merger. It is possible that the merger will eliminate one of the more serious and active suppliers and, as a result, will significantly affect the level of competition for customers and load. *RPA-51,* p. 12, l. 4-13. Eliminating an active supplier with a sizeable number of retail customers and load is hardly a positive benefit for retail competition.

The record in this case clearly establishes that there has been very little switching to alternate electricity suppliers by JCP&L customers and, therefore, very little retail competition. Exhibit *RPA-46* revealed that, by January 27, 2000, only 7,510 of 992,533 JCP&L customers, or 0.76%, had service from an alternate electricity supplier. Even that paltry figure was relatively positive compared to subsequent events that led to suppliers dropping the few shopping customers and forcing them back to the regulated BGS. The Board website contained statistics for April 23, 2001 showing that only 4,640 JCP&L customers or 0.47% still had an alternate electricity supplier. Tr. 681:17-23. In making his recommendations about the state of retail competition, Mr. Frame did not consider this dismal picture of retail competition important.[9] Tr. 677:17 to 678:8. In Exhibit *RPA*-47 the Joint Petitioners admitted

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[9] The BPU website currently states that as of May 7, 2001 only 2,845 JCP&L customers or only 0.29%, still have an alternate supplier.

they expect “that virtually all shopping customers will return to GPU Energy for their supply needs by June 2001.” With the absolute lack of retail competition for JCP&L customers at this time, it is even more important for the Board to make certain that the proposed merger will have positive benefits for retail competition. Therefore, the Board should not approve the merger without adopting the recommendations of the Ratepayer Advocate outlined herein, including keeping GPU's transmission assets under PJM control for at least ten years following the merger and conducting a more detailed market power assessment using an energy system simulation model. The current merger proposal does not provide such benefits and should not be approved in its current form.

In addition, it would be inappropriate for the Board to rely on an analysis that depends almost entirely on the Merger Guidelines HHI screening tool, as Mr. Frame’s testimony does. Using the HHI as a screening tool should not be the end of the review of this issue. As discussed below, the Board needs a more detailed study of market power before it can decide that market power concerns either exist or do not exist. This study is the energy system simulation model recommended by Ratepayer Advocate witnesses Biewald and Schlissel. *RPA-50,* p. 22, l. 3-7. The reasons supporting such further assessment are amply stated in their direct testimony.

> HHI calculations are based on a limited set of snapshots of the markets examined in terms of loads, resources, and transmission capacities. There may be situations during a typical year when loads and transmission capacities differ from those studied and actual post-merger market shares may be higher. For example, there could be a hot summer high demand day along the east coast while temperatures were more moderate in FirstEnergy’s service area. In such a situation, the energy available and transferred to PJM from FirstEnergy could be much greater than any of the values presented in Mr. Frame’s HHI calculations.
>
> A proper analysis of the market power implications of the proposed merger would require an **energy system simulation model to look at the hourly behavior of the market under a wide variety of external conditions and bidding behaviors.** Such a more realistic model would provide better insight into potential market power concerns

than just a formalistic HHI calculation. [*RPA-50,* pp. 21-22, emphasis added].

Although the HHI calculations can provide some useful information about post-merger market power, the Ratepayer Advocate asserts that Mr. Frame's calculations are too flawed to be trustworthy. His analysis contains several errors and/or biases that skew the results and make it undependable. The Ratepayer Advocate witnesses, Messrs. Biewald and Schlissel, pointed out several of these errors in their prefiled direct testimony. They stated that the relatively small changes in HHI in Mr. Frame's study were due to his underestimation of the generation that FirstEnergy could have available to sell in the PJM markets. *RPA-50,* p. 17, l. 12-16. Contrary to Mr. Frame's assumptions, FirstEnergy has claimed that there are likely to be times when FirstEnergy's capacity resources[10] will be transferable from FirstEnergy into the PJM East market[11] in amounts exceeding Mr. Frame's assumed capacity of 216 MW in the Summer period.

The peak load diversity between FirstEnergy and GPU was the subject of the rebuttal testimony of FirstEnergy witness Robert A. Kaiser. Mr. Kaiser estimated that FirstEnergy and GPU's load diversity was in the range of 200 to 700 MW for each of the top 50 peak hours in 1999, with the average load diversity at an average of 350 MW for the 50 peak hours. *P-11,* p. 5, l. 7-17.[12] When asked what other supply options would be available to FirstEnergy to help meet GPU's peak load requirements, Mr. Kaiser testified that the 350 MW on average could be delivered on peak to support GPU load and that "This support is not dependent on transmission availability." *Id.,* p. 17-19.

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[10] I.e., FirstEnergy's existing capacity, its capacity expansion plans and the peak load diversity between FirstEnergy and GPU service territories.

[11] The PJM East market includes the retail service territories of JCP&L and other New Jersey electric suppliers. *P-6, p. 4.*

[12] He also testified that FirstEnergy could deliver up to 4,000,000 MWH annually to GPU in off-peak periods. *Id.*

Mr. Kaiser further stated that:

> In addition, FirstEnergy has a 10 year contract supply of **western PJM energy** which provides 400 MW in 2002, ramping up to 500 MW in 2005, and 600 MW in 2008 which could be used to serve GPU Energy's obligations. Other FirstEnergy power plants may also be utilized to support GPU Energy's obligations if the proposed PJM West organization becomes operational. Finally, FirstEnergy is exploring the development and purchase of **additional generation resources within PJM** to assist in meeting JCP&L's BGS requirement. [*Id.,* p. 6, l. 3-9, emphasis added].

This testimony supports the statements by Messrs. Biewald and Schlissel that Mr. Frame underestimated the amount of generation that FirstEnergy could have available to sell in the PJM markets. Although there are reasons discussed elsewhere in this initial brief why FirstEnergy's claims of having energy available for JCP&L's customers may not be realized, it is instructive that FirstEnergy has asked the Board to rely on these claims. In assessing concerns about FirstEnergy's potential market power, it is clearly sensible to include the effect of the claimed FirstEnergy energy supply to be used for JCP&L's load.

Mr. Frame's calculations of market concentration suffer from the flaw of not including all the energy supply options that FirstEnergy claims could be made available to serve GPU. In addition to the above-mentioned supply from peak load diversity that does not depend on transmission capability to serve GPU load, FirstEnergy has purchased 1,100 MW of annual firm transmission capacity from its control area to PJM for 2001 and has the right of first refusal for this transmission in 2002. This transmission capacity will assist FirstEnergy in delivering its existing generation capacity and new generation capacity additions into the PJM markets. As stated by Mr. Kaiser:

> We have or are in the process of installing 1155 MW of new peaking capacity in ECAR. 390 MW came on line in 2000. Another 425 MW will be available for the summer of 2001. The final installment of 340 MW will be available for the summer of 2002. In addition, FirstEnergy is in the process of increasing the output from our nuclear plants. These uprates will increase our generation capability by 150 MW in

2002. These installations will increase FirstEnergy's reserve margin in ECAR, and together with the other capacity additions planned in ECAR, will reduce the volatility of prices in ECAR, and free up the capacity at Seneca to serve GPU Energy POLR obligations. [*P-11, p. 7, l. 11-17*].

The alleged availability of this energy also supports Messrs. Biewald and Schlissel's testimony that Mr. Frame underestimated the amount of generation that FirstEnergy could have available to sell in the PJM markets. Underestimating the generation that FirstEnergy could use to sell in the PJM markets serves to understate the post-merger HHI and understates the increase in market concentration that would occur because of the merger. *RPA-50, p. 19, l. 10-13.*

Another flaw in Mr. Frame's analysis is his failure to examine all appropriate power markets. He failed to examine the combined FirstEnergy and PJM market in his study. This combined market is a relevant one to analyze, because it is a market in which both companies currently produce and sell electricity and in which the merged company will continue to produce and sell electricity. *Id., p. 19, l. 14-17.*

Messrs. Biewald and Schlissel's analysis of this combined market showed that the merger would cause the market power concentration in that market to increase beyond the levels that the Merger Guidelines consider to create a market power problem. The Merger Guidelines indicate that a market with an HHI between 1000 and 1800 should be viewed as moderately concentrated. A market with an HHI above 1800 should be considered highly concentrated, and **adverse market power effects can be presumed**. The analysis of this market illustrates that the HHIs for the combined FirstEnergy/PJM market caused by the merger range from 1,323 to 2,453 in the different time periods. *RPA-50, Exhibit BEB/DAS-3.* Therefore, the combined FirstEnergy/PJM market will be **moderately concentrated** during most time periods as a result of the proposed merger and **highly**

concentrated during the Winter and Spring off-peak periods. *Id.* The post-merger HHIs in the Winter and Spring off-peak periods are so high that adverse market power effects should be presumed.

The Merger Guidelines indicate that mergers increasing the HHI by more than 100 points in moderately concentrated markets potentially raise significant competitive concerns. Mergers increasing the HHI by over 50 points in highly concentrated markets also potentially raise significant concerns. Where the post-merger HHI exceeds 1800, "it will be presumed that mergers producing an increase in the HHI or more than 100 points are likely to create or enhance market power or facilitate its exercise."[13] *RPA-50, p. 20, l. 5-12.*

Messrs. Biewald and Schlissel's analysis shows that the increases in HHI from the proposed merger are above 100 for all time periods, and for some periods increase by 250 or more due to the merger. *RPA-50,* p. 20, l. 3-5. Consequently, despite the Joint Petitioners' arguments to the contrary, the record in this case establishes that the proposed merger raises significant competitive concerns in the combined FirstEnergy/PJM market. As outlined above, the post-merger HHIs in the Winter and Spring off-peak periods are so high that adverse market power effects should be presumed. These are facts that the Board should not ignore. The proposed merger should not be approved until the Joint Petitioners can provide reliable evidence that the Merger Guidelines screen violations found by the Ratepayer Advocate witnesses do not raise actual market power problems. To date the Joint Petitioners have failed to provide such evidence.

Another problem raised by Mr. Frame's own study results is that FirstEnergy dominates its

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[13] April 2, 1992, U.S. Department of Justice and Federal Trade Commission Horizontal Merger Guidelines, at pages 30 and 31.

own market area with market shares exceeding 70% for some of the periods being modeled. This significant control of its own market area gives FirstEnergy the potential power to greatly influence the cost of energy exports to other markets including PJM. *RPA-50, p. 20, l. 17-20.*

Additionally, as Messrs. Biewald and Schlissel discovered, Mr. Frame's model produces a number of anomalous results. *RPA-50, p. 20, l. 21 to p. 21, l. 6.* For example, the HHI increases for the FirstEnergy destination market are **highest** in the off-peak periods when the most GPU capacity is available to the FirstEnergy market. However, the opposite happens in his analyses of the PJM market when the amount of available FirstEnergy capacity is the highest during peak load periods. The fact that Mr. Frame's model appears to behave one way for one market and in the opposite way for another market raises undeniable doubts about its worth.

Similarly, comparing Mr. Frame's Sensitivity for an Off Peak 650 MW Sale to GPU scenario (Exhibit APP-313) with his Base Case (Exhibit APP-306) shows the merged capacity in the PJM market in the Spring/Fall off-peak time periods **increases** from 1979 MW to 2489 MW and the merged market share **increases** from 11.8% to 14.3%. However, the post-merger HHI **decreases** from 1320 to 1302. Mr. Frame's model also shows a post-merger HHI **decrease** for the FirstEnergy destination market in the same time period.[14] *RPA-50, p. 21, l. 7-13.* One would expect that increases in merged capacity and merged market share would result in higher post-merger HHIs, not lower. This indicates a flaw in the model that again casts doubt on its credibility.

For all of these reasons, the Board should not rely on Mr. Frame's analyses or on his conclusion that the proposed merger will not have an adverse impact on retail competition in New Jersey. Instead the Board should require the Joint Petitioners to present a more detailed assessment

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14 *P-6, Attachment 1, Exhibits APP-306 and APP-313.*

of market concentration and market power than Mr. Frame's testimony provides. This detailed assessment should include the energy system simulation model Ratepayer Advocate witnesses Biewald and Schlissel recommended. *RPA-50, p. 22, l. 3-7.*

The Board should also place no credence in Mr. Frame's hasty conclusion that the proposed merger presents no vertical market power concerns. *P-6, Attachment 1, pp. 72-75.* Mr. Frame briefly summarizes the concerns and rejects them with very little analysis. He relies on the fact that GPU and FirstEnergy have agreed to have their transmission assets operated by PJM and the Alliance respectively. However, a vertically integrated electric utility with significant generation and transmission assets does not need to rely on transmission availability alone to wield market power. It may simply contract with its own generation affiliate in a preferential manner to the exclusion of other suppliers and thereby inhibit generation competition and drive up prices to end users. Also, code of conduct regulations do not provide a foolproof answer to this problem.

Mr. Frame dismisses the concerns about vertical market power by stating that GPU is currently a net purchaser of energy and capacity, not a seller. *Id.* He believes that even if the post-merger FirstEnergy could artificially raise energy prices, the negative effects of higher energy prices on the post-merger affiliate GPU as a net purchaser would more than offset the higher revenues received for the energy by FirstEnergy. However, this "analysis" does not take into account the fact that JCP&L now has the authority to defer any energy costs above its BGS rates in its Deferred Balance and will ultimately pass through those artificially higher energy prices to its New Jersey customers in full. *RPA-51, p. 9, l. 3-14 and p. 11, l. 11-21.* In this scenario, FirstEnergy could exercise vertical market power to drive up energy prices and thereby increase its profits and JCP&L will pass through those higher energy prices to its customers through the Deferred Balance cost

recovery and itself remain financially whole and completely unharmed. Only the JCP&L customers suffer from this result. Mr. Frame's glib dismissal of this problem is no solution for JCP&L customers, and the Ratepayer Advocate urges the Board to reject Mr. Frame's unsupported conclusion and not approve the merger as proposed unless the Board adopts the conditions recommended by the Ratepayer Advocate set forth herein.

Moreover, because Mr. Frame's conclusions on vertical and horizontal market power rely so heavily on his assumption that GPU's transmission assets will remain under PJM control after the merger, the Board should condition any merger approval on a requirement that FirstEnergy actually keep those assets under PJM control for ten years after the merger and require FirstEnergy to petition the Board for approval of any future attempt to remove the assets from PJM. Additional, related requirements are detailed more fully in Section VII of this initial brief, addressing PJM and transmission-related issues.

IV. Impact on Customer Rates

POINT III

THE PROPOSED MERGER IS NOT IN THE PUBLIC INTEREST BECAUSE JCP&L'S CUSTOMERS WOULD NOT RECEIVE ANY MERGER-RELATED COST SAVINGS UNDER THE JOINT PETITION. THEREFORE, THE BOARD SHOULD NOT APPROVE THE MERGER WITHOUT THE CONDITION THAT JCP&L ACCURATELY QUANTIFY AND PASS ALL OF THE FORECAST NET MERGER SAVINGS TO ITS CUSTOMERS VIA A DISTRIBUTION BASE RATE REDUCTION EFFECTIVE ON THE DATE THE MERGER IS CONSUMMATED.

As discussed in Point I, the Board must determine whether the proposed merger will result in a positive benefit to the public interest. Even under the more lenient "no harm" standard, the Board must determine that the merger would be "in the public interest" and would not adversely affect JCP&L's customers, rates or employees. With respect to JCP&L's rates following the merger, the Board is required to "evaluate the impact of the acquisition on . . . the rates of ratepayers affected by the acquisition of control . . . and on the provision of safe and adequate service at just and reasonable rates." *N.J.S.A.* 48:2-51.1. Notably, the Joint Petitioners did not seek a review of JCP&L's current base rates in conjunction with the merger Petition. Likewise, the Board did not determine that it would undertake such a review in conjunction with its consideration of the merger.

There is no dispute that under traditional rate base/rate of return regulation, JCP&L's customers are entitled to all cost reductions that result from the merger. In fact, Joint Petitioners' have conceded this point. *P-13* at p. 9 (Alexander rebuttal); *P-12* at pp. 7-8 (Marsh rebuttal). The result should be no different merely because Joint Petitioners have chosen not to ask for a base rate review in this matter. Therefore, it is clear that the merger will not meet the applicable public interest

standard (either the "positive benefits" or "no adverse impact" standard) unless the Board conditions its approval upon JCP&L passing all of the forecast net merger savings to its customers via a base distribution rate reduction effective on the date the merger is consummated.[15]

A. PURSUANT TO *N.J.S.A.* 48:2-51.1 AND ITS COMPREHENSIVE REGULATORY AUTHORITY, THE BOARD HAS THE JURISDICTION TO CONDITION ITS APPROVAL OF THE PROPOSED MERGER ON PETITIONERS' PASSING THROUGH AN APPROPRIATE MERGER-RELATED RATE REDUCTION TO JCP&L'S CUSTOMERS.

Under the Board's general jurisdictional powers as set forth in *N.J.S.A*. 48:2-1 *et seq*., it is the clear intent of the Legislature that the Board have regulatory power over New Jersey public utilities to ensure that the public interest is protected and does not adversely affect the provision of safe and adequate utility service at just and reasonable rates. *New Jersey Resource Corp. v. NUI Corp*. 57 PUR 4th 709, 714 (January 31, 1984). Moreover, as the courts of this State have consistently held, the Legislature has granted the Board the widest possible jurisdiction over public utilities. *Township of Deptford v. Woodbury Town Sewerage Corporation*, 54 *N.J.* 418 (1969). The Board is free to use its discretion and to call upon its expertise in an attempt to balance the needs of ratepayers and shareholders. *See In re Jersey Central Power and Light Co.*, 85 *N.J.* 520 (1981). Based on this wide-ranging jurisdiction and its more specific authority under *N.J.S.A*. 48:2-51.1 and 48:3-10, it is clear that the Board is vested with the authority to make the approval of the merger of any New Jersey utility contingent upon the pass through of the net merger savings to the ratepayers.

As discussed *supra*, Joint Petitioners have not asked the Board to review the reasonableness

[15] Of course, as discussed *infra*, Joint Petitioners have presented no meaningful or reliable calculation of merger savings, nor have they proposed to share any of their "back of the envelope" $150 million annual savings estimate with customers. *P-5* (Alexander testimony), at 6.

of JCP&L's rates in conjunction with the merger Petition; nor has the Board determined to undertake such a review on its own accord. Therefore, in this case, the adequacy of JCP&L's current rates, including its appropriate capital structure, return on equity, and overall rate of return, has not been examined as it would have been in a base rate case filing. Moreover, JCP&L's rates are currently subject to a cap, lasting through July 31, 2003 under the Board's restructuring order.[16] *I/M/O Jersey Central Power and Light Co. d/b/a GPU Energy -- Rate Unbundling, Stranded Costs and Restructuring Filings*, BPU Docket Nos. EO97070458, EO07070459 and EO97070460, Order dated March 7, 2001.

Similarly, Joint Petitioners have not proposed any performance-based rate plan, or other merger savings tracking mechanism that would ensure that customers receive the benefit of merger-related cost reductions. In other recent utility mergers, both the Board and the regulatory commissions of other states have ordered such mechanisms as conditions of the merger approval, so that ratepayers receive the benefits of the post-merger utility cost reductions. *I/M/O the Joint Petition of Bell Atlantic Corporation and GTE Corporation for Approval and of Agreement and Plan of Merger*, BPU Docket No. TM98101125 (Order, March 15,1999), p. 13 *;* *I/M/O the Board's Review of the Amended and Restated Agreement and Plan of Merger Dated as of April 21, 1996 By and Between NYNEX Corporation and Bell Atlantic Corporation*, BPU Docket No. TM96070504 (*Order*, May 22, 1997), pp. 21-22; *See Application of Public Service Co. of Colorado for Commission Authorization to Merge with Southwestern Public Service Co., et al.*, Decision No. C96-1235, Decision Approving Application in Docket No. 95I-464E, p. 78 (November 29, 1996).

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[16] As discussed *infra*, the rates established through July 2003 are capped, not frozen. Therefore, a merger-related reduction to these rates, including the regulated distribution rate, is completely permissible under both the EDECA and the Board's restructuring order.

The Board's established precedent in recent electric merger cases is to require the New Jersey utility to pass through merger savings via a rate reduction effective with the closing date of the merger. *I/M/O Petition of Atlantic City Electric and Conectiv, Inc. for Approval of a Change in Ownership and Control*, ("Conectiv merger"), January 7, 1998, BPU Docket No. EM97020103, OAL Dkt. No. PUC 4935-97, Order at 7-8; *I/M/O Consideration of the Joint Petition of Orange & Rockland Utilities, Inc. For Approval of the Agreement and Plan of Merger and Transfer of Control,* ("Rockland merger"), April 1, 1999, Order at 15. In the *Conectiv* merger, the Board ordered Atlantic Electric to reduce its rates by 75% of the estimated merger savings, effect with the date the merger reached financial closing. *Conectiv Merger* Order at 7, 8, and 22. Similarly, in its Order in the RECo/ConEd merger, the Board ordered RECo to reduce its rates by 75% of the net merger savings anticipated. *Rockland merger* Order at 15.

Thus, the Board's precedent and policy is clearly to require the New Jersey electric utility that is merging (or being acquired, as JCP&L is by FirstEnergy) to pass through a significant portion of the calculated savings, in the form of an immediate rate reduction, commensurate with the date the merger closes. The precedential value of the Board's decisions in both the *Conectiv* and *Rockland* merger cases is compelling, because both were fully litigated cases, and not the result of settlements.

Many other state utility commissions have also ordered rate reductions as conditions of merger approval, in both settled and litigated cases. While the regulatory and statutory requirements in other jurisdictions do not necessarily equate with those in New Jersey, these cases are illustrative, particularly because many state commissions have ordered that customers are entitled to a large portion of the projected merger savings. For example, in the recent merger case reviewed by the Oregon Public Utilities Commission involving Enron Corp. and Portland General Electric Company

("PGE"), the Oregon Commission decided that the stipulation signed by the parties agreeing to pass through 100% or $141 million of the merger savings to the ratepayers is in the public interest. *I/M/O the Application of Enron Corp. for an Order Authorizing the Exercise of Influence Over Portland General Electric Company*, 177 PUR 4th 587, 595-596 (June 4, 1997). Similarly, in an order approving the merger of Baltimore Gas and Electric Company (BG&E) with Potomac Electric Power Company (PEPCo), the Public Service Commission in Maryland deemed it appropriate to decrease customer rates by 75% of the first year's net merger savings. *Re: Baltimore Gas and Electric Company*, 176 PUR4th 316, 336 (April 16, 1997). In ordering the rate decrease, the Maryland Commission specifically stated that the customers should share in the net merger savings through lower rates and such benefits should be shared with customers as soon as possible. *Id.*[17] In California, there is a statutory mandate that a minimum of 50% of the net short and long-term net economic benefits of a utility merger must go to the merging utilities' customers. *See* Cal. Pub. Util. Code § 854(b) (1996). Moreover, as discussed *supra*, the Board itself required both Atlantic and Rockland to reduce their base rates as a condition of merger approval.

Under its statutory mandate, the Board is required to "evaluate the impact of the acquisition on . . . the rates of ratepayers affected by the acquisition of control . . . and on the provision of safe and adequate service at just and reasonable rates." *N.J.S.A.* 48:2-51.1. Given this empowering language, the Board's broad regulatory jurisdiction over public utilities, the Board's own precedent, and recent, nationwide-precedent for passing merger savings to customers through an immediate base rate decrease, the Board clearly has jurisdiction to condition its approval of the merger on a specific percentage allocation of the forecast merger savings flowing to JCP&L's customers. For the reasons

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[17] The planned BGE/PEPCO merger never reached closure and was abandoned.

discussed in Point III. B. *infra*, JCP&L's customers should receive all of the net merger savings.

B. JCP&L'S CUSTOMERS, NOT FIRSTENERGY SHAREHOLDERS, ARE ENTITLED TO RECEIVE ALL OF THE NET MERGER SAVINGS.

There are several reasons why it is both unreasonable and unlawful for JCP&L to retain **any** of the net merger savings for the benefit of the Company's shareholders. Therefore, the Board should only approve the merger upon the condition that JCP&L flows through all of the net merger savings to its ratepayers. In New Jersey, rates have historically been set equal to the costs of providing utility services, plus an appropriate return on rate base. *See N.J.S.A.* 48:2-21. If the utility's costs of providing service increase or decrease, changes in such costs are fully reflected in a base rate proceeding. Therefore, when there is a decrease in costs, as is likely in this merger, ratepayers receive the full benefit of utility cost reductions, just as cost increases are reflected in the rate setting process.

In this respect, Joint Petitioners have provided absolutely no legal or factual justification for allowing FirstEnergy's shareholders to receive and retain all of the merger-related cost reductions until the time JCP&L files its next base rate case. This is particularly important in the case of JCP&L, whose rates are capped until August 1, 2003. Because Joint Petitioners have not proposed to share any merger-related cost savings with customers, they would clearly retain all of the merger savings for the foreseeable future. This result is untenable, particularly at a time when JCP&L is accruing enormous deferred costs for future recovery from its customers. *See Verified Joint Petition,* at p. 9. Moreover, JCP&L's earnings will not be adversely impacted by the Ratepayer Advocate's proposal that all of the savings should go to reduce rates. JCP&L's net earnings will not change if

rates are reduced to the same extent that costs will be reduced as a result of the merger.

Joint Petitioners' proposal that JCP&L's customers receive no portion of the merger-related cost savings in this case stands in marked contrast to the 1996-1997 merger between Ohio Edison and Centerior Energy that created FirstEnergy Corporation. There, FirstEnergy agreed to implement substantial rate reductions for its customers, particularly its residential customers, as a condition of merger approval. The Public Utilities Commission of Ohio ("PUCO") Order approving the merger and the associated rate plan stated:

> The transition rate credit program is designed to provide rate relief during the term of the plan and to avoid the need to review rates during the plan period while the companies make changes in their operations to achieve efficiencies. The transition rate credits are estimated to reduce residential and general service customers' charges by approximately $400 million during the plan period (Application at 10). The specific terms of the transition rate credit program are described below. [*I/M/O the Application of FirstEnergy Corp. on Behalf of Ohio Edison Company, the Cleveland Electric Illuminating Company, and the Toledo Edison Company, et al. and I/M/O the Commission's Review of the Merger of Ohio Edison Company and Centerior Energy Corporation*, Case Nos. 96-1211-EL-UNC and 96-1322-EL-MER, *Order* dated January 30, 1997 at p. 14].[18]

The PUCO then discussed the particulars of the rate reductions for residential customers:[19]

> The proposed rate plan provides that, on a bills rendered basis, residential customer bills (not the residential "customer charge") would be reduced by: $3.00 per month from the 210th day following the effective time of the merger through June 30, 2000; $4.00 per month effective July 1, 2000 through June 30, 2001; and $5.00 per month effective July 1, 2001 through December 31, 2005. [*Id.* at p. 15].

These guaranteed rate reductions are to last from mid-1997 through the end of 2005. The rate reductions started at $36 per year and quickly increase to $60 per year, per residential customer. In addition, the PUCO order also called for the FirstEnergy Ohio utilities to file tariffs for rates to be

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[18] A copy of the PUCO's Order may be found on the PUCO's web site at: www.puc.state.oh.us/docket/orders/document/97%5Fearlier/96-1211.pdf

[19] Commercial customers also received rate relief. *Id.*

effective January 1, 2006 that would reduce overall base rates by $310 million, "with a reduction in residential base rates of 20 percent." *Id.* at 16.

In contrast, FirstEnergy has offered JCP&L's New Jersey ratepayers absolutely no rate reductions commensurate with merger approval. Joint Petitioners have introduced no record evidence to explain why FirstEnergy's Ohio customers deserved substantial rate reductions commensurate with the closure of the Ohio Edison/Centerior merger, but New Jersey customers warrant rate benefits of **zero**. The Board should reject Joint Petitioners' blatant attempt to retain all of the merger-related cost savings for the shareholders' benefit, and instead adopt the Ratepayer Advocate's recommendations with regard to merger savings.

C. JOINT PETITIONERS HAVE UTTERLY FAILED TO QUANTIFY THE NET MERGER SAVINGS ASSOCIATED WITH THE PROPOSED MERGER.

Unlike the *Conectiv* and *Rockland* mergers, Joint Petitioners in this case have completely failed to provide evidentiary support for costs to achieve the merger or the expected level of merger savings. Joint Petitioners filed no synergy study of merger savings, or any detailed estimates of transaction or transition costs. In short, Joint Petitioners utterly failed to sustain their burden of proving that the merger will either result in a positive impact on rates, or that it will not have an adverse effect on customers' rates.

Joint Petitioners' claimed rationale for failing to document expected merger savings or expected merger-related costs is that they will purportedly will not seek to recovery merger related costs that exceed merger-related savings. *Verified Joint Petition*, ¶17. However, this "promise" also virtually guarantees that JCP&L's customers will see absolutely no benefits from the merger. Of

course, it is also an empty promise, because Joint Petitioners have quantified neither side of the equation (costs to achieve or savings), nor have they provided even narrative descriptions of the merger-related restructuring that will begin immediately upon financial closing. As FirstEnergy Chief Financial Officer Richard Marsh admitted during cross-examination, it is possible that merger-related costs could subsume all merger-related savings for JCP&L. Tr.973:6-18. Thus, because the record is utterly silent on merger savings, costs to achieve savings, or transition plans, the Board is in the untenable position of having to decide whether the merger is in the public interest based upon a blank sheet of paper. The Board must give short shrift to Joint Petitioners' flagrant attempt to circumvent sharing any portion of the merger-related cost savings with JCP&L's customers, by simply failing to quantify anticipated savings.

Joint Petitioners' sole attempt at quantifying merger-related savings is the $150 million annual savings "figure" that appears in Mr. Alexander's direct testimony. *P*-5, at 6. However, it is immediately apparent that the $150 million "guesstimate" is nothing more than a "back of the envelope" number that bears no factual relationship to the proposed FirstEnergy/GPU merger. [20] Rather, the $150 million number was arrived at by multiplying the combined FE/GPU companies' pre-merger operation and maintenance ("O&M") costs by 5%. *RPA*-23, Appendix (Response to S-OCE-14).[21] Joint Petitioners apparently decided to use a 5% multiplier by examining the projected cost savings from several other utility-industry mergers. *RPA-23*, Appendix (Response to S-OCE-8); Tr.967:17 to 968:12; *RPA-57.* However, as Ratepayer Advocate witness David Peterson testified,

[20] In fact, during cross-examination, Mr. Alexander was unable to definitively state whether the $150 million estimate was a net savings number (i.e., net of costs to achieve) or a gross number. Tr. 202:13 to 206:9.

[21] During the evidentiary hearing, Joint Petitioners' testified that JCP&L's "share" of the $150 million estimate would be about $15 million annually. Tr.997:6 - 998:7

many of these mergers never even were consummated, and the average calculated cost savings was 8.1% of O&M, rather than the 5% Joint Petitioners used. As Mr. Peterson testified:

> When requested to provide the basis for the five percent of O&M estimate, the Joint Petitioners provided a chart of published merger savings estimates from 32 announced utility mergers.[22] The savings estimates for the group, expressed as a percentage of non-fuel O&M expenses, ranged from just 2 percent to 16 percent. If central tendency can be considered "typical", the average announced savings of this 32 merging company sample was 8.1 percent, rather than Mr. Alexander's claim of 5 percent. [Exh. *RPA-23*, at 27].

Moreover, many of the mergers in Petitioners' "sample" group were not even consummated, and Joint Petitioners' witness Marsh admitted he did not know if the estimated savings for most of the mergers was ever tracked or achieved. Tr. 970:17-24; *see also RPA-23*, at 27-28. Notably, for the 1997 merger of Ohio Edison/Centerior (to form FirstEnergy), Mr. Marsh acknowledged that the 9.1% merger savings estimate, a significantly higher figure than the 5% Joint Petitioners assumed in their "calculation" here, was indeed achieved. Tr.970:25 to 971:8.

Compounding the absolute lack of substance behind Joint Petitioners' $150 million estimate (based on other mergers) is their failure to produce **any** evidence concerning projected savings form the merger under consideration. Mr. Peterson explained, in uncontroverted testimony, why Petitioners' $150 million estimate was completely unsubstantiated:

> Mr. Alexander's estimate is not based on an examination of savings opportunities for the merging companies [i.e., FirstEnergy and GPU]. Therefore, it is devoid of support and credibility. In response to several discovery requests attempting to determine the reliability of Mr. Alexander's savings estimate, the Joint Petitioners repeatedly responded that specific savings opportunities have not yet been identified. For example, no specific calculations have been done regarding the overall reduction in capital costs following the merger.[23] No specific calculations of the deferred

[22] *RPA-23*, Appendix (Joint Petitioners response to S-OCE-8).
[23] *RPA-23*, Appendix (Joint Petitioners response to NJB-9).

> balance reductions have been performed.[24] The merger savings that may be applicable to JCP&L has not been determined.[25] Specific impact of the merger on investment in distribution plant has not been quantified.[26] Data on payroll reductions at JCP&L have not been prepared.[27] The identity of specific cost reductions has not been developed[28] and no detailed studies of merger savings has been performed.[29] Accordingly, Mr. Alexander's savings estimate is not reliable. [*RPA*-23 at 26-27].

In sum, Joint Petitioners' have failed to provide any record evidence as to whether there will be any merger-related savings. They have similarly failed to provide any evidence on what the merger-related costs will be -- either transaction costs or transition costs. Faced with this record, the Board cannot determine whether FirstEnergy's proposed acquisition of GPU will result in benefits to customers or harm to customers. Accordingly, the Board should not approve the merger unless and until Joint Petitioners file a detailed analysis of merger-related savings and costs, and the Board and parties to this case have the opportunity to review and respond thereto in an evidentiary hearing process.

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[24] *RPA-23*, Appendix (Joint Petitioners response to NJB-12).
[25] *RPA-23*, Appendix (Joint Petitioners response to NJB-13 and NJB-15).
[26] *RPA-23*, Appendix (Joint Petitioners response to NJB-15).
[27] *RPA-23*, Appendix (Joint Petitioners response to S-ENE-5 and RAR-68).
[28] *RPA-23*, Appendix (Joint Petitioners response to S-OCE-3).
[29] *RPA-23*, Appendix (Joint Petitioners responses to S-OCE-14 and RAR-60).

D. THE BOARD MUST DIRECT JOINT PETITIONERS TO FULLY QUANTIFY NET MERGER SAVINGS AND THEREAFTER REQUIRE JCP&L TO REDUCE ITS DISTRIBUTION RATES TO THE LEVEL NECESSARY TO PASS ALL OF THE NET MERGER SAVINGS TO ITS CUSTOMERS.

It has become nearly routine practice in the utility industry for the merging utility to file a detailed study of expected merger savings with the regulatory commission as part of its petition for merger approval. In New Jersey, both Atlantic Electric and Rockland Electric filed such merger savings estimates as part of their petitions. As the Board acknowledged in its Order in the *Conectiv* merger, the standard industry practice is to examine expected synergy savings over the ten-year period following the merger. Such a detailed synergy study provides an analysis of *both* the expected costs to achieve the merger[30] and the expected cost savings. The expected ten-year savings[31] is then annualized, and converted into a "revenue requirement" basis for ratemaking purposes. This type of ten-year synergy study was used in both the Conectiv and Rockland mergers. *Conectiv merger* Order at 6-7; *Rockland merger* Order at 7.

As discussed in detail in the direct and surrebuttal testimony of Ratepayer Advocate witness David Peterson (*RPA*-23 and *RPA*-24), as well as in the preceding section of this brief, Joint Petitioners have completely failed to provide any meaningful or reliable calculation of estimated merger-related costs or savings.[32] Similarly, they have not proposed to share any portion of any

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[30] Merger costs include both transaction costs (e.g., legal and consulting fees) and transition costs (e.g., costs to integrate the two merging companies).

[31] In the *Conectiv merger* case, Board Staff recommended that the Board use a **fifteen-year** forecasting period for cost savings, rather than the ten-year period petitioners used. *See Conectiv merger* Order at 7.

[32] However, Joint Petitioners have not ruled out seeking recovery of merger-related costs at some future time. *See RPA-24* (Peterson surrebuttal) at 6, citing Alexander rebuttal (*P*-13) at 14. While Mr. Alexander testified on cross-examination that he believed FirstEnergy would expense most merger-related costs in the year they were incurred (Tr. 206:10 to 207:6), this alone

realized savings with customers. Nor have they proposed any Board-authorized mechanism to track merger savings for the future benefit of customers, although FirstEnergy is developing a merger-savings tracking mechanism that will be ready in early summer of 2001. Tr. 964:22 to 967:14.

Notably, during cross-examination at the evidentiary hearings, it became evident that Joint Petitioners are currently engaged in more detailed studies of merger-related savings. Witnesses Alexander and Michael Chesser both discussed the "as-is" and "to-be" merger study teams that are identifying "best practices" and levels of achievable cost savings from the merger. *See, e.g.,* Tr. 219-221. Mr. Alexander also admitted that FirstEnergy has retained two different consulting firms, including Deloitte Touche, to assist in this ongoing study of merger-related savings opportunities. Tr.219:16 to 221:17. Mr. Alexander specifically acknowledged that these consultants' work was, in part, to identify and quantify merger-related cost savings:

> Q. [Mr. Eisenstark] Is part of that project that they are working on an effort to identify some specific levels of cost savings that will be achieved whether it's this year or next year or whether it's five years from now as a result of the merger?
>
> A. [Mr. Alexander] Cost savings will be an outcome of the To Be analysis that's being undertaken. [Tr.220:13-20].

In addition, witness Marsh acknowledged that Joint Petitioners are developing an "automated" system to track merger savings for several years into the future. Tr. 964:19-967:15; *RPA-56*. Despite these ongoing activities to measure and track merger-related cost savings, Joint Petitioners have chosen to not share the results of these studies with the Board or the parties to this case. Indeed, Mr. Alexander testified that FirstEnergy had no plans to share the results of the merger integration studies with the Board:

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would not prevent Joint Petitioners from seeking to recover some level of merger-related costs in a future base rate case filing.

> Q. [Mr. Eisenstark] Going back to a merger integration team and the work that they are doing, I guess the To Be phase and McKenzie and Deloitte Touche are assisting in that project, and it's your position, I believe, that the Board should approve this merger petition prior to those studies being completed?
>
> A. [Mr. Alexander] Yes.
>
> Q. Do you have any plans, FirstEnergy, on filing those sort of studies with the Board, if the Board should approve the merger after the fact or not?
>
> A. I wouldn't plan on it, no. [Tr. 227:6-18].

Instead, Joint Petitioners are asking the Board to buy the proverbial "pig in a poke", and approve the merger based on a paucity of record evidence.

Ratepayer Advocate witness Peterson explained why it is critical that the Board have the detailed merger savings and integration team analyses **prior** to reaching its decision here:

> [T]he Board needs this information now to determine if the merger is in the public interest. No one can say for sure that there will be net savings, or that there will be no harm, until after cost-effective merger savings have been identified. Nevertheless, the Joint Petitioners are asking the Board to approve the merger without the benefit of these fundamental analyses. Ultimately, the success or failure of the merger, in no small measure, depends on the results of the transition team studies and on FirstEnergy's commitments to implement the recommendations made by the transition team. This is the minimum information that is necessary to determine if the merger is in the public interest. The Board should not be asked to approve this merger when it has been denied basic information providing a detailed road map showing how cost-effective savings can be achieved. Without carefully examining the merger integration team's analyses identifying potential merger savings and costs to achieve, the Board cannot reasonably conclude the merger is in the public interest and that no harm will come to JCP&L's ratepayers and employees. [*RPA-24* (Peterson surrebuttal testimony) at 5-6].

The Board should swiftly and soundly reject the Joint Petitioners' "approve it now, and we'll fill in the details later" approach, and instead require Joint Petitioners to fully quantify all merger-related savings, via a detailed synergy study of merger-related costs and savings over a ten-year period following financial closing. Thereafter, if based on this review (and its review of the rest of

the record), the Board determines that the merger meets the public interest standard under *N.J.S.A.* 48:2-51.1, it could then grant approval. However, any grant of merger approval should be conditioned on JCP&L passing all (100%) of the net merger-related cost savings through to its customers as an immediate reduction to its regulated distribution rate. The fact that JCP&L's rates are capped under the Board's restructuring order is irrelevant for several reasons, most notably that the rates are capped -- **not** frozen. As Ratepayer Advocate witness Peterson testified:

> By pointing to JCP&L's rate cap, the Joint Petitioners would have the Board believe that because rates cannot be increased as a result of the merger, no harm can result. This clearly is backwards logic. The underlying strategy of this merger is to enable the combined company to better meet competition for retail load by increasing efficiencies and lowering costs. Because JCP&L's cost of service following the merger should fall, rather than increase, the fact that there is a rate cap is irrelevant.
>
> JCP&L's energy delivery services in New Jersey will remain subject to the Board's regulatory powers in the restructured industry environment. Distribution rates will continue to be set by the Board based on JCP&L's cost of service. To the extent that JCP&L's rates deviate unreasonably from its underlying cost of service, those rates are not just and reasonable. Therefore, if the merger produces substantial savings to JCP&L, and if those savings are not correspondingly reflected in JCP&L's rates, an adverse rate impact will result. JCP&L's rates, under those circumstances, would not reflect its underlying cost of service. Such rates cannot be considered just and reasonable. [*RPA-23*, at 29-30].

Under Joint Petitioners' proposal, the utility would retain all cost savings until JCP&L's base rates are next reset. This is simply unjust -- particularly when GPU's shareholders will have already received an aggregate "bonus" of $1 billion in the purchase premium paid by FirstEnergy. To avoid this unjust and unreasonable result, the Board should:

1. Direct the Joint Petitioners to submit a comprehensive study of anticipated merger-related costs and savings; and

2. If, after the Board and all parties to this case have the opportunity to review (and

respond to) this additional analysis (including evidentiary hearings), the Board determines that Joint Petitioners have demonstrated that the merger would result in a net positive benefit to New Jersey ratepayers (and if it meets all other statutory criteria for approval), the Board should then condition merger approval on the pass through of 100% of the annualized savings as a reduction to JCP&L's distribution rates contemporaneously with the closing of the merger transaction. [*See RPA-23*, at 31].

<u>POINT IV</u>

UNDER NO CIRCUMSTANCES SHOULD JOINT PETITIONERS BE ALLOWED TO CHARGE JCP&L'S CUSTOMERS FOR, OR OFFSET MERGER SAVINGS BY, THE MERGER ACQUISITION PREMIUM OR EXECUTIVE SEPARATION PAYMENTS.

A. ACQUISITION OR "GOODWILL" PREMIUM

An acquisition premium arises in this proposed merger because the price FirstEnergy has offered to pay for GPU's stock, plus estimated transaction costs, far exceeds GPU's current fair market value. The Joint Petitioners estimate a $1.034 billion goodwill premium will be recorded on FirstEnergy's books as a result of this transaction.[33] *RPA-23* (Peterson Testimony), p. 23.

Although Joint Petitioners claim that "[n]o rate recovery of [the goodwill premium] is contemplated by FirstEnergy"[34], the Board should firmly rule that under no circumstances will JCP&L be allowed to recover any portion of the goodwill premium from customers, either in rates or as an offset to merger savings. As Ratepayer Advocate witness Peterson testified at length, there is no justification from a policy or ratemaking viewpoint for allowing a utility to recover an acquisition premium from its customers. *See RPA-23,* at 23-25. Moreover, in the *Conectiv* merger decision, the Board ruled that the acquisition premium could not be passed through to ratepayers in any form. *I/M/O Petition of Atlantic City Electric and Conectiv, Inc. for Approval of a Change in Ownership and Control*, ("Conectiv"), January 7, 1998, BPU Docket No. EM97020103, OAL Dkt. No. PUC 4935-97, Initial Decision, p. 9.[35] Other commissions have also denied recovery of acquisition

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[33] Response to RAR-53, in *RPA-23*, Appendix.

[34] *Verified Joint Petition*, paragraph 21, page 13.

[35] In the Rockland/ConEd merger, petitioners did not seek recovery of the acquisition premium.

premiums in merger cases. *See*, *e.g.*, *I/M/O The Application of Enron Corp. for an Order Authorizing the Exercise of Influence Over Portland General Electric Company*, 177 PUR 4th 587, 595-596 (June 4, 1997); *Re: Maui Elec. Co., Ltd.*, 99 PUR 4th 280, 286 (1988); *Re: Entergy Corporation*, 146 PUR 4th 292, 333-334 (1993).

B. EXECUTIVE SEPARATION PAYMENTS

It is often common in mergers that senior executives of the merging companies agree to retire either immediately or soon after the merger is consummated. It is also common that such executives receive "separation payments", usually referred to as "golden parachutes", in conjunction with the merger agreement. In this matter, Joint Petitioners have not quantified the magnitude of any golden parachute payments or other special executive compensation costs. Nor have Joint Petitions definitively stated whether they will seek to recover the costs of such payments from ratepayers.[36] As Ratepayer Advocate witness David E. Peterson testified:

> Golden parachutes refer to severance payments made to executives who will lose their current positions as a result of the merger. Severance compensation packages offered to key officers generally exceed the level of compensation that is offered to the rank and file employees that also may be displaced because of the merger. Since it is the executives who are largely the driving force in this merger and who will define post-merger resource requirements, those executives should not be allowed to promote their self interests at the expense of ratepayers. Golden parachute costs should not be deemed a recoverable merger expense. This is consistent with the Board's treatment of golden parachute costs in the Conectiv merger.[37] [*RPA-23* (Peterson testimony),

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[36] Joint Petitioners' Witness Hafer, a recipient of certain "golden parachute" executive bonuses (including a three-year "consulting" contract, at full salary after retirement), did state that he was under the impression that Joint Petitioners were not seeking recovery of these types of costs from customers. Tr. 67:13-19.

[37] I/M/O Petition of Atlantic City Electric and Conectiv, Inc. for Approval of a Change in Ownership and Control, Order dated January 7, 1998, Docket No. EM97020103, Initial Decision, p. 10 [fn. in testimony].

at p. 22].

The Board denied recovery of "golden parachute" type expenses in its decision in both the Conectiv merger and the Rockland merger. *Conectiv merger* Order , Initial Dec. at p. 10; *Rockland merger* Order at p. 13. Moreover, the Board's policy has long-disfavored allowing utilities to recover executive bonus packages through rates. *See, e.g., I/M/O Petition of Jersey Central Power & Light Co. for an Increase in Base Rates*, BPU Docket No. ER91121820J, Orders dated February 26 and June 15, 1993. Thus, the Board should definitively rule that any such "golden parachute" payments will never be recoverable in rates, or as an offset to any merger savings. Any special executive separation payments, including bonuses, enhanced retirement or severance costs for executives, or post-employment "consulting" arrangements should be included in this category of non-recoverable costs.

POINT V

JOINT PETITIONERS HAVE NOT DEMONSTRATED THAT THE PROPOSED MERGER WILL IMPROVE JCP&L'S ENERGY SUPPLY OPTIONS, OR REDUCE EITHER ITS BGS COSTS OR ITS DEFERRED BALANCE.

The Joint Petitioners attempt to support their request for merger approval by claiming that the merger could provide GPU with greater flexibility and more supply options (for meeting its BGS requirements) than it has now. *Verified Joint Petition, para. 17, p. 9.* However, as discussed by Messrs. Biewald and Schlissel, the Joint Petitioners again have not presented a detailed plan of the specific resources that would be dedicated by the merged company to provide capacity and energy to serve JCP&L's native loads in New Jersey or GPU's native load elsewhere in PJM. *RPA-50, pp. 7-8.* The Joint Petitioners have also not committed to the promise that the merged company **actually would** provide energy to JCP&L's customers at more favorable prices than JCP&L could otherwise obtain on a stand-alone basis through the open market. Thus, Petitioners' claim that the merger will reduce JCP&L's BGS costs and its deferred balance is completely unsubstantiated.

In fact, when directly asked in discovery whether it would make such a commitment to assist JCP&L meet its load obligations with favorably priced energy, FirstEnergy specifically refused to make such a commitment based on what it called "a hypothetical set of post-merger facts." *P-11, Attachment RAK-2 (Response to RAR-158).* If FirstEnergy considers this type of assistance as "a hypothetical set of post-merger facts," then what is the Board supposed to make of its claim in the Verified Joint Petition that it would indeed provide such assistance? As the Joint Petitioners stated:

> Joint Petitioners are aware of the Board's concerns associated with the potential magnitude of JCP&L's deferred balance . . . . As a generation owner, FirstEnergy could provide greater flexibility and additional supply options and therefore

> potentially reduce JCP&L's cost of purchased power, which could help reduce JCP&L's deferred balance from what it would have been otherwise. [*Verified Joint Petition,* ¶ 17, p. 9].

FirstEnergy obviously does not consider itself bound to provide this alleged merger benefit, but expects the Board to rely on this promise to approve the merger. As seen in the response to RAR-158 cited above, instead of affirming the requested commitment, FirstEnergy merely repeated its halfhearted claim that "FirstEnergy Services is **expected** to be able to supply at least a portion of GPU Energy's power supply requirements during times when prices would be less than those that would be paid by JCP&L in the open market on a stand-alone basis." (Emphasis added.) Thus, the Board clearly does not have a sufficient factual basis to rely on this alleged merger benefit for energy supply when it decides whether to approve the merger.

FirstEnergy has been extremely unclear throughout these proceedings about how or even whether it will be able to provide energy to help JCP&L serve its BGS obligation. Its witness Robert A. Kaiser gave seemingly contradictory responses to questions about how FirstEnergy plans to help JCP&L using FirstEnergy's supply portfolio.[38] He confirmed that FirstEnergy would have about 13,000 MW of generation installed at year end 2002, and that FirstEnergy's own peak load is about the same 13,000 MW, so that at best only a small portion of JCP&L's load might be served from FirstEnergy's generation. Tr. 872:20 to 873:3. His prefiled rebuttal testimony also confirms that the ability of FirstEnergy's generation to serve JCP&L is "uncertain, and dependent upon plant

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[38] FirstEnergy also has not even decided which personnel or management structure it will use for its energy supply planning and procurement post-merger. Mr. Kaiser, an employee of FirstEnergy Services, is currently responsible for the energy supply planning for all of FirstEnergy's regulated utility load and its unregulated load. Tr. 865:22 to 866:7. However, he did not know who would be responsible for this function post-merger or whether the management structure would be the same as today. Tr. 866:12 to 867:7.

performance, fuel costs and PJM LMP." *P-11,* p. 5, l. 2-3.

The only figure actually cited for how much energy FirstEnergy could supply to GPU is 4,000,000 MWH annually and that this would be only off-peak. *P-11,* p. 5, l. 3-5. Mr. Kaiser also testified that this off-peak power to GPU includes not only JCP&L, but the two Pennsylvania utility affiliates, Metropolitan Edison and Pennsylvania Electric Company, and that he assumed that "roughly half" of the 4,000,000 MWH would serve JCP&L because JCP&L has "roughly half" of the GPU customers. Tr. 924:5-22. However, FirstEnergy's President, Mr. Alexander, equivocated when testifying to how certain this off-peak energy supply to JCP&L might be.

> Q Is that a firm commitment by FirstEnergy to make off-peak power available to, for example, JCP&L for use in meeting it's [sic] basic generation service load?
>
> A What we're trying to identify is **whether or not** we will have any excess power during off-peak periods. We have some **at this point** and it would be **our intentions** as part of the overall procurement strategy to use that power to reduce GPU Energy's costs. [Tr. 194:7 to 195:7, emphasis added].
>
> Q And why is it potentially available and not certainly available, if you know, or I could pursue it with Mr. Kaiser, if he's the better witness.
>
> A Well, the first reason is that the **customers in Ohio and Pennsylvania of the utilities that own the generation have first call on all of that power.** So until those types of requirements are satisfied, the amount of that capacity is not necessarily, you know, will, **may or may not be available at this point in time.** [Tr. 195:22 to 196:8, Emphasis added].

Mr. Alexander also testified that, under restructuring case stipulations of settlement, FirstEnergy's generation resources are committed through 2005 to serve existing Ohio customers as provider of last resort, and are committed through approximately 2007 as provider of last resort for its Pennsylvania Power Company customers. Tr: 196:9 to 197:5. Combining these facts with Mr. Kaiser's statement that FirstEnergy's generation resources of 13,000 MW almost exactly match its

peak load obligation, it is evident that FirstEnergy has little additional capacity or energy it could provide to JCP&L for BGS from now through the August 1, 2003 end of the transition period.

Not only is the amount of energy supply for JCP&L from FirstEnergy resources unclear, but the methods FirstEnergy would use to serve JCP&L's load are also unclear. When asked how FirstEnergy plans to serve JCP&L, Mr. Kaiser first stated that it would be by bilateral contract with JCP&L. Tr. 876:4-12. Mr. Kaiser also said the contract would be at a firm price.

> Q So would you envision having a -- would you envision having a firm price contract with JCP&L and then where that actual supply came from whether it's from existing FirstEnergy plant or have to go out in the wholesale market, that risk and that decision would be up to FirstEnergy's [sic] Services.
>
> Is that what you're saying?
>
> A Yes, that's what we envision. [Tr. 877:22 to 878:6].

Nevertheless, the witness then immediately contradicted this testimony when asked how the firm price would be determined.

> A The contract would be a contract subject to FERC approval and FERC requires sales between affiliates be priced on a cost basis. So we would negotiate with Jersey Central a contract that would provide energy, and to the extent that we can, capacity from our plants at a cost base and then we would flow through to Jersey Central the market based cost of energy that we would procure for them. [Tr: 879:8-16].

Needless to say, a contract whose price floats based on market prices is not a firm price contract. Mr. Kaiser also agreed that FirstEnergy's plans, such as they are, are to expose JCP&L's ratepayers to the risk associated with a pass-through of market-priced energy.

> Q The price under that contract, would it be, and sorry for trying to ask this again, but would it be a single set fixed price?
>
> Let's try to use hypothetical numbers.

> Let's say you could provide a certain amount of energy to GPU, to use numbers I'm familiar with, in kilowatt hours, three cents a kilowatt hour was FirstEnergy's cost, would you provide that at three cents a kilowatt hour under a firm fixed price contract and then that would be all essentially GPU Energy's customers would be exposed to or would GPU Energy's customers also be exposed to some market based component of that pricing that could potentially be above the hypothetical three cents?
>
> A The latter case. [Tr. 880:15 to 881:7].

Exposure to market-priced energy is precisely the risk that JCP&L's BGS customers face today, given JCP&L's ability to recover its Deferred Balance from ratepayers after August 1, 2003. Because JCP&L's customers would apparently still be subject to market risk for BGS costs under FirstEnergy's proposal, it is clear that there will be little if any benefit from FirstEnergy's control over GPU's energy supply options.

There is further evidence that FirstEnergy has greater concerns over profitability and maximized revenues than providing JCP&L with the alleged greater flexibility in BGS energy supply options. When asked by Wall Street analysts whether FirstEnergy will sell power to GPU if there are opportunities for higher prices elsewhere, FirstEnergy Chairman Burg admitted the company will look at the economic trade-offs and consider what is best for its bottom line going forward. *RPA-50,* p. 8, l. 16-23. The goal of maximizing the prices at which FirstEnergy can sell its electricity is clearly inconsistent with its claim that the merger will provide JCP&L with energy at prices more favorable than it would be able to obtain on a stand-alone basis. Without a firm commitment to provide actual energy savings to JCP&L ratepayers, this alleged merger benefit is non-existent.

The Joint Petitioners have acknowledged that there could be circumstances when FirstEnergy will not sell power to JCP&L if it can find another buyer willing to pay higher prices. In Exhibit

RPA-55 (response to RAR-64), FirstEnergy stated that "if [FirstEnergy] can sell elsewhere at a higher price, it should do so." While FirstEnergy claims that the increased margins from the sale at a higher price would cover GPU's replacement power costs, it has not provided any accounting detail as to how this could be accomplished. If FirstEnergy's unregulated marketing subsidiary, FirstEnergy Services, makes that sale at a higher price and obtains the higher margins, then how are the higher margins passed through to JCP&L to reduce its energy costs (or Deferred Balance)? The Ratepayer Advocate is not aware of any evidence from FirstEnergy that outlines how this could take place. The Board should not be willing to rely on this phantom merger benefit when deciding whether to approve the merger.

The Ratepayer Advocate recommends that the Board adopt the recommendations made by its witnesses Biewald and Schlissel, to help assure that these energy supply benefits actually take place. The witnesses recommended that the following conditions be attached to any merger approval:

> FirstEnergy should be required to dedicate its existing and new capacity, to the extent possible, to serving JCP&L's native load during both peak and off-peak hours.
>
> No preference should be given to FirstEnergy Services customers in PJM over JCP&L's native load.
>
> FirstEnergy should provide energy to JCP&L's native load at cost with the prices not to exceed the established shopping credit. The prices at which FirstEnergy provides energy to JCP&L's native load also should be no higher than the prices at which FirstEnergy Services provides energy to its customers in PJM.
>
> Consequently, there should be no merger-related increases in the MTC/BGS deferred balance. At the same time, all merger-related energy supply savings should be flowed through to reduce the MTC/BGS deferred balance. [*RPA-50,* p. 9].

These conditions will help make the tenuous promise of merger benefits a reality.

The Joint Petitioners also raise concerns that the purported energy supply merger benefits may not occur by citing to the transmission constraints between ECAR and PJM. *See RPA-50,* p. 10, l. 1-11. FirstEnergy is currently trying through a PJM working group to generally increase Available Transfer Capability on the PJM system. It is also negotiating with PJM to allow its assets located within or near PJM West to be designated as PJM capacity resources pursuant to PJM West rules. If successful, these two efforts should increase FirstEnergy's ability to deliver capacity and possibly also on-peak energy to serve GPU load. *Id.,* p.10, l. 13-18. FirstEnergy also has the option to pursue membership in PJM West. As a member of PJM West, FirstEnergy's generation assets could be designated as PJM capacity resources and would no longer be subject to the transfer limitations imposed on external resources, although FirstEnergy would still be subject to any congestion charges associated with bilateral deliveries of power from its generation in PJM West to GPU's load over congested interfaces. *Id.,* p. 11, l. 1-12.

However, the Ratepayer Advocate urges the Board to adopt additional conditions on any merger approval to protect JCP&L's ratepayers should FirstEnergy's current efforts to increase deliverability of its energy fail. As Messrs. Biewald and Schlissel testified:

> If FirstEnergy is unable to resolve problems related to its ability to serve JCP&L's BGS load with its generation assets by December 31, 2001, it should immediately initiate an analysis of the deliverability improvements and power-supply benefits of joining PJM West. FirstEnergy should be required to file the completed analysis with the BPU and the [Ratepayer Advocate] by no later than June 30, 2002. [*RPA-50,* p. 11, l. 7-13].

This study would allow the Board to evaluate the PJM West option, to help assure the delivery of promised energy supply benefits to JCP&L and its customers.

POINT VI

THE BOARD SHOULD DEFINITIVELY RULE THAT JCP&L'S CUSTOMERS WILL HAVE NO FINANCIAL RISKS OR EXPOSURE RELATING TO FIRSTENERGY'S NUCLEAR OR FOSSIL-FUEL GENERATION ASSETS, AS A CONDITION OF ANY MERGER APPROVAL.

The Ratepayer Advocate witnesses, Biewald and Schlissel, have identified two merger-related risks that could be visited upon JCP&L's ratepayers unless the Board conditions any merger approval on FirstEnergy insulating the JCP&L ratepayers from these risks. These post-merger risks relate to FirstEnergy's ownership of nuclear generating plants and environmental liabilities related to its fossil fuel generating plants.

As outlined in its Joint Proxy Statement/Prospectus at page 18:

> GPU shareholders receiving FirstEnergy common stock in the merger will be exposed to risks relating to the ownership of electric generation assets, including nuclear plants.
>
> As a result of recent sales by the GPU Energy companies of Three Mile Island Unit-1, the Oyster Creek Station and substantially all of their fossil fuel and hydroelectric generating plants, GPU has become primarily a transmission and distribution business. FirstEnergy, on the other hand, continues to own and operate numerous electric generating facilities, including fossil and nuclear-fueled plants. **Some of the risks associated with the operation and cost of operation of electric generating facilities differ from those relating to GPU's utility and non-utility businesses as currently constituted, including risks relating to unscheduled plant outages, changing environmental requirements, nuclear plant decommissioning, and disposal of spent nuclear fuel. GPU shareholders who after the merger hold FirstEnergy common stock will be exposed to risks associated with the generation portion of the electric utility industry that are not currently applicable to GPU.** [Emphasis added].

FirstEnergy owns four nuclear power plants comprising about 30 percent of its total generating capacity. *RPA-50,* p. 12, l. 13-14. As revealed in FirstEnergy's 1999 Form 10K filing

with the U.S. Securities and Exchange Commission ("SEC"), the ownership of these nuclear facilities exposes FirstEnergy to certain regulatory, technical and financial uncertainties:

> The NRC has promulgated and continues to promulgate regulations related to the safe operation of nuclear power plants. The Companies cannot predict what additional regulations will be promulgated or design changes required or the effect that any such regulations or design changes, or the consideration thereof, may have upon their nuclear plants. Although the Companies have no reason to anticipate an accident at any of their nuclear plants, if such an accident did happen, it could have a material but currently undeterminable adverse effect on the Company's consolidated financial position. In addition, such an accident at any operating nuclear plant, whether or not owned by the Companies, could result in regulations or requirements that could affect the operation or licensing of plants that the Companies do own with a consequent but currently undeterminable adverse impact, and could affect the Companies' abilities to raise funds in the capital markets. [FirstEnergy's 1999 Form 10K Report, at p. 6, *RPA-50,* pp.12-13].

GPU has reduced its ratepayers' exposure to similar risks by divesting the TMI-1 and Oyster Creek nuclear plants. However, the proposed merger threatens to expose JCP&L's ratepayers to new nuclear-related risks through FirstEnergy's ownership of its four nuclear units. The proposed merger does not even allege sufficient benefits to offset in any way this increased risk. The Board should not approve the merger unless it requires assurances from FirstEnergy that JCP&L's ratepayers will not be liable for any costs related to the financial risks associated with FirstEnergy's ownership of nuclear power plants, other than to pay the energy cost of providing any output from FirstEnergy's nuclear units that is used to supply JCP&L's native load if that cost is at or below JCP&L's BGS rate. JCP&L's ratepayers should also not be exposed to any costs resulting from FirstEnergy's nuclear plant outages or accidents, any nuclear stranded costs, or nuclear decommissioning costs.

As outlined in the direct testimony of Messrs. Biewald and Schlissel, the merger also may expose JCP&L's ratepayers to additional financial risks related to FirstEnergy's ownership of its fossil fuel generating plants. *RPA-50,* pp. 13-15. The U.S. Environmental Protection Agency ("EPA") and

Department of Justice ("DOJ") sued FirstEnergy in November 1999 for violating the Clean Air Act by making major modifications to extend the operating life of its Sammis Plant without installing necessary pollution control equipment. The alleged violations of the Clean Air Act dated back to 1984. The EPA and DOJ complaint seeks permanent injunctive relief to require the installation of "best available control technology" and civil penalties of up to $27,500 per day of violation. JCP&L's ratepayers should not be exposed to any of the potentially significant damages and penalties related to this litigation. *Id.*

The attorneys general in several eastern states including New York, Connecticut, and Massachusetts have also filed similar lawsuits against FirstEnergy regarding emissions from the Sammis Plant. *RPA-50,* p. 13, l. 23-25. JCP&L's ratepayers should not be exposed to any of the potentially significant damages and penalties related to that litigation. The possible magnitude of this liability is shown in the settlements reached in similar lawsuits. The U.S. EPA and DOJ settled their Clean Air Act litigation against the Tampa Electric Company and have reached a tentative settlement with Cinergy Corporation. Virginia Power also reached an agreement with the EPA, DOJ, and the State of New York before litigation was initiated.

Tampa Electric will be required in its settlement to spend approximately $1 billion to install emissions-control equipment, pay a $3.5 million fine, and fund between $10 million and $11 million on environmentally beneficial projects in its region designed to mitigate the impact of emissions from its plants. *RPA-50,* p. 14, l. 7-13. The tentative settlement of the EPA and DOJ litigation against Cinergy has been valued at $1.4 billion. Under this settlement, Cinergy will pay an $8.5 million civil penalty, perform $21.5 million in environmental projects, and significantly reduce air pollution from its coal-fired power plants. *Id.,* p. 14, l. 13-17. The cost of Virginia Power's agreement to reduce

the emissions from its fossil-fired facilities has been projected to be $1.2 billion. *Id.,* p. 14, l. 18-19. JCP&L's ratepayers should not be exposed to any damages and penalties resulting from other litigation brought against FirstEnergy related to any fossil fuel power plant emissions or violations of the Clean Air Act or other environmental laws or regulations.

There also are additional financial risks associated with FirstEnergy's responsibility for cleaning up polluted sites. Two of FirstEnergy's electric utility subsidiaries, Cleveland Electric Illuminating Company and Toledo Edison Company, have been named as "potentially responsible parties" for three sites listed on the Superfund National Priorities List and are aware of their potential involvement in the cleanup of several other sites. *RPA-50,* p. 15, l. 9-14. If these companies were held liable for 100% of the cleanup costs of all sites, the ultimate liability could be as high as $340 million, although FirstEnergy believes that their share of the actual cleanup costs will be substantially less. *Id.,* p. 15, l. 15-17. The Board should also condition any merger approval on FirstEnergy completely insulating JCP&L's ratepayers from any exposure to the potential costs of cleaning up these or any other polluted sites owned by FirstEnergy or any of its affiliated companies.

FirstEnergy has attempted to deny these risks by calling them speculative. *P-13,* p. 17, l. 8-10. However, the risks were serious enough and so far from "speculative" that FirstEnergy itself realized it had the obligation to reveal them in its Joint Proxy Statement/Prospectus and in its 1999 10-K filing with the SEC. It is also vital to remember that other utilities have had to incur substantial expense to litigate and settle the environmental lawsuits due to their generating plants. FirstEnergy has provided no facts to distinguish its situation sufficiently to remove these risks from consideration by the Board. Therefore, the Board should definitively rule that JCP&L's customers will not be subject to <u>any</u> financial risks or consequences from FirstEnergy's nuclear or fossil generation

operations.

POINT VII

THE BOARD SHOULD REQUIRE JOINT PETITIONERS TO FILE A SEPARATE PETITION FOR BOARD REVIEW AND APPROVAL OF THE NEW SERVICE COMPANY AND ALL COST ALLOCATION FORMULAS.

The Joint Petitioners have indicated that they plan to form a new, as yet unnamed FirstEnergy Service Company after the merger closes. *Verified Joint Petition, P-2*, p. 7. Presumably, the new service company will provide the usual range of corporate support services to JCP&L and the other regulated and unregulated subsidiaries of the new FirstEnergy parent company.

The Joint Petition is literally silent on any specifics of the new service company. There is no evidence on either the structure of the service company, what functions it will perform, or what cost allocation formulas FirstEnergy might propose. According to FirstEnergy witness Anthony Alexander, "[i]t is too early to describe in any detail what the specifics of the new arrangement [service company] will be." *P-5*, p. 12. In the absence of any detailed information, the Board clearly cannot assess whether the proposed merger would affect the ability of the merged company to provide service at "just and reasonable" rates. Undoubtedly, service company costs allocated to FirstEnergy's New Jersey operations will ultimately impact rates for customers in its New Jersey service territory. Furthermore, in its evaluation of the merger, the Board is statutorily obligated to consider the impact of the merger on the ability of the merged company to provide service at "just and reasonable" rates. *N.J.S.A*. 48:2-51.1. Whether the resulting rates are "just and reasonable" turns, in part, upon the proper allocation of service company costs.

Moreover, the Board must retain jurisdiction to review both the proposed service company structure and associated cost allocation formulas to guard against cross-subsidization. The potential

for cross-subsidization of competitive services by regulated functions, or of Ohio regulated costs by New Jersey rates, will be increased in a multi-state holding company structure such as that proposed by Joint Petitioners. The Board recognized the potential for cross-subsidization in a previous multi-state electric utility merger case. Among the conditions placed by the Board on its approval of the Conectiv merger was that Conectiv "shall abide by Board decisions related thereto [to the service company agreement and cost allocation manual] for purposes of utility rates and services." *Conectiv Merger Order*, pp. 16-17.

Without specific facts and cost allocation information, the Board has no basis to evaluate the impact of the service company costs on the rates to be paid by New Jersey customers. Moreover, as Ratepayer Advocate witness David Peterson testified, the transfer of corporate offices and the service company to Ohio will complicate the Board's regulation of JCP&L and will likely increase both the cost and the frustration of regulation for all parties concerned. *RPA-23*, p. 36. Although the Joint Petitioners have stated that they will file any new service agreement with the Board for its review and approval, the merged company should also be required to file a cost allocation manual as well. *Petition*, *P-2*, p. 14. Therefore, the Ratepayer Advocate recommends that the Board condition any merger approval upon the requirement that Joint Petitioners:

> (1) file for Board approval of the structure and creation of the new, post-merger service company; and (2) subject themselves to Board jurisdiction for filing, review, and approval of any cost allocation manual or formulas that the new service company will use, in addition to any other regulatory approvals that may be required. *See Peterson Testimony*, *RPA-23*, at p. 36.

There is ample precedent for such a requirement. In both the Conectiv and Rockland merger cases, the Board conditioned its approval of the merger on the filing of a service company agreement and cost allocation manual for BPU review and approval. *Conectiv Merger Order*, pp. 17, 22; *Rockland*

Merger Order, pp. 12, 19. The Board should follow its own precedent and order FirstEnergy and GPU to submit to the Board's jurisdiction and approval of the service company agreement and all cost allocation formulas.

POINT VIII

THE BOARD SHOULD ADOPT THE RATEPAYER ADVOCATE'S RECOMMENDATIONS CONCERNING POST-MERGER CAPITAL STRUCTURE, TO ENSURE THAT THE MERGER DOES NOT ADVERSELY EFFECT JCP&L'S COST OF CAPITAL, WHICH WOULD IN TURN LEAD TO HIGHER RATES FOR JCP&L'S CUSTOMERS.

As set forth in the filed testimony of Ratepayer Advocate witness James Rothschild, the proposed merger has the potential to impact the capital structure and cost of capital of JCP&L. *Rothschild Testimony*, *RPA-25.* JCP&L's cost of capital is a product of its capital structure, which is the relative proportion of debt and equity used to finance its assets. Changes which affect JCP&L's capital structure and cost of capital have the potential to greatly affect the rates of its New Jersey customers. The cost of capital is used to establish rates in base rate proceedings. Hence, a higher cost of capital will generally result in higher rates. A utility's current capital structure also impacts the computation of its actual earned return on equity, which could be used by the Board to determine if the utility is earning more than its allowed rate of return.

Of particular relevance in this proceeding is the potential for post-merger manipulation of the capital structure of a regulated subsidiary, such as JCP&L. The proposed merger will result in a more complex company, with substantial unregulated operations. *RPA-25*, p. 15. Under the post-merger structure, there are more options for management regarding capital structure selection at the subsidiary level than there would be if the subsidiary, such as JCP&L, were a stand-alone company. *RPA-26*, p. 4. While there is a substantial incentive for the parent company to lower its overall cost of capital on a consolidated basis, there is no similar incentive for a regulated utility subsidiary, where a greater cost of capital results in higher rates for utility service under traditional rate base/rate of

return regulation. *RPA-25*, p. 15.

An established regulated utility subsidiary likely poses less business risk than a new, unregulated venture. Business risk is reflected in the capital structure of the entity. Generally, lower business risk would permit a utility to take on more debt than a more risky business venture. *RPA-25*, p. 16. Mr. Rothschild found that an established regulated utility subsidiary like JCP&L can and does provide cash flow to service more debt than it has outstanding. *RPA-25*, p. 16. That cash could be used to increase borrowing at the JCP&L subsidiary level or at the consolidated level. Therein lies the dilemma: "[i]f JCP&L's higher cash flow is used to finance a higher proportion of debt at the parent level rather than at the Jersey Central level, the percentage of equity in Jersey Central's capital structure remains high even though the overall debt/equity ratio of the parent may be brought to more cost effective levels." *Id*. Therefore, the Board should take measures now to ensure that JCP&L's ratepayers receive the benefits of changes in the overall capital structure of the post-merger company which reduce its overall cost of capital.

Another area of concern identified by Mr. Rothschild is FirstEnergy's history of repurchasing its common stock, thereby increasing its financial risk.[39] *RPA-25*, p. 17. As Mr. Rothschild testified, stock repurchases have the effect of reducing the proportion of common equity and increasing the proportion of debt in a company's capital structure. An increase in debt and decrease in equity by definition increases a company's financial risk. Increases in financial risk increase a company's cost of debt. However, such changes might also serve to lower its overall cost of capital, since equity

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[39] The credit standing and associated bond ratings of a company are impacted by its business risk and financial risk, as well as those of its parent. *RPA-25*, p. 12. Business risk relates to the risks inherent in a company's business, while financial risk refers to the risk associated with the capital structure chosen to finance the company assets. *Id*. Generally, the lower the percentage of equity, the greater the financial risk. *Id*.

costs more than debt. *Id*. Therefore, the Board must take steps now (as a condition of any merger approval) to ensure that the cost benefits associated with a lower percentage of common equity are reflected in future JCP&L ratemaking proceedings.

Based on his analysis, in order to protect ratepayers, Mr. Rothschild recommends that several conditions be imposed on any merger approval. *RPA-25*, pp. 8-9. Mr. Rothschild's recommendations are based on the assumption that the consolidated capital structure of the parent is the appropriate proxy for what management believes will produce the lowest overall cost of capital. *RPA*-26, p. 2. However, Mr. Rothschild also qualifies this concept, by recognizing that there are reasons why a low-risk, regulated utility subsidiary may need a different amount of common equity in its capital structure than the consolidated company. *Id*. Therefore, Mr. Rothschild recommends that -- absent convincing proof to the contrary -- the Board should set the capital structure for a regulated subsidiary based on either the capital structure of the consolidated company or the regulated subsidiary, using whichever of the two has the lower percentage of common equity. *RPA*-25, p. 8. If the actual or consolidated capital structure is not used, then the justification for the use of any other capital structure should include an analysis that demonstrates that the chosen capital structure is the most beneficial to New Jersey ratepayers. *Id*. at pp. 8-9. Furthermore, in order to monitor earnings and ongoing changes in the post-merger capital structure of JCP&L and its parent, Mr. Rothschild recommends that the Board should require the filing of annual reports by JCP&L showing its return on equity and return on rate base using [1] the actual capital structure of JCP&L and [2] the actual capital structure of the consolidated company. *Id*. at p. 9. The Ratepayer Advocate strongly urges that the conditions recommended by Mr. Rothschild be adopted to protect JCP&L's New Jersey ratepayers.

V. Impact on Employees

POINT IX

THE BOARD SHOULD ADOPT THE RATEPAYER ADVOCATE'S RECOMMENDATIONS TO MITIGATE THE POTENTIAL ADVERSE IMPACTS OF THE MERGER ON JCP&L's EMPLOYEES AND ON THE NEW JERSEY ECONOMY.

A. THE BOARD HAS A STATUTORY OBLIGATION TO PROTECT JCP&L'S EMPLOYEES AND, AS A MATTER OF POLICY, SHOULD CONSIDER THE IMPACT OF THE MERGER ON THE NEW JERSEY ECONOMY.

It is well settled that under the operative statutes in this proceeding, the Board, in making its overall determination of whether the merger will result in a positive benefit to the public interest, has a statutory obligation to ensure that the merger does not negatively impact the employees of JCP&L. *N.J.S.A.* 48:2-51.1 and 48:3-10. The relevant sections of these provisions provide in pertinent part:

> In considering a request for approval of an acquisition of control, the board shall evaluate the impact of the acquisition . . . on the employees of the affected public utility . . . . [*N.J.S.A.* 48:2-51.1].
>
> Where, by the proposed . . . transfer . . ., it appears that the public utility . . . may be unable to fulfill its obligation to any employees thereof with respect to pension benefits previously enjoyed, whether vested or contingent, the board shall not grant its authorization unless the public utility seeking the board's authorization assumes such responsibility as will be sufficient to provide that all such obligations to employees will be satisfied as they become due. [*N.J.S.A.* 48:3-10].

Moreover, as matter of policy, the Board should also consider the impact the merger may have on the New Jersey economy as a whole. While the relevant statutes do not expressly require the Board to consider the entire New Jersey economy as part of its review, considering the Board's broad jurisdictional powers to protect the public interest in general (*N.J.S.A.* 48:2-1 *et seq.*), as a

matter of policy the Board should ensure that the merger does not adversely impact the State's economic well-being.[40] The corporate presence of a major electric utility in the State, with many executives and employees, should also surely be a matter of concern in any consideration of the economic impact of the merger on the State. Furthermore, the impact of the merger on over 2,000 New Jersey-based GPU employees will undoubtedly affect the State's economy, particularly in those areas where JCP&L operates.

B. THE JOINT PETITIONERS' EVIDENCE UTTERLY FAILS TO ESTABLISH THAT THE PROPOSED MERGER WILL BENEFIT EMPLOYMENT AND ECONOMIC GROWTH IN NEW JERSEY; INDEED, IT SHOWS JUST THE OPPOSITE.

Although various witnesses testifying on behalf of the Joint Petitioners have opined on the proposed merger's impact on New Jersey and JCP&L's New Jersey employees, the Joint Petitioners have yet to provide detailed data and information about how New Jersey and JCP&L's New Jersey employees will be affected by the merger. However, from what can be gleaned from the meager material provided by the Joint Petitioners, an untold number of JCP&L's New Jersey employees may lose their jobs as a result of the proposed merger and the Joint Petitioners have made no assurances that the merged company will maintain a significant corporate presence in this State.

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[40] Indeed, the economic vitality of the State of New Jersey has become an increasingly important issue to the Legislature, as demonstrated in its more recent pronouncements. For example, in its legislative findings and declarations on alternative forms of regulation, the Legislature stated as follows:

> The Legislature finds and declares that it is the policy of the State to implement programs which effectuate the economic development goals of attracting and retaining business, maintaining and creating jobs and enhancing the economic vitality of the State. [*N.J.S.A.* 48:2-21.24].

For example, Mr. Michael J. Chesser, a witness for the Joint Petitioners, testified the post-merger company will have a "significant...managerial presence in New Jersey." *P*-4, p.3. However, the Joint Petitioners have not yet determined what functions and positions will remain at JCP&L's Morristown, New Jersey headquarters. *RPA*-8. Thus, the Joint Petitioners have provided little assurance that the Morristown operations of JCP&L will not be significantly reduced in scope.

The proposed merger, as presented, has even more ominous implications for JCP&L's New Jersey employees, as set forth in the Joint Petitioners' discovery responses and testimony. Clearly, the Petitioners anticipate that cost savings will emanate from reduced staffing levels. *RPA*-22. The Joint Petitioners further anticipate that some supervisory, managerial, and officer duties will be eliminated. *RPA*-19.

Notwithstanding their claims that staffing levels will likely be reduced, the Joint Petitioners' claim that career opportunities for JCP&L's existing employees will be enhanced. Mr. Fred D. Hafer, a witness for the Joint Petitioners, testified that the merged company will "offer greater career opportunities for its [JCP&L's] existing employees." *P*-3, p. 4. This is a curious and entirely unsupported statement, since JCP&L did not present any formal studies to analyze the economic impact of the merger on its current employees. Indeed, throughout this proceeding, the companies have stated that decisions regarding employment following the merger have not yet been made and will likely not be made until sometime later. *See* Tr.88. The only "promise" GPU employees have from FirstEnergy is that they will be "considered" for positions with the post-merger company. *See RPA-5*; *P-4* (Chesser testimony) at p. 7. This "promise" is of little value -- presumably <u>anyone</u> who submits a resume for employment with FirstEnergy would be "considered" for employment.

FirstEnergy has not prepared an estimate of work force reductions for the three-year period

following the proposed merger. *RPA-18.* Furthermore, the Joint Petitioners have not provided any data on planned payroll reductions at JCP&L, nor have they provided data on post-merger staffing levels. *RPA-17.* In fact, according to Mr. Hafer's oral testimony, only two GPU executives (one of whom is Mr. Hafer) have been offered positions with the post-merger company. Tr.51-52. Thus, the Board is being asked to rule on the merger without the benefit of understanding how the merger will economically impact either New Jersey or JCP&L's employment base.

The only protections offered to JCP&L employees which were identified by the Joint Petitioners are a memorandum of understanding ("MOU") entered by JCP&L and its bargaining unit employees, an enhanced severance package for JCP&L employees who are laid-off, and a "no loss in benefits" package for employees who remain (i.e., if they do not lose their jobs as a result of the merger). *P-7*, pp. 16-17. The MOU extends "no layoff" protection to JCP&L's bargaining unit employees for a two-year period. *P-7*, Sched. MBR-2; Tr. 1064.

Significantly, the MOU only covers JCP&L's bargaining unit employees and offers no protection for JCP&L's non-bargaining unit employees, such as those employed in management, engineering and and administrative functions. Tr. 588-89. By its very nature, the enhanced severance package provides no assurances of continued employment for JCP&L's New Jersey employees. Tr.1065. Finally, the comparable benefits package only helps ensure that <u>continuing</u> JCP&L employees will not see a loss of employee benefits -- it does not give any assurance of job retention following the merger. Tr.1060.

In sum, the Joint Petitioners have clearly stated that reductions in staffing will occur as a result of the proposed merger, but have offered few details and virtually nothing to ameliorate the impact of those reductions on JCP&L's New Jersey employees, nor have the Joint Petitioners made a

commitment to maintain a certain staffing level at JCP&L's Morristown headquarters or identified which functions will be based in New Jersey post-merger. Absent more concrete information and adequate protective measures, the proposed merger will likely adversely impact JCP&L's New Jersey employees and have an unreasonable adverse impact on the New Jersey economy.

C. THE BOARD SHOULD REQUIRE THAT ANY LABOR FORCE REDUCTIONS BE IMPLEMENTED ON A PRO-RATA BASIS STARTING WITH EACH COMPANY'S PRE-MERGER NUMBER OF EMPLOYEES.

While the Petition and accompanying testimony is all but silent on the plans for workforce reductions, it is clear that some level of employee downsizing is likely to be necessary for Joint Petitioners to achieve even the unsupported $150 million in annual cost savings. Some number of positions in New Jersey may need to be eliminated for the merging companies to achieve these merger savings. However, JCP&L's current employees deserve a reasonable measure of protection. Notably, the Merger Agreement does not adequately protect JCP&L's New Jersey employees from arbitrary or disproportionate treatment in the downsizing effort that will be necessary to achieve the cost savings. It is not clear whether or not JCP&L sought protection of its employment base during the confidential negotiations between the merging companies. What is clear is that the merging companies have still not specified how many workers will lose jobs, and how many of these will be JCP&L employees (as opposed to FirstEnergy employees). As of the close of evidentiary hearings, Joint Petitioners' witnesses still could not identify any level of projected layoffs or the specifics of where those layoffs would come from. *See, e.g.*, Tr.88; *RPA-17, RPA-18.*

To protect JCP&L's current employment base from unreasonable and disparate treatment,

the Ratepayer Advocate recommends that the Board should require that any labor force reductions be implemented on a pro-rata basis starting with each company's projected number of employees as of August 1, 2000, prior to the merger reductions. *Peterson Testimony*, *RPA-23*, pp. 34-35. This pro-rata reduction will help mitigate the potential adverse impacts on JCP&L's employment base. Moreover, the Ratepayer Advocate's pro-rata reduction proposal will help to offset the fact that New Jersey is, in essence, losing a large utility. GPU's corporate headquarters will likely be closed or reduced in scope shortly after the merger is consummated, and it is unclear how many New Jersey employees JCP&L would have after the merger closing. Absent clear provisions to protect JCP&L's New Jersey employees and ensure a continued strong corporate presence in New Jersey, the new merged entity will in all sense be an Ohio utility.

In sum, the Ratepayer Advocate's pro-rata reduction proposal balances the competing interests of JCP&L's employees and FirstEnergy's management. It does so by providing job security to an equitable portion of JCP&L's current employees, while providing sufficient flexibility for management to assemble a competent and efficient management team. Notably, the Board afforded Atlantic Electric employees similar protections as a condition of its approval of the Conectiv merger. *Conectiv Merger Order*, p. 12.[41] There is no reason that the Board should not insist that JCP&L's employees, and the economy of the State of New Jersey, are not disproportionally worse off because of the proposed merger into an Ohio-based utility.

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[41] Similarly, the Board required Rockland to maintain, in the interim period following its acquisition by ConEd, at least 27 field positions in New Jersey. *Rockland merger* Order at p. 17.

D. THE BOARD SHOULD REQUIRE THAT GPU HAVE THE RIGHT TO APPOINT AN EQUAL NUMBER OF MEMBERS TO THE NEW FIRSTENERGY BOARD OF DIRECTORS, TO ENSURE THAT NEW JERSEY-SPECIFIC ISSUES ARE NOT BYPASSED BY AN OHIO-BASED CORPORATE PARENT.

The Agreement of Merger calls for FirstEnergy to nominate ten of the sixteen members of the newly-constituted FirstEnergy Board of Directors. *P*-3, p. 3. GPU would be allowed to nominate a minority of six members. *Id.* As Ratepayer Advocate witness Peterson testified:

> This unequal representation on the board is in spite of the fact that GPU is approximately comparable in size to FirstEnergy. GPU brings considerable assets and value to this transaction, if the Joint Petitioners' claims are to be believed. Yet, New Jersey's interests may suffer because of the unequal representation of GPU on FirstEnergy's Board. [*RPA*-23, p. 32].

As the following chart from Mr. Peterson's testimony reveals, the unequal Board representation is contrary to the approximately equal size of the assets and revenues of GPU and FirstEnergy:

($Million)

	GPU	FirstEnergy
Customers	2,100,000	2,200,000
Revenue	$ 2,530	$ 3,310
Assets	$20,549	$18,101
Long-term debt	$ 4,897	$ 5,966[42]

In sum, the proposed composition of the Board of Directors, along with the lack of definition of the management structure, would not give JCP&L (or GPU) equal voice in the management and operations of the combined company. If this results, the interests of its New Jersey ratepayers may be adversely affected. Therefore, to remedy this adverse impact, the Board should adopt the Ratepayer Advocate's recommendation that GPU be permitted to appoint an equal number of directors to the new FirstEnergy Board of Directors. *See RPA-23*, p. 32.

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[42] *RPA-23*, p. 5.

E. THE BOARD SHOULD CONDITION ANY MERGER APPROVAL UPON JCP&L MAINTAINING A CORPORATE HEADQUARTERS IN NEW JERSEY, STAFFED BY AN ADEQUATE NUMBER OF SENIOR-LEVEL EXECUTIVES.

Based on the Joint Petition and direct testimony, FirstEnergy's commitment to maintain a corporate presence in New Jersey is unclear. The extent of that commitment is to "maintain GPU's current offices and presence in their current general locations in Morristown, New Jersey and Reading, Pennsylvania."[43] This statement is insufficient to protect New Jersey's economic interests or the Board's regulatory powers. In order to ensure that decision-makers with knowledge of local issues and New Jersey regulatory policy are available in New Jersey after the merger closes, the Board should condition any merger approval on FirstEnergy's commitment to maintain JCP&L's corporate headquarters in New Jersey, staffed with an adequate number of senior-level executives knowledgeable in New Jersey issues and regulatory policy. *See Peterson Testimony, RPA*-23, p. 34.

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[43] Verified Joint Petition, *P*-2, Exhibit A, FirstEnergy's Amendment No. 1 to SEC Form S-4, page 77.

VI. Impact on the Provision of Safe and Adequate Utility Service at Just and Reasonable Rates

<u>POINT X</u>

THE MERGER IS NOT IN THE PUBLIC INTEREST BECAUSE, AS PROPOSED, IT WILL ADVERSELY IMPACT THE ABILITY OF THE COMPANY TO PROVIDE SAFE AND ADEQUATE SERVICE AT JUST AND REASONABLE RATES.

In reviewing the proposed merger, the Board must consider the impact on "the provision of safe and adequate service at just and reasonable rates." *N.J.S.A.*48:2-51.1. The Joint Petitioners have claimed as a merger benefit an improvement or enhancement in system reliability and customer service. *P*-8, p. 3. To deliver on this benefit, the Joint Petitioners state that the implementation of "best practices" between the two companies will provide benefits relating to transmission and distribution reliability and customer service. *Id*. However, the Joint Petitioners have not identified any specific "best practices" that they will implement in JCP&L's service territory. Nor have they identified any specific performance standards or goals that will be used to measure compliance with the vague promises of improvement. The Ratepayer Advocate has proposed specific performance standards and programs designed to assure that the Joint Petitioners' promises are fulfilled. As explained more fully below, if the Board is to approve the merger, it should condition such approval on adoption of the Ratepayer Advocate's proposed service quality and reliability standards, as well as the low-income assistance programs that the Ratepayer Advocate proposed in its direct case.

A. Issues Concerning Reliability and Customer Service Are Relevant to the Merger Proceeding.

The lack of any specificity to accompany the Joint Petitioners' promises is exacerbated by the real risks of deterioration of service quality and reliability that may occur as a result of the approval of the merger. As the Joint Petitioners' Joint Proxy Statement/Prospectus indicates, among the risks that the merger presents is that "management...will have to dedicate a substantial effort to integrating [the] two companies and therefore, its focus and resources may be diverted from...operational matters." Ratepayer Advocate witness Barbara Alexander explained in detail the potential impact of this merger on customer service and reliability:

> GPU Energy's proposed merger with FirstEnergy will drive the participating companies to reduce costs and find savings that can pay for the costs incurred to bring about the merger companies. * * * However, it is also possible to make changes that adversely effect service quality. [*RPA-43* at 10-11].

Furthermore, as Ms. Alexander testified, the internal reorganization and move to regional centers is likely to result in internal disruption that, combined with the push to realize corporate savings promised to shareholders as a result of the merger, is likely to result in degraded service quality and reliability of service. *RPA-43* at 12. Therefore, without specific performance targets that lock in the promises of improvement in reliability and customer service, the merger cannot be presumed to provide substantial benefits to ratepayers.

In rebuttal testimony, the Joint Petitioners questioned the relevance of Ms. Alexander's proposed service quality index ("SQI") in this case, claiming that: (1) the Board reserved the issues relating to compliance with the Board's May 1, 2000 Order in Docket No. EA99070485 (the "Outage Investigation") in its transmittal letter dated February 5, 2001; and (2) Ms. Alexander's

recommendation that the Board establish an SQI was not appropriate in this case. *P-7*, pp. 2-3 and 5-6. Board Staff made similar allegations in a motion it filed to strike portions of the testimony of Ms. Alexander and Petitioners' witnesses Roche and Carey, but later withdrew its motion during the evidentiary hearing. Tr.328:6-328:22.

Joint Petitioners' arguments are simply incorrect. Ms. Alexander's testimony on customer service and reliability issues does not address JCP&L's compliance with the Board's May 1, 2000 Outage Investigation Order, nor does it in any manner comment on the adequacy of that Order. That Order adopted an auditor's report and made recommendations regarding technical issues, including how GPU should conduct inspections, file reports, and follow through with maintenance practices in the future. *I/M/O The Board's Review and Investigation of GPU Energy Electric Utility System's Reliability,* Docket No. EA99070485 (Order 5/1/00). With respect to reliability, Ms. Alexander's testimony focused on establishing appropriate customer service and reliability indices, to insure that the merger benefits promised by the Joint Petitioners actually materialize for the benefit of its customers. Moreover, much of Ms. Alexander's testimony responds directly to the service reliability claims that Joint Petitioners made first in the Petition, and later in the testimony of witnesses Earl Carey (*P-8*) and Michael Roche (*P-7*).

Furthermore, the Joint Petitioners' allegation (*P-7*, pp. 5-6) that Barbara Alexander's testimony somehow circumvents or interferes with the Board's existing reliability standards is also unsupported by the evidence in this case. Nowhere in Ms. Alexander's testimony did she recommend that the existing reliability standards be ignored. On the contrary, she recommended that a SQI be adopted as a complement to the Board's existing regulations, not as a replacement for the existing standards. *RPA-44,* pp. 4-5. There is legitimate concern that the merger-induced pressures to cut

costs will negatively impact the service quality and reliability provided to JCP&L's customers. With this concern in mind, Ms. Alexander recommended that the Board implement additional safeguards, by establishing a measurable and enforceable SQI as a condition of any merger approval.[44] Therefore, Ms. Alexander's recommendations are clearly not impermissible changes to the Board's reliability regulations, but rather are appropriate supplements thereto, which respond to the specific merger proposal at issue in this proceeding and the Joint Petitioners' promises that if the merger is approved, JCP&L's customers will experience an improvement in service quality and reliability.

Moreover, unlike Ms. Alexander's proposed SQI, the Board's interim standards address only reliability issues and do not have any customer service standards. In recent years, JCP&L's unified call center has been performing at inadequate levels. *RPA*-43, p. 16. Standards must be in place for customer service so that further deterioration is prevented. Barbara Alexander's testimony properly emphasized the importance of indices to measure service performance and a triggering of customer restitution when necessary so that management will be in tune to any deterioration in service. *RPA-23*, at 24.

N.J.S.A. 48:2-51.1 requires that the Board investigate whether the proposed merger will affect the utility's ability to provide safe and reliable service at just and reasonable rates. Therefore, the consistent interpretation of the Board's transmittal letter is that the parties are not to address the issue of compliance with the May 1, 2000 Order, but can and should address issues and make recommendations concerning the proposed merger's impact on customer service and reliability. That is precisely what Ms. Alexander's testimony in this proceeding does.

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[44] Ms. Alexander made similar recommendations in the FirstEnergy/GPU merger proceeding in Pennsylvania. Like New Jersey, Pennsylvania recently established reliability performance standards. 52 Pa. Code Section 57.191 *et. seq*.

B. A RELIABILITY AND CUSTOMER SERVICE QUALITY INDEX SHOULD BE IMPLEMENTED TO ENSURE THAT JCP&L'S CUSTOMERS CONTINUE TO RECEIVE SAFE AND ADEQUATE SERVICE FOLLOWING THE MERGER.

In determining whether the proposed merger is "in the public interest," the Board is statutorily obligated to consider the impact of the merger on the utility's ability to provide safe and adequate utility service at just and reasonable rates. *N.J.S.A.* 48:2-51.1. Furthermore, in merger cases, the Board has considered the impact of the proposed merger on the provision of utility service as a factor in determining whether the proposed merger is in the public interest. *See New Jersey Natural*, *supra; New Jersey Resources*, *supra*; *United Water*, *supra*; *Atlantic City Electric Co., supra.* The Ratepayer Advocate submits that absent a verifiable and enforceable Service Quality Index monitoring service quality and reliability, the merger, as proposed, is not "of positive benefit to the public interest" and the Joint Petitioners' application for approval should be denied. Moreover, as demonstrated below and in the testimony of Ms. Alexander, the merger could adversely impact the ability of the merged company to provide safe and adequate service. Hence, the merger, as proposed (i.e., without any service quality or reliability standards), does not even meet the lower "no adverse impact"standard of review applied to service factors set out in *N.J.S.A.* 48:2-51.1.

The absence of verifiable service standards of performance is especially troubling in the context of a utility merger during a period of industry restructuring and high energy costs in the wholesale marketplace. Given the potential for significant merger savings, the management of the merged company will be under tremendous pressure to achieve the projected cost savings. Furthermore, the transition to a merged company will take place during a period of restructuring for the State's electric industry, with new competitive pressures and other demands placed on the merged company's finite resources. This scenario, coupled with the absence of a <u>verifiable</u> commitment to

customer service and service reliability, places the New Jersey customers of the merged company at great risk. Without an SQI that includes enforceable reliability standards, the New Jersey customers will undoubtedly be adversely affected by the merger.

According to the Customer Average Interruption Duration Index ("CAIDI")[45] data provided by JCP&L, its customers suffer through outages that are longer in duration than any other electric utility customer in New Jersey. *RPA-43*, Attachment A (RAR-130). Furthermore, JCP&L's call center performance has been below the statewide average and has remained inadequate for several years. *RPA-43*, at 17. Between 1997 through 2000, JCP&L's response rate ranged from 42% to 71% of the calls in less than 60 seconds, whereas the typical industry average is 80% of the calls answered within 30 seconds. *RPA*-43, p. 17. Compared to the industry average, Ms. Alexander noted that, "Jersey Central's customers have experienced poor service quality." *Id.*

Throughout this proceeding, the Joint Petitioners have alleged that JCP&L's service quality and reliability will improve due to the merger. *See, e.g., P-8*, p. 3. The Joint Petitioners have argued throughout this proceeding that not only will JCP&L's customers not see deterioration of service quality and reliability, but there will be noticeable improvements. In Mr. Carey's surrebuttal, he states that "I am convinced there will be no deterioration of service quality and reliability following the completion of the merger." *P-8,* at 3. He goes on to state that with the installation of new systems, maintenance procedures and the combined "best practices" of the two companies, service quality and reliability will improve. *Id.*

Mr. Michael Chesser gave similar testimony stating that he believed customer service and

[45] CAIDI is a measure of the average length of time (in minutes) power is off to customers each time there is an interruption to supply.

reliability would improve, although he could not commit to specific levels of improvement the Company will reach post merger. Tr.91:19-20. The Joint Petitioners' position is clearly stated in Mr. Anthony Alexander's testimony when he conceded that the Joint Petitioners would not commit to reach any level of service reliability:

> Q. Have Joint Petitioners or FirstEnergy made any specific commitment to improving JCP&L's service reliability if the merger closes?
>
> A. As to specific commitments other than to follow the Orders of the Commission here and to put in place our management and best practices between the two organizations, no.
>
> [Tr.232:12-19].

Similarly, Mr. Alexander admitted that Joint Petitioners would not commit to any specific levels of improvement in customer service. *Id.*

Therefore, it is clear that Joint Petitioners are not willing to back-up their promises of improved reliability and customer service with any measurable standards or even specific new programs that they will implement upon completion of the merger. In order to bring the promised service quality and reliability benefits of the merger to JCP&L's customers and to prevent any deterioration of services, Barbara Alexander recommended that the approval of this merger be contingent upon, among other things, the Board implementing a SQI at specific levels to insure that service quality and reliability improve as the Joint Petitioners repeatedly assert. As proposed by Ms. Alexander, the SQI should have: 1) specific baseline performance standards; and 2) customer restitution payments for failure to maintain these performance standards. The following are the baseline performances the Ratepayer Advocate believes JCP&L should be able to achieve post merger:

Performance Area	Proposed Baseline Performance Standard
CAIDI	Move to 128 minutes over a three-year period
SAIFI	.8 interruption/customer
Call Center, % Ans. In 30 sec.	80% within 30 seconds
Call Center Busy Rate: % calls	<1%
Disconnection Ratio (per 1000 customers)	.84
Installation of Service	No more than 3 days
Missed Appointments	Baseline to be set after 18 mos.
OSHA Incidence Rate (or similar metric)	Performance within top 10% of compatible EEI Companies
BPU Complaint Rate (per 1000 customers)	1.37

RPA-43, p. 20.

In addition to the foregoing indices, Ms. Alexander also proposed to track momentary outages, by including the Momentary Average Interruption Frequency index ("MAIFI") as one of the indices in the SQI. This recommendation is in response to Mr. Carey's testimony regarding GPU Energy efforts to compile such data in Pennsylvania. *RPA-44*, p. 11. Moreover, during Mr. Carey's cross examination, he indicated that FirstEnergy currently tracks the MAIFI index in Ohio and that he considers it to be one of the important factors to consider in reliability of service. Tr. 616:9 - 617:13.

Ms. Alexander also recommends that JCP&L be subject to customer restitution payments for the failure to maintain or improve service quality as measured by the recommended SQI. Through such a mechanism, JCP&L will have an incentive to improve its current substandard level of performance. Any restitution dollars should be returned to customers in the form of a one-time rebate

or a reduction in regulated transmission and distribution rates on a pro-rata basis, with the restitution amount capped at 5% of JCP&L's distribution, operations and maintenance expenses of approximately $5 million. In order to assure compliance, JCP&L should be ordered to report its SQI results annually to the Board, Ratepayer Advocate, and other interested parties including its customers. *RPA*-43.

Ms. Alexander's recommended SQI should not be difficult for the merged company to implement. JCP&L already tracks SAIFI, SAIDI and CAIDI for its own internal monitoring of reliability. Tr. 569:18-23. FirstEnergy presently collects and files data on CAIDI, SAIFI, SAIDI, MAIFI, and call center performance with the Ohio PUC. *RPA*-42. Clearly, the Joint Petitioners consider the use of reliability indices as a helpful tool to gauge their performance. Without adopting Ms. Alexander's recommendations, the Board has only the Joint Petitioners vague assurances that improvements will be made, while the risk of deterioration of service quality and reliability are left squarely on the ratepayers' shoulders. The Board should reject the Joint Petitioners' attempt to shift the burden of the merger to the New Jersey customers, by adopting Barbara Alexander's recommendations with respect to service quality and reliability.

C. THE MERGER SHOULD NOT BE APPROVED AS PROPOSED BY THE JOINT PETITIONERS BECAUSE THERE ARE NO POSITIVE BENEFITS TO GPU'S LOW-INCOME CUSTOMERS AND THE MERGER WOULD ADVERSELY AFFECT THE ABILITY OF THE COMPANY TO ADEQUATELY SERVE ITS LOW-INCOME CUSTOMERS.

The Ratepayer Advocate submits that the merger -- as proposed -- would adversely affect the ability of JCP&L to serve its low-income customers. Hence, the proposed merger would not be of positive benefit to the JCP&L's low-income customers and, therefore, would not be in the public interest. Without additional safeguards for these customers, the merger application, as filed, should be denied.

In evaluating the proposed merger, the Board must determine whether the merger is "in the public interest." *See* Point I, *supra*. The appropriate test of whether the merger is in the public interest is whether the merger is "of positive benefit to the public interest." *See* Point I, *supra*. The Ratepayer Advocate submits that a determination of whether the merger is in the "public interest" includes an evaluation of its impact on low-income customers. It is beyond dispute that the "public interest" includes the interests of all customers, and necessarily low-income customers. More specifically, the Board should consider measures to help low-income customers as a means to alleviate the impact of the merger on low-income ratepayers. The Board is also statutorily obligated to evaluate the impact of the merger on the utility's ability to provide a "safe and adequate" service to its customers at "just and reasonable rates." *N.J.S.A.* 48:2-51.1. It is clear that the record amply demonstrates that the proposed merger will adversely affect the ability of JCP&L to adequately serve its low-income customers. Furthermore, there is ample evidence which shows that the proposed merger does not adequately address the needs of low-income customers.

Ratepayer Advocate witness Barbara Alexander testified that low-income issues are appropriately raised in utility merger cases because low-income customers are likely to suffer the consequences of degraded service quality and reliability that may occur post merger. *RPA*-44, p. 13. More than any other customer segment, low-income customers are more likely to avail themselves of customer service centers, call centers, payment arrangement options and have contact with more customer service representatives than any other residential or business customers. Clearly, the low-income ratepayers will feel the effects of any degradation of service first and more acutely. The Joint Petition and testimony are vague, with very little details or specifics on whether FirstEnergy plans to cut customer service personnel and facilities. This uncertainty is yet another example of a long line of vague responses that may prove to be a detriment to customers, especially the low-income customers in JCP&L's service territory. On cross-examination by the Ratepayer Advocate, Mr. Roche could not confirm or deny any future plans to eliminate customer payment centers in JCP&L territory:

> Q. And looking at page 2 of that response to RAR-133, am I correct that in looking at this response you identify on the second page six locations in New Jersey which GPU customers can currently essentially go and pay their bills?
>
> A. That is correct.
>
> Q. Okay. Can you tell us here today whether FirstEnergy or Joint Petitioners have committed to keeping those same number customer payment centers open after the merger?
>
> A. I - - I do not know. I believe that's part of the analysis that we heard about on Monday, the To Be Analysis. [Tr. 582:2-15].

With Joint Petitioners offering no concrete plans to maintain customer payment centers, it is essential that the Board protect consumers, especially low-income customers, from the corporate pressures to close customer payment centers to save money.

Additionally, as noted in Ms. Alexander's rebuttal testimony, low-income programs such as LIHEAP, New Jersey SHARES, Lifeline and WARM programs are not sufficient to meet the needs of the poor in JCP&L's territory. *RPA-44*, at 16. LIHEAP is targeted to the customer's primary heating bill and is typically not available to electric utilities unless the customer has electric heat. The SHARES program is only available to customers in a one-time emergency and does not address the affordability of the overall electric bill. Lifeline is targeted to elderly and disabled customers only. Finally, WARM is an existing demand-side management program that delivers energy efficiency and conservation services to low-income customers. As a result, none of these programs are targeted to assist low-income customers and make the electric bill affordable. Therefore, a large portion of the low-income and financially-distressed customers in JCP&L's service territory have no access to the assistance they need to pay their electric bills. It is clear that the limited, existing assistance programs available to JCP&L customers are not sufficient to meet the needs of the financially-distressed customers. *RPA-44*, at 16.

Faced with similar limitations on the funding levels available from federal and state programs in Pennsylvania, GPU's Pennsylvania utilities (Metropolitan Edison and Pennsylvania Electric) will spend approximately $5.3 million in 2000 on a bill payment assistance program (known as the Customer Assistance Program or CAP) and $7.6 million for this program in 2001. This program is in addition to contributions by these utilities to Pennsylvania crisis funds and their own WARM programs, funded at a level of $2.7 million in 2000 and $3.2 million in 2001. Both CAP and WARM

will increase to a combined spending level of $13 million in 2002 for the two Pennsylvania GPU Energy distribution companies. *RPA-43*, at 31. In contrast, in New Jersey JCP&L has committed to spend only $150,000 for its contribution to New Jersey Shares and $3.3 million for the low-income weatherization program (essentially replacing the "WARM" program) pursuant to the Board's Order issued in the Comprehensive Resource Analysis proceeding. *See RPA*-43, Appendix (response to RAR-138); *RPA-34*.

In response to the threat of degrading service quality due to the merger, the Ratepayer Advocate recommends that the Board adopt safeguards to insure that the merged companies: (1) are required to submit an extensive study on maintaining and/or potential closing of any payment centers prior to closing any of its existing payment centers; and (2) provide affordable electricity to all customers through implementation of additional low-income programs. With respect to the customer payment centers, a definite commitment from the Joint Petitioners is necessary to insure that the customer service quality does not degrade post merger due to the loss of customer payment centers. In the Atlantic Electric merger case, the ALJ expressed concern over Atlantic's plan to close customer payment centers, and to substitute local offices with a 1-800 number that the customers could use. In requiring a comprehensive report before any customer payment centers would be allowed to close, the ALJ stated the following:

> I believe that, given the problems of low-income customers, it would be far more beneficial for these individuals to have the opportunity to meet face-to face with customer representative in an area convenient to their residences to discuss such problems. Therefore, I recommend to the Board that its approval of the merger be conditioned on the Company providing a full study regarding continuation of walk-in customer service facilities in the Atlantic City, Bridgeton and Hammonton areas of its service territory. Until such a study is undertaken, customer service centers should remain open to service

the needs of the utility ratepayers. [Initial Decision at p. 25].

I/M/O the Petition of Atlantic City Electric Company and Conectiv, Inc. For Approval of a Change in Ownership and Control, BPU Docket No. EM97020103.

The Ratepayer Advocate asserts that the same conditions should be imposed on the Joint Petitioners as a condition of any merger approval here. The Joint Petitioners should be required to submit an extensive study on maintaining and/or potential closing of any payment centers to insure the protection of JCP&L customers.

Moreover, for the reasons set forth herein, a comprehensive low-income program is a proper response to the merger proposal and the Board should require the Joint Petitioners to implement a low-income bill payment assistance program comparable to that in effect in both Ohio and Pennsylvania, as a condition of any merger approval. There is no reason to treat New Jersey's low-income customers in a discriminatory manner as a result of the proposed merger. New Jersey's low-income customers should have access to comparable programs available to FirstEnergy's and GPU Energy's customers in Ohio and Pennsylvania. The Pennsylvania PUC has found that a properly designed and executed low-income program will benefit the utilities by reducing the cost of the program, collection costs and uncollectible expenses reflected in rates. *RPA*-44, p. 16. There is no reason the Board in New Jersey should not follow the lead in Pennsylvania by establishing low-income programs to assist JCP&L customers especially at this time when the Board is considering the merger's impact on customers.

With the special needs of the low-income population in mind, Barbara Alexander recommended that the Board order JCP&L to implement a bill payment assistance program similar to the Customer Assistance Program ("CAP") currently implemented by GPU Energy's Pennsylvania

electric utilities. The CAP program in Pennsylvania has two components: 1) debt forgiveness; and 2) a percentage of income payment plan ("PIPP"), a monthly subsidy to assist payment troubled customers pay their bills based on monthly income. *RPA*-43, p. 32. Payment troubled customers with a gross household income below 200% of the federal poverty guideline receive debt forgiveness, while payment troubled customers at or below 150% of federal poverty guidelines receive both a monthly subsidy and debt forgiveness for pre-program arrears. Under the Pennsylvania program, in addition to household income, eligible customers must be "payment troubled" which is defined as a customer that has $100 or less in disposable income after expenses. The percentage of income to be allocated to the payment of the energy bill is determined by using a guideline. [46] The balance of the payment troubled customer's bill is considered the "shortfall" amount that the subsidy will cover.

With respect to the arrears forgiveness portion of the program, a payment prior to the due date will result in an automatic monthly forgiveness equal to 1/24 of the total arrearage established at the time of program enrollment. This arrears forgiveness program should be integrated with the arrears forgiveness program promised by GPU Energy as part of the CRA proceeding, but instead of linking it to the WARM program, it should be linked to the bill payment assistance program or CAP. Customers apply for enrollment in these programs through local community-based organizations that coordinate the enrollment process with the implementation of LIHEAP and other financial assistance programs. *RPA-43*, p. 33.

Keeping in line with the expenditures in Pennsylvania, Ms. Alexander recommends that the Board condition any merger approval by requiring JCP&L to implement the CAP so that by 2004, $5 million is budgeted to benefit approximately 8,000 low-income customers. This expenditure is in

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[46] See *RPA*-43, p. 32, for the specifics of the guideline.

addition to GPU Energy's low-income weatherization program and proposal for debt forgiveness for low-income customers approved as part of the Comprehensive Resource Analysis proceeding, BPU Docket No. EX99050347 (which should continue at their current funding levels). The Board may wish to revisit this issue at the time the Board completes its Universal Service proceeding and implements a more comprehensive arrearage forgiveness program. However, the Board should not delay its review and consideration of low-income program proposals as part of this merger proceeding to a later date, because of the clear linkage between the merger proposal and the services and service quality provided to low-income customers.

To facilitate the enrollment process, low-income customers should be automatically considered for participation in CAP, WARM, and arrearage forgiveness programs in the CRA proceeding by social service and intake agencies currently operating in New Jersey for LIHEAP and other assistance programs. *RPA*-43, at 32. Implementation of a program modeled after the Pennsylvania CAP should be relatively simple for GPU because of their Pennsylvania utilities' experience administrating the programs.

In addition to recommending the foregoing CAP programs, as a condition of the merger, the Ratepayer Advocate recommends that the Board require JCP&L to implement a "heat-related" moratorium on disconnection in severe summer weather so that elderly and low-income households will not have to choose between cooling and maintaining electricity for lights and refrigeration. *RPA-43*, at p. 39. Also, the Board should also require JCP&L to explore and implement a low-income aggregation program so that low-income customers participating in universal service programs can obtain access to the lowest cost electric service. *Id.* Finally, to further increase awareness of these programs, the Board should require JCP&L to implement an educational program

targeted to eligible low-income customers. *RPA-43*, p. 40. With education, customers can be aware of these energy assistance programs to expedite assistance when necessary.

The EDECA was passed into law two years ago and yet there is still no indication if or when a statewide, comprehensive universal service program will be established. However, JCP&L's low-income customers need assistance now, especially in response to the pressures to cut costs as a result of the pending merger. Therefore, the Ratepayer Advocate urges the Board to adopt the low-income initiatives as set forth in the record of this case, to protect JCP&L's low-income customers from the negative impact the proposed merger may have on them, and to ensure that these customers receive positive benefits as a condition of any merger approval.

VII. Issues Pertaining to Reliability and Operation of the Region's Bulk Power Transmission System.

POINT XI

THE BOARD SHOULD REQUIRE JOINT PETITIONERS TO KEEP THE GPU TRANSMISSION ASSETS IN PJM FOR A PERIOD OF AT LEAST TEN YEARS; ANY REQUEST FOR EARLY TERMINATION SHOULD BE FILED WITH THE BOARD FOR REVIEW AND APPROVAL AFTER EVIDENTIARY HEARINGS.

A. THE BOARD HAS JURISDICTION TO REQUIRE JOINT PETITIONERS TO LEAVE THE GPU TRANSMISSION ASSETS IN PJM AND TO SEEK BOARD APPROVAL FOR ANY REQUEST TO WITHDRAW FROM PJM, BECAUSE SUCH ACTION WOULD DIRECTLY AFFECT RETAIL RATES AND SERVICE RELIABILITY IN NEW JERSEY.

As discussed *supra*, the Board has broad authority to regulate New Jersey public utilities and their operations. *N.J.S.A.* 48:2-13. GPU must receive Board approval before transferring the stock and control of the utility to another entity. *N.J.S.A.* 48:3-10. The Board must analyze a merger request in relation to several issues including the proposed merger's effects on competition, rates, utility employees and the provision of safe and adequate service at just and reasonable rates. *N.J.S.A.* 48:2-51.1. Accordingly, the Board necessarily has the authority to impose conditions on the acquisition of a New Jersey utility, especially when those conditions are aimed at preserving the ability of the utility to provide safe and adequate service at just and reasonable rates.

It is unquestionable that the ability of JCP&L to provide safe and adequate service includes the issue of service reliability. JCP&L's participation as a transmission owner in PJM is also necessarily implicated when system reliability is involved. One of PJM's reasons for existence is to assure reliability of the transmission grid that delivers power to JCP&L to distribute to its retail customers. The Board's authority to condition the merger approval by requiring FirstEnergy to maintain GPU's transmission assets under PJM's control for ten years, as the Ratepayer Advocate has recommended, arises directly from its legal obligation to assure safe and adequate service to

JCP&L's customers.

Furthermore, PJM's duties also include operating energy markets in which JCP&L participates to its benefit and to the benefit of its customers. The impact of the energy markets' operations on JCP&L's jurisdictional retail rates also cannot be denied. As discussed *supra*, FirstEnergy plans to participate in these markets to serve JCP&L's BGS customers. Therefore, the merger's effect on how efficiently and economically these PJM markets can operate is also directly implicated in the Board's jurisdiction to require FirstEnergy to maintain GPU's transmission assets under PJM control.

Additionally, the EDECA plainly adopts the policy of encouraging retail electricity competition. The ability of PJM's energy and capacity markets to operate efficiently and economically directly affects the ability of retail marketers serving New Jersey customers to obtain power to serve those customers. The Board's obligation under the EDECA to oversee retail competition in New Jersey requires the agency to exercise its authority over the impacts of the merged company's decisions concerning the transmission assets. The Board may participate as an intervenor in any FERC proceeding over the removal of GPU's transmission assets from PJM. However, it is clear that mere participation as an intervenor at the FERC does not give the Board the flexibility and control necessary to protect the interests not only of **JCP&L's** retail customers, but also the interests of **all New Jersey electric retail customers** from the likely negative effects of removing GPU's transmission assets from PJM.

The requirement under *N.J.S.A.* 48:2-51.1 that the Board ensure that a proposed merger provides positive benefits for retail competition involves the issues of market power that may be wielded by the merged company. It is also undeniable that the Board's jurisdiction to forestall the

improper use of market power includes its authority to require the merged company to take steps to assure that such improper market power will never occur. These reasons amply establish the Board's jurisdiction to adopt the Ratepayer Advocate's recommendations on maintaining GPU's transmission assets under PJM's control.

As established above, the Joint Petitioners' assertion of no horizontal or vertical market power concerns is based on Mr. Frame's assumption that GPU's transmission assets will continue to be under the operational control of PJM following the merger and that FirstEnergy will have no preferential rights to the limited import capability into PJM. *P-6.,* Attachment 1, pp. 9, 72-75. Because these two assumptions are vital to Mr. Frame's conclusions, Messrs. Biewald and Schlissel have recommended that the Board condition any merger approval on the post-merger company committing to maintaining the viability of these assumptions.

The Joint Petitioners would satisfy the first condition by committing to keep GPU transmission assets under the control of PJM for ten years following the merger, unless continued PJM operation of these assets would result in financial distress to the merged companies or the Joint Petitioners can show that early termination provides significant benefits to JCP&L's ratepayers without a material increase in market power to applicable destination markets. In the event that early termination is warranted, the Joint Petitioners should be required to file for approval of early termination by the Board. *RPA-50, p. 23.*[47] The Joint Petitioners should also be required to commit

[47] In a ruling issued at its public meeting on May 24, 2001, the Pennsylvania Public Utilities Commission ordered, as a condition of merger approval, that the merged company "shall not withdraw the transmission facilities of Metropolitan Edison Company or Pennsylvania Electric Company [GPU's Pennsylvania utilities] from the operational control of the PJM Interconnection, L.L.C., unless the merged company . . . has first applied for and obtained authorization by order of this Commission, and such application shall be granted only upon an affirmative showing that withdrawal would not adversely affect the continued provision of adequate, safe and reliable

unconditionally to not asserting native load priority on its direct interconnection with GPU so long as GPU is part of PJM.

Although the Joint Petitioners have stated that they have no plans **at this time** to change either of these situations,[48] they have not committed to do so for a definite term and have actually reserved the right to alter these conditions without Board approval and for unspecified reasons. *RPA-50, p. 24; RPA-51, pp. 2-4.* For the reasons discussed herein this is unacceptable, and the Ratepayer Advocate urges the Board to adopt its witnesses' recommendations with respect to continuation of the GPU transmission assets in PJM as a condition of any merger approval.

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electric service to the citizens of the Commonwealth nor adversely affect system reliability or the competitive market in the Commonwealth . . . . *Joint Application for Approval of the Merger of GPU, Inc. With FirstEnergy Corp.*, *et al.*, Docket No. A-110300F0095, Motion of Commissioner Terrance J. Fitzpatrick, at p. 3 (Public Meeting May 24, 2001).

[48] *P-10, pp. 4-10.*

CONCLUSION

As the Ratepayer Advocate argued at the outset of this brief, the proposed merger of GPU and FirstEnergy raises issues that are extremely important to the companies, their customers and employees, and the economy of the State of New Jersey. The need to carefully review the merger and ensure that customers' interests are adequately protected is even more crucial as the electric power industry struggles with the implementation of retail competition. Therefore, the Ratepayer Advocate respectfully requests that the Board only approve the merger if all of the foregoing recommendations, as discussed herein and in the record of this case, are made explicit conditions of approval.

Respectfully submitted,

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N.J. DIVISION OF THE RATEPAYER ADVOCATE

Dated: May 25, 2001

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