

133 FERC ¶ 61,222
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Jon Wellinghoff, Chairman;
Marc Spitzer, Philip D. Moeller,
John R. Norris, and Cheryl A. LaFleur.

FirstEnergy Corp.

Docket No. EC10-68-000

Allegheny Energy, Inc.

ORDER AUTHORIZING MERGER AND DISPOSITION
OF JURISDICTIONAL FACILITIES

(Issued December 16, 2010)

1. On May 11, 2010, as supplemented on June 21, 2010,¹ FirstEnergy Corp. (FirstEnergy) and Allegheny Energy, Inc. (Allegheny) (together, Applicants) filed an application seeking Commission authorization under sections 203(a)(1) and 203(a)(2) of the Federal Power Act (FPA)² for a proposed transaction in which FirstEnergy will acquire Allegheny. The Commission has reviewed the application under the Commission's Merger Policy Statement.³ As discussed below, we will authorize the proposed transaction as consistent with the public interest.

¹ The May 11, 2010 filing is referred to here as the Application. The June 21, 2010 filing was made in response to a Commission staff request for additional information and is referred to here as Applicants' Supplement.

² 16 U.S.C. § 824b (2006).

³ See *Inquiry Concerning the Commission's Merger Policy Under the Federal Power Act: Policy Statement*, Order No. 592, FERC Stats. & Regs. ¶ 31,044 (1996), *reconsideration denied*, Order No. 592-A, 79 FERC ¶ 61,321 (1997) (Merger Policy Statement). See also *FPA Section 203 Supplemental Policy Statement*, 72 Fed. Reg. 42,277 (Aug. 2, 2007), FERC Stats. & Regs. ¶ 31,253 (2007). See also *Revised Filing Requirements Under Part 33 of the Commission's Regulations*, Order No. 642, FERC Stats. & Regs. ¶ 31,111 (2000), *order on reh'g*, Order No. 642-A, 94 FERC ¶ 61,289 (2001). See also *Transactions Subject to FPA Section 203*, Order No. 669, FERC Stats.

(continued...)

I. Background

A. Description of the Parties

1. FirstEnergy

2. FirstEnergy is a holding company under the Public Utility Holding Company Act of 2005⁴ (PUHCA 2005) whose subsidiaries and affiliates are involved in the generation, transmission and distribution of electricity, as well as energy management and other energy-related services. Its seven electric utility operating companies serve customers in Ohio, Pennsylvania, and New Jersey, and in a small village in New York just across the Pennsylvania state line. FirstEnergy's generation subsidiaries control approximately 14,800 megawatts (MW) of generation capacity.

a. FirstEnergy Operating Companies

3. FirstEnergy merged with GPU, Inc. (GPU) in 2001.⁵ This is reflected in FirstEnergy's subsidiary electric utility operating companies, which can be separated into two groups of companies. The first consists of FirstEnergy's original operating companies: Pennsylvania Power Company (Penn Power) and the companies operating in Ohio, which include Ohio Edison Company, The Cleveland Electric Illuminating Company, and The Toledo Edison Company (collectively, Ohio Companies). The second consists of the former GPU operating companies (GPU Companies): Pennsylvania Electric Company (Penelec), Metropolitan Edison Company (MetEd), and Jersey Central Power & Light Company (JCP&L). Collectively, these companies are known as the FirstEnergy Operating Companies.

4. All of the states in which the FirstEnergy Operating Companies operate have implemented retail competition. As part of that process, the FirstEnergy Operating Companies have divested virtually all of their generation facilities: the Ohio Companies and Penn Power divested their generation facilities to a merchant affiliate, FirstEnergy

& Regs. ¶ 31,200 (2005), *order on reh'g*, Order No. 669-A, FERC Stats. & Regs. ¶ 31,214, *order on reh'g*, Order No. 669-B, FERC Stats. & Regs. ¶ 31,225 (2006).

⁴ 42 U.S.C. § 16451 *et sec.* (2006).

⁵ *Ohio Edison Co.*, 94 FERC ¶ 61,291 (2001). FirstEnergy was formed in 1997 through the merger of Ohio Edison Company and its subsidiary, Pennsylvania Power Company, with Centerior Energy Corp. and its subsidiaries, The Cleveland Electric Illuminating Company and The Toledo Edison Company. *Cleveland Electric Illuminating Co.*, 77 FERC ¶ 61,032 (1996).

Solutions Corp. (Solutions), and the GPU Companies divested their generation facilities to third parties.

5. The FirstEnergy Operating Companies are load serving entities and transmission customers within their respective regional transmission organizations (RTO) and participate in markets administered by those RTOs. The FirstEnergy Operating Companies provide distribution service to approximately 2.1 million customers in Ohio, 1.3 million customers in Pennsylvania, and 1.1 million customers in New Jersey. The FirstEnergy Operating Companies obtain or will obtain virtually all of their power to supply provider of last resort service to their non-shopping customers through state commission sanctioned competitive solicitations conducted within their respective states.

6. The FirstEnergy Operating Companies are authorized to sell power at market-based rates.⁶ However, Applicants state that aside from the purchase of power to meet their provider of last resort service obligations, the FirstEnergy Operating Companies' wholesale market activities generally are limited to the sale of the capacity and energy from JCP&L's 200 MW ownership interest in the Yards Creek pumped storage plant and other generator contracts that predate generation divestiture. The marketing activities, including procuring power, renewable energy credits and power related products, are performed by FirstEnergy's Regulated Commodity Sourcing group, which is located within the energy delivery organization of FirstEnergy Service Company and is separate from Solutions.

b. FirstEnergy's Transmission Affiliates

7. The Ohio Companies and Penn Power transferred their transmission assets to American Transmission System, Incorporated (American Transmission) in 2001. American Transmission is a wholly-owned subsidiary of FirstEnergy, and its transmission assets include approximately 7,100 circuit miles of transmission lines with nominal voltages of 345 kV, 138 kV and 69 kV. American Transmission's transmission system has 35 interconnections with six neighboring areas, including high capacity ties with Penelec, Duquesne Light Company (Duquesne) and Allegheny to the east; with certain Michigan utilities to the north; and with American Electric Power Service Corporation and Dayton Power & Light Company to the south.

8. Effective October 1, 2003, American Transmission transferred operational control of its transmission facilities to the Midwest Independent Transmission System Operator,

⁶ *The FirstEnergy Operating Cos.*, Docket No. ER01-1403-010 (Aug. 26, 2009) (unpublished letter order) (discussing FirstEnergy Companies' continued authorization to transact at market-based rates).

Inc. (Midwest ISO) under the GridAmerica umbrella.⁷ The Commission subsequently authorized American Transmission to terminate its membership in the Midwest ISO and to transfer its facilities and operational control thereof to PJM Interconnection, L.L.C. (PJM), effective June 1, 2011.⁸ The GPU Companies' transmission assets are also under the operational control of PJM.

c. FirstEnergy's Merchant Affiliates

9. FirstEnergy's power sales affiliate, Solutions, owns, operates, or contractually controls power plants or other capacity resources with a total system capacity of approximately 14,800 MW. Applicants state that Solutions is a power marketer engaged in the sale of electricity at market-based rates to wholesale customers and to retail

⁷ See *Midwest Indep. Transmission Sys. Operator, Inc.*, Docket No. ER05-1435-000, GridAmerica Companies' Signature Pages to the Midwest ISO Agreement at 2-3 (Sept. 1, 2005) (stating that GridAmerica Companies would, upon withdrawal of their facilities from GridAmerica, automatically become members of the Midwest ISO for a term ending no earlier than five years from the "control date" for American Transmission, October 1, 2003); see also *Midwest Indep. Transmission Sys. Operator, Inc.*, 113 FERC ¶ 61,096, at P 3-4 (2005).

⁸ *American Transmission Systems, Inc.*, 129 FERC ¶ 61,249 (2009) (Realignment Order), *order on clarification and reh'g*, 130 FERC ¶ 61,171 (2010), *reh'g pending*. The Commission conditioned its authorization on the following: (1) the submission of American Transmission's proposed replacement rates in a separate filing and, in the context of that filing, the Commission's consideration of whether American Transmission's existing customers will have access to continued transmission service as required by the Midwest ISO TO Agreement, Agreement of Transmission Facilities Owners to Organize the Midwest Independent Transmission System Operator, Inc.; FERC Electric Tariff, Second Revised Rate Schedule FERC No. 1 (Midwest ISO TO Agreement); (2) the submission of a separate filing addressing American Transmission's exit fee obligations under the Midwest ISO TO Agreement; (3) the submission of a separate filing addressing American Transmission's obligations regarding the construction of new facilities as required by the Midwest ISO TO Agreement; and (4) American Transmission's receipt of all applicable federal and state regulatory approvals, including the Commission's determination that American Transmission's proposed replacement arrangements comply with the Commission's *pro forma* OATT, satisfy the Commission's standards regarding deviations to the *pro forma* OATT, and are otherwise just, reasonable, and not unduly discriminatory. Realignment Order, 129 FERC ¶ 61,249 at P 4.

customers in states throughout the Eastern and Midwestern United States in which retail access programs have been initiated.

10. Solutions owns the following generation-only companies that own and/or operate generation facilities in Ohio and Pennsylvania: FirstEnergy Generation Corp., FirstEnergy Nuclear Generation Corp., and FirstEnergy Generation Mansfield Unit 1 Corp.

11. Applicants state that Solutions and its generation subsidiaries are not franchised public utilities and do not have captive customers. Neither Solutions nor its subsidiaries own or control transmission or distribution facilities other than limited interconnection facilities connected to their generation.

2. Allegheny

12. Allegheny is a holding company under PUHCA 2005. Its subsidiary operating companies deliver electric service to over 1.5 million customers.

a. Allegheny Power Companies

13. Allegheny Power is the trade name of Allegheny's three electric utility operating companies: Monongahela Power Company (Mon Power), The Potomac Edison Company (Potomac Edison), and West Penn Power Company (West Penn) (collectively, the Allegheny Power Companies). The Allegheny Power Companies are wholly-owned subsidiaries of Allegheny, and through them Allegheny provides regulated franchised energy delivery service to customers in portions of Maryland, Pennsylvania, Virginia, and West Virginia. Other than certain generating assets that Mon Power owns and uses to serve its customers in West Virginia, the Allegheny Power Companies have divested their generation assets to Allegheny's wholly-owned subsidiaries Allegheny Energy Supply Company, LLC (AE Supply) and Green Valley Hydro, LLC (Green Valley).

14. The Commission has authorized the Allegheny Power Companies to sell capacity and electric energy at wholesale at market-based rates⁹ and to make hourly non-firm energy sales with one another at the PJM index price for the Allegheny Power

⁹ *Allegheny Power Serv. Corp.*, 82 FERC ¶ 61,245 (1998).

transmission zone of PJM.¹⁰ The Allegheny Power Companies' transmission assets are under the operational control of PJM.¹¹

15. Mon Power owns generation, transmission and distribution facilities and is engaged in the generation, transmission, distribution, and sale of electricity in northern West Virginia. Mon Power provides bundled retail electric service to customers in West Virginia at cost-based rates. Applicants state that Mon Power does not have any wholesale captive customers.

16. West Penn owns transmission and distribution facilities and is engaged in the transmission, distribution, and sale of electricity in southwestern, south-central, and northern Pennsylvania. West Penn is the provider of last resort in Pennsylvania for retail electricity customers who have not chosen an alternative retail energy supplier. Applicants state that West Penn does not own any generation facilities and does not have any wholesale or retail captive customers.

17. Potomac Edison owns transmission and distribution facilities and is engaged in the transmission, distribution, and sale of electricity in western and central Maryland, northern Virginia, and northeastern West Virginia. Potomac Edison is a provider of last resort in Maryland for retail electricity customers that have not chosen an alternative retail energy supplier. In Virginia and West Virginia, Potomac Edison provides bundled retail electric service to customers at cost-based rates. Applicants state that Potomac Edison does not own any generation facilities and does not have any wholesale captive customers.

b. Allegheny's Transmission Affiliates

i. Trans-Allegheny Interstate Line Company

18. Trans-Allegheny Interstate Line Company (Trans-Allegheny) is a wholly-owned subsidiary of Allegheny Energy Transmission, LLC, a direct, wholly-owned subsidiary of Allegheny. Trans-Allegheny owns and operates certain transmission assets located at substations owned by the Allegheny Power Companies and a public utility subsidiary of American Electric Power Co., Inc. (AEP). In addition, Trans-Allegheny is constructing the Trans-Allegheny Interstate Line, a 500 kV transmission line from a new substation in southwestern Pennsylvania, across northern West Virginia, and into northern Virginia to

¹⁰ *Allegheny Power Serv. Corp.*, 90 FERC ¶ 61,002 (2000).

¹¹ *PJM Interconnection, L.L.C.*, 98 FERC ¶ 61,072, *clarified*, 98 FERC ¶ 61,235 (2002).

a point where construction of the line will be continued by Virginia Electric and Power Company to an existing substation in northern Virginia.

ii. **PATH West Virginia Transmission Company, LLC and PATH Allegheny Transmission Company, LLC**

19. Potomac-Appalachian Transmission Highline, LLC (Potomac-Appalachian) is a limited liability company that is a wholly-owned, indirect subsidiary of Allegheny and an affiliate of AEP formed to own the membership interests in certain operating companies, including PATH West Virginia Transmission Company, LLC (PATH-WV) and PATH Allegheny Transmission Company, LLC (PATH-Allegheny). The Allegheny subsidiary and AEP affiliate that formed Potomac-Appalachian control PATH-WV jointly. The Allegheny subsidiary controls PATH-Allegheny. PATH-WV and its wholly-owned subsidiary, PATH-WV Land Acquisition Company, will finance, construct, own, operate, and maintain a portion of the Potomac-Appalachian Transmission Highline transmission project in West Virginia. PATH-Allegheny and its wholly-owned subsidiary, PATH-Allegheny Land Acquisition Company, will finance, construct, own, operate, and maintain the remainder of this project in West Virginia. PATH Allegheny Virginia Transmission Corporation, a wholly-owned subsidiary of PATH-Allegheny, will finance, construct, own, operate, and maintain the Appalachian Transmission Highline transmission project in Virginia. PATH Allegheny Maryland Transmission Company, LLC, which is owned by Potomac Edison and PATH-Allegheny, will finance and own the project in Maryland, and Potomac Edison will construct, operate, and maintain the project.

c. **Allegheny's Merchant Affiliates**

20. AE Supply is a wholly-owned subsidiary of Allegheny. It develops, owns, and operates electric generating facilities, as well as markets power in competitive wholesale and retail markets, both directly and through subsidiaries. AE Supply and its subsidiaries own and operate approximately 7,015 MW of generation located in PJM. AE Supply markets energy, capacity, and ancillary services in wholesale markets pursuant to its market-based rate authorization granted by the Commission.¹²

21. Buchanan Generation, LLC (Buchanan) is a subsidiary of AE Supply. Buchanan owns an approximately 80 MW generating facility located in Buchanan County, Virginia. AE Supply's wholly-owned subsidiary, Buchanan Energy Company of Virginia, LLC, owns 50 percent of Buchanan; CNX Gas Corporation, which is not affiliated with AE

¹² See *Allegheny Energy Supply Co.*, 88 FERC ¶ 61,303 (1999).

Supply, owns the other 50 percent. Buchanan has authorization to sell capacity, electric energy and ancillary services at market-based rates.¹³

22. AE Supply owns approximately 59 percent of Allegheny Generating Company (Allegheny Generating), and Mon Power owns the remaining approximately 41 percent. Allegheny Generating owns an undivided 40 percent interest (equating to approximately 1,109 MW) in the approximately 2,272 MW (summer rating) Bath County Pumped Storage Project located in Bath County, Virginia.¹⁴ Allegheny Generating sells its share of the output of this project to its respective owners in proportion to their ownership shares at cost-based rates.

23. Green Valley is a direct, wholly-owned subsidiary of Allegheny. It owns four hydroelectric generation stations located in Virginia. The Commission has authorized Green Valley to sell electric energy, capacity, and ancillary services at market-based rates.¹⁵

24. Applicants state that none of AE Supply, its subsidiaries, or Green Valley are franchised utilities, and none of them has captive customers. In addition, none of them own or control any electric transmission or distribution facilities, other than the limited interconnection facilities they may own as part of their generation facilities.

B. Description of the Transaction

25. FirstEnergy will acquire Allegheny in the proposed transaction through a stock-for-stock exchange in which Allegheny stockholders will receive FirstEnergy stock worth approximately \$4.7 billion. Element Merger Sub, Inc., a wholly-owned direct subsidiary of FirstEnergy, will merge with and into Allegheny. Allegheny will continue as the surviving entity and become a direct wholly-owned subsidiary of FirstEnergy and its stock will no longer be publicly-traded.

26. Allegheny stockholders will receive 0.667 of a share of FirstEnergy common stock for each share of Allegheny common stock that they hold. Applicants estimate that following completion of the proposed transaction, Allegheny stockholders will own approximately 27 percent of the FirstEnergy common stock outstanding, and FirstEnergy

¹³ *Buchanan Generation, LLC*, Docket No. ER02-1638-000 (May 29, 2002) (unpublished letter order).

¹⁴ Virginia Electric and Power Company owns the remaining 60 percent interest in the Bath County Pumped Storage Project and serves as the project operator.

¹⁵ *Green Valley Hydro, LLC*, Docket No. ER00-2924-000 (Aug. 17, 2000) (unpublished letter order).

shareholders will own approximately 73 percent of the FirstEnergy common stock outstanding.

27. Effective upon completion of the proposed transaction, FirstEnergy will increase the size of its Board of Directors by two members to 13 and will appoint two current Allegheny Board members to the FirstEnergy Board. These two directors will serve on committees of the FirstEnergy Board on a basis proportionate to the size of the FirstEnergy Board.

II. Notice of Filing and Responsive Pleadings

28. Notice of the Application was published in the *Federal Register*, 75 Fed. Reg. 28,800 (2010), with interventions and protests due on or before July 12, 2010. Notice of the Applicants' Supplement was published in the *Federal Register*, 75 Fed. Reg. 37,787 (2010), with interventions and protests also due on or before July 12, 2010. The New Jersey Board of Public Utilities, the Public Service Commission of Maryland, and the Public Utilities Commission of Ohio filed notices of intervention. PJM Interconnection, L.L.C., the New Jersey Division of the Rate Counsel, American Municipal Power, Inc., Allegheny Electric Cooperative, Inc., the Borough of Chambersburg, Pennsylvania, Industrial Energy Users-Ohio, Met-Ed Industrial Users Group and Penelec Industrial Customer Alliance, West Penn Power Industrial Intervenors, Direct Energy Business, LLC, the Commonwealth of Pennsylvania Department of Environmental Protection, Constellation Energy Commodities Group, Inc. and Constellation NewEnergy, Inc., Exelon Corporation, Old Dominion Electric Cooperative, and the City of Hagerstown and the Towns of Thurmont and Williamsport, Maryland (Maryland Municipals) filed timely a motions to intervene. The Office of the Ohio Consumers' Counsel, the West Virginia Consumer Advocate Division, and the Maryland Office of People's Counsel (collectively, Joint Consumer Advocates) filed timely motions to intervene and a joint protest. The Pennsylvania Office of Consumer Advocate (Pennsylvania Advocate), Citizen Power, Inc. (Citizen Power), and Duquesne also filed timely motions to intervene and either protest or comment. On August 17, 2010, Duquesne filed a notice of withdrawal of its motion to intervene and protest. On September 13, 2010, Met-Ed Industrial Users Group and Penelec Industrial Customer Alliance withdrew their motion to intervene, and on the same date West Penn Power Industrial Intervenors withdrew its motion to intervene. The Maryland Municipals filed a protest on November 29, 2010, and they filed a notice of withdrawal of their protest on December 1, 2010.¹⁶

¹⁶ The notices of withdrawal filed by Duquesne, Met-Ed Industrial Users Group, Penelec Industrial Customer Alliance, and West Penn Power Industrial Intervenors became effective by operation of Rule 216(b)(1) of the Commission's Rules of Practice and Procedure.

(continued...)

29. On July 27, 2010, Applicants filed an answer to the protests. The Joint Consumer Advocates and Citizen Power filed answers to Applicants' answer.

III. Discussion

A. Procedural Issues

30. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure,¹⁷ the notices of intervention and timely, unopposed motions to intervene serve to make the entities that filed them parties to this proceeding.

31. Rule 213(a)(2) of the Commission's Rules of Practice and Procedure¹⁸ prohibits an answer to a protest unless otherwise ordered by the decisional authority. We will accept the answers of the Applicants, the Joint Consumer Advocates, and Citizen Power because they have provided information that assisted us in our decision-making process.

B. Standard of Review Under Section 203

32. Section 203(a)(4) requires the Commission to approve a transaction if it determines that the transaction will be consistent with the public interest. The Commission's analysis of whether a transaction will be consistent with the public interest generally involves consideration of three factors: (1) the effect on competition; (2) the effect on rates; and (3) the effect on regulation.¹⁹ Section 203 also requires the Commission to find that the transaction "will not result in cross-subsidization of a non-utility associate company or the pledge or encumbrance of utility assets for the benefit of an associate company, unless the Commission determines that the cross-subsidization, pledge, or encumbrance will be consistent with the public interest."²⁰ The Commission's regulations establish verification and informational requirements for applicants that seek a determination that a transaction will not result in inappropriate cross-subsidization or pledge or encumbrance of utility assets.²¹

18 C.F.R. § 385.216(b)(1) (2010). We will grant the withdrawal by the Maryland Municipals.

¹⁷ 18 C.F.R. § 385.214 (2010).

¹⁸ *Id.* § 385.213(a)(2).

¹⁹ *See* Merger Policy Statement, FERC Stats. & Regs. at 30,111.

²⁰ 16 U.S.C. § 824b(a)(4) (2006).

²¹ 18 C.F.R. § 33.2(j) (2010).

C. Analysis Under Section 203

1. Effect on Competition – Horizontal Market Power

a. Applicants' Analysis

33. Applicants state that the proposed transaction will not adversely affect horizontal competition. Applicants reviewed the markets in which FirstEnergy and Allegheny have generation, and identified overlapping generation in the PJM market.²² Applicants analyzed the PJM market as a whole with American Transmission integrated into PJM as the relevant market for the proposed transaction. Additionally, Applicants analyzed several alternative markets including: (1) PJM with American Transmission remaining in the Midwest ISO; (2) Midwest ISO with American Transmission remaining in the

²² Applicants retained Dr. William H. Hieronymus to analyze the competitive effects of the proposed transaction, and attached his testimony as Attachment J to the Application. Dr. Hieronymus performed an Appendix A analysis, in which he determined the pre- and post-transaction market shares from which the market concentration or Herfindahl-Hirschman Index (HHI) change can be derived. The HHI is a widely accepted measure of market concentration, calculated by squaring the market share of each firm competing in the market and summing the results. The HHI increases both as the number of firms in the market decreases and as the disparity in size between those firms increases. Markets in which the HHI is less than 1,000 points are considered to be unconcentrated; markets in which the HHI is greater than or equal to 1,000 but less than 1,800 points are considered to be moderately concentrated; and markets in which the HHI is greater than or equal to 1,800 points are considered to be highly concentrated. The Commission has adopted the Federal Trade Commission/Department of Justice Horizontal Merger Guidelines, which state that in a horizontal merger, an increase of more than 50 HHI points in a highly concentrated market or an increase of 100 HHI points in a moderately concentrated market fails its screen and warrants further review. U.S. Department of Justice and Federal Trade Commission, *Horizontal Merger Guidelines*, 57 Fed. Reg. 41,552 (1992), *revised*, 4 Trade Reg. Rep (CCH) ¶ 13,104 (April 8, 1997). We note that on April 20, 2010, the Federal Trade Commission (FTC) and Department of Justice (DOJ) proposed new Horizontal Merger Guidelines that revise these guidelines. On August 19, 2010, the FTC and DOJ issued final, revised versions of the guidelines based on this proposal. The revised guidelines raise the thresholds for the measures of market concentration. Our analysis here is based in the guidelines in effect prior to August 19, 2010.

Midwest ISO; and (3) PJM East.²³ Applicants also analyzed a joint PJM/Midwest ISO market and a “Midwest” market²⁴ composed of parts of PJM and the Midwest ISO.²⁵

i. PJM (with American Transmission integrated into PJM)

34. Applicants analyzed the PJM market as a whole assuming the integration of the American Transmission system into PJM. Applicants performed the Delivered Price Test (DPT) analysis of Economic Capacity and Available Economic Capacity. Applicants contend that the analysis of Economic Capacity is more relevant than the Available Economic Capacity analysis because most states in the study area have implemented retail competition. Under the Economic Capacity measure, the post-merger PJM market with American Transmission is unconcentrated (i.e., HHI is below 1,000) in all but three periods. Specifically, the post-merger HHIs are 765 (summer super-peak 1), 892 (summer super-peak 2), 980 (summer peak), 1,054 (summer off-peak), 866 (winter super-peak), 969 (winter peak), 1,000 (winter off-peak), 870 (shoulder super-peak), 990 (shoulder peak), and 1,014 (shoulder off-peak) with the summer off-peak, winter off-peak, and shoulder off-peak period HHIs above 1,000 with HHI increases of over 100. The failures which occur in the summer off-peak, winter off-peak, and shoulder off-peak periods are the only screen failures in the Applicants’ horizontal market power analysis.²⁶

²³ As noted above, the transfer of operational control of Applicants’ transmission facilities to PJM would be effective on June 1, 2011.

²⁴ In their composition of the “Midwest” market, Applicants’ analysis excluded areas in the Midwest ISO that are frequently constrained, such that the additional generation located in them cannot compete in the “Midwest” market. Additionally, the Applicants excluded the whole of PJM East. *See* Application, Exhibit J – Testimony of William H. Hieronymus at 16 n. 33.

²⁵ We note that the Commission has not identified either of these areas as a market the Applicants would otherwise be required to study. Accordingly, we will not review Applicants’ analysis of a joint PJM/Midwest ISO market or the “Midwest” market. *See infra* n.39. While the Commission did not require the analysis of these two alternative markets and does not find that either analysis was necessary for our determination, we note that the results of each of these analyses show that the merger would not cause any competitive concern in either area. *See* Application, Exhibit J – Testimony of William H. Hieronymus at 16-17.

²⁶ Applicants note that under the HHI threshold of 1,500 for an unconcentrated market in the new DOJ Guidelines there would not be HHI failures in any of the ten periods based on the study filed by Applicants. Answer at 6-7.

Applicants contend that these screen failures do not raise any competitive concerns because they occur during off-peak periods when the units setting the market price are large baseload nuclear and coal units. Under the Available Economic Capacity measure, the post-merger PJM market with American Transmission is unconcentrated in all periods, with HHIs significantly below the 1,000 threshold. The analysis also shows no impact on the Ancillary Services markets in PJM post American Transmission integration, or on the PJM capacity markets.

ii. PJM (prior to American Transmission being integrated into PJM)

35. Applicants also analyzed the PJM market under the assumption that American Transmission remained in the Midwest ISO. Under the Economic Capacity measure, post-merger HHIs in this analysis range from 752 to 1,059, with the highest HHI in the summer off-peak period. Even though the market becomes relatively concentrated in the summer off-peak and shoulder off-peak periods (with HHIs of 1,059 and 1,004, respectively), the HHI increases of 31 and 32 are well below the 100 point threshold the Commission uses for screening purposes.²⁷ Accordingly, Applicants argue that the DPT analysis of the PJM market prior to American Transmission's integration shows the transaction will have no adverse effect on competition in that market.

iii. Midwest ISO (prior to American Transmission being integrated into PJM)

36. Applicants also analyzed the Midwest ISO market under the assumption that American Transmission's system remained in that market. The Midwest ISO market post-merger is unconcentrated in all time periods, with HHI increases all below 20.²⁸ Accordingly, Applicants state that the DPT analysis of the Midwest ISO market shows that the transaction will have no adverse effect on competition in that market.

iv. PJM-East

37. Applicants also analyzed the PJM-East submarket within PJM. In PJM East, which consists of New Jersey, the Delmarva Peninsula, and eastern Pennsylvania, the analysis shows that the market is moderately concentrated in seven periods with HHIs ranging from 936 to 1,228, but the HHI increases are well under 100. Accordingly,

²⁷ Order No. 642, FERC Stats. & Regs. at 31,896 n.62.

²⁸ Applicants did not study the effect of the merger on the Midwest ISO market after American Transmission's integration into PJM since neither FirstEnergy nor Allegheny will own generation in the Midwest ISO once that occurs.

Applicants assert that the DPT analysis of the PJM-East submarket shows the transaction will have no adverse effect on competition.

b. Protests and Comments

38. Citizen Power states that it is concerned about the impact of the proposed transaction on competition, and it also states that the Commission should fully investigate the proposed transaction. The Joint Consumer Advocates and the Pennsylvania Advocate both raise concerns about the effect of the proposed transaction on competition.

39. First, the Joint Consumer Advocates and the Pennsylvania Advocate both object to the fact that Applicants have argued that no mitigation is necessary regarding the three screen failures identified in their analysis. The Joint Consumer Advocates state that because the application demonstrates market power above acceptable thresholds, Applicants should be required to mitigate any market power issues. They suggest that the Commission consider divestiture of generation assets. Additionally, the Pennsylvania Advocate argues that Applicants' claim that there is no need to address the screen failures is inconsistent with the public interest because competitive harms could result from the exercise of market power in those periods.

40. Second, the Pennsylvania Advocate asserts that Applicants' proposal could allow them to withhold capacity from the market. Specifically, it states that the proposed transaction would provide Applicants with the ability and incentive to withhold output in order to increase market price, and Applicants' profits, substantially. According to the Pennsylvania Advocate, Applicants would have the ability and incentive to withhold coal units during off-peak periods. Specifically, it states that Allegheny has eight coal plants that are located on the flat portion of the supply curve which are candidates for withholding. The Pennsylvania Advocate argues that Applicants could increase their net energy revenues by approximately \$100,000 per hour by withholding the plants in question. It states that economic withholding of these plants in the form of high bid prices could be detected by the market monitor, but other forms of withholding, such as premature retirement, are beyond the purview of the market monitor and the RTO, unless the units are necessary for regional reliability.

41. Third, the Pennsylvania Advocate argues that Applicants' analysis is incomplete because it fails to analyze all the appropriate geographic and product markets. It contends that one appropriate geographic market that Applicants overlooked is PJM West, which it describes as the PJM market, without PJM East. Additionally, the Pennsylvania Advocate states that because Applicants each control significant amounts of low cost generation they should be required to analyze the market in relation to competitive procurement of power in Pennsylvania and other restructured PJM states. The Pennsylvania Advocate also contends that the analysis is incomplete because it does not take into account projects Applicants will undertake in the future that will increase their generation capacity.

c. Answers

42. In response to the requests of the Joint Consumer Advocates and the Pennsylvania Advocate for a mitigation proposal in light of screen failures, Applicants state that these arguments ignore the Commission's position that screen failures are not proof of a market power problem and are only indicative of a possible need for further inquiry. Applicants argue that when there are only a limited number of screen failures, the Commission has in the past considered whether those failures represent systematic screen failures.²⁹

Applicants state that the screen failures identified in their analysis are similar to others that the Commission has found were not systematic and thus not likely to raise competitive concerns.³⁰

43. Applicants state that the Pennsylvania Advocate's argument that the proposed transaction could allow Applicants to withhold capacity from the market was based on an illustrative example of an instance of withholding rather than a comprehensive analysis of the transaction. Applicants also contend that the example is flawed because it simply illustrates mathematically how withholding coal capacity under certain circumstances could increase gross energy revenues. Applicants state that it is based on unrealistic assumptions and does not include the costs that the merged company would incur to execute this withholding strategy.³¹

44. In response to arguments that Applicants' analysis is incomplete because it fails to analyze all the appropriate geographic markets, Applicants state that they have analyzed all relevant geographic markets that they are required to analyze under long-standing Commission precedent on the relevant geographic markets for section 203 applicants in PJM, i.e., the PJM market as a whole and PJM East, as well as two alternate geographic markets. They note that the Commission has stated that it will define specific submarkets and that there would then be a rebuttable presumption that those submarkets should be used for purposes of conducting a market power analysis.³² Applicants also note that the Commission stated that it would acknowledge a submarket only if a party submits sufficient evidence for doing so, such as evidence as to whether there are frequently binding transmission constraints during historical seasonal peaks. Applicants contend

²⁹ Answer at 4.

³⁰ *Id.* at 4-5 (citing *Nevada Power Co.*, 113 FERC ¶ 61,265, at P 15 (2005) (*Nevada Power*)).

³¹ *Id.* at 9.

³² *Id.* at 11.

that no protestor submitted evidence to support its argument that there should be analysis beyond what the Applicants submitted.³³

45. Finally, Applicants dispute that their analysis is flawed because they needed to analyze the competitive procurement market in Pennsylvania and other restructured states and did not consider the proposed Norton Energy Storage Project. They argue that they adequately analyzed any potential market power that results from the proposed transaction and that the Commission does not usually require the study of competitive procurement markets or planned projects that do not yet exist.³⁴

46. The Joint Consumer Advocates state in their answer that while Applicants' Appendix A analysis does not constitute determinative evidence that the proposed transaction will give the Applicants market power, the screen failures described in the application are valid indicators of potential market power issues. They maintain that the Applicants have not shown why there is no competitive problem under the specific facts presented in this case. The Joint Consumer Advocates maintain that Applicants have simply asserted in their answer that the Commission should approve their application because it has approved other mergers that presented market concentration issues. They also maintain that Applicants have simply reiterated their argument that the off-peak screen failures occur when the supply curve is relatively flat and when the generating capacity involved is mostly baseload capacity that is not well-suited for executing a withholding strategy. The Joint Consumer Advocates reiterate that the Pennsylvania Consumer Advocate's protest demonstrates that Applicants would have both the ability and the incentive to withhold during off-peak periods. They argue that since Applicants have not met their burden of demonstrating that the proposed transaction will not harm competition and have not proposed mitigation measures, the Commission should determine an appropriate mitigation strategy if it determines that mitigation is necessary.

47. Citizen Power notes that Applicants state in their answer that an evidentiary hearing is not required in this matter because no material issues of fact have been raised and that the Commission can base its analysis on the information contained in the record. Citizen Power states that it disagrees with this conclusion. It maintains that a screen failure, regardless of its degree, triggers the need for further analysis. It also states that while the *Nevada Power* case cited by the Applicants can provide relevant information, it cannot provide information sufficient to determine the effects of the proposed transaction on market power in Pennsylvania. Finally, Citizen Power states that the fact that the screen failures occur in off-peak periods does not provide information that is sufficient to

³³ *Id.* at 13 - 14.

³⁴ *Id.* at 14-16.

show that the proposed transaction will not result in market power. Citizen Power thus concludes that this matter should be set for a full evidentiary hearing.

d. Commission Determination

48. We find that, based on Applicants' representations, the proposed transaction will have no adverse effect on horizontal competition.

49. Applicants have shown that there are three screen failures in this case out of the ten time periods. They occur in off-peak periods where Applicants have relatively low market shares involving comparatively small HHI increases.³⁵ While we have stated that as a general matter off-peak screen failures should not be disregarded, they do not by themselves establish that a proposed transaction will adversely affect competition.³⁶ Our concern normally is with cases in which there are systematic screen failures, i.e., failures that "present a consistent pattern across time periods and/or markets,"³⁷ in markets that are highly concentrated, and where the entity seeking the approval has a significant share of the market.³⁸ From this perspective, the screen failures that Applicants present do not raise competitive concerns because they do not involve systematic failures in a highly concentrated market. In light of this and as further explained below, we find that there is no indication that the proposed transaction will create or enhance the Applicants' ability to exercise market power.

50. First, we do not find the argument of the Pennsylvania Advocate concerning withholding of generating capacity to be convincing. The Pennsylvania Advocate provides a hypothetical calculation showing that the withholding strategy it describes could provide the Applicants with increases in net energy revenues of approximately \$100,000 per hour. However, the Pennsylvania Advocate has not provided any basis for concluding that the strategy is plausible in light of the specific facts of this case. The

³⁵ The ten time periods are summer super-peak 1, summer super-peak 2, summer peak, summer off-peak, winter super-peak, winter peak, winter off-peak, shoulder super-peak, shoulder peak, and shoulder off-peak. Specifically, post merger HHIs for the summer off-peak, winter off-peak, and shoulder off-peak periods were 1,054, 1,000, and 1,014, with HHI increases of 111, 111, and 110, respectively. Further, the highest market share in these three periods is 15.4 percent.

³⁶ *Ohio Edison Co.*, 94 FERC ¶ 61,291, at 62,044 (2001).

³⁷ *CP&L Holdings, Inc.*, 92 FERC ¶ 61,023, at 61,054 (2000).

³⁸ *Nevada Power Co.*, 113 FERC ¶ 61,265, at P 15 (2005) (*Nevada Power*).

Pennsylvania Advocate's argument, as we understand it, is simply that low cost units "on a flat section of the supply curve could be candidates for withholding under some circumstances. . . ." ³⁹ This general observation does not demonstrate why withholding is a concern under the specific circumstances presented here, and the Pennsylvania Advocate does not otherwise provide any analysis that would constitute such a demonstration. Moreover, we note that withholding the plants through high bid prices could be detected by the market monitor, which even the Pennsylvania Advocate, concedes. Moreover, regarding the Pennsylvania Advocate's claim that applicants could withhold the plants by retiring them prematurely, we find this claim to be both speculative and an unlikely scenario considering the time, cost, and operational difficulty associated with bringing these plants back into service in order to temporarily manipulate prices. The Pennsylvania Advocate has not explained, let alone provided evidence demonstrating, that the benefits of such a strategy would outweigh the costs. Additionally, the Commission has found when looking at the effect on competition in other cases that when the units in question are baseload, as in the hypothetical situation raised here, withholding capacity would not raise prices by enough to generate sufficient additional revenues to offset the revenues that would be lost to Applicants from having to forgo sales from its low-cost generation. ⁴⁰

51. In short, the Pennsylvania Advocate does not explain fully how a baseload withholding strategy would prove beneficial to the Applicants, and as a result it does not show the existence of an incentive to withhold through premature retirement.

52. Second, the Pennsylvania Advocate maintains that PJM West is a separate submarket and that Applicants have failed to analyze it. However, as the Commission has previously explained, the critical issue in defining relevant geographic markets is identifying the sellers who can physically and economically compete in a market. ⁴¹ Where transmission constraints are binding such that no additional imports from outside the region are possible, the region should be defined as a separate relevant geographic

³⁹ Pennsylvania Advocate Protest at 7.

⁴⁰ *USGen. New England, Inc*, 109 FERC ¶ 61,361 at P 23 (2004); *Ohio Edison Co.*, 94 FERC ¶ 61,291, at 62,044 (2001); *Commonwealth Edison Company*, 91 FERC ¶ 61,036, at 61,133 n.42 (2000).

⁴¹ Merger Policy Statement, FERC Stats. & Regs. at 30,132; *Wisvest-Connecticut, LLC*, 96 FERC ¶ 61,101, at 61,401-02 (2001) (convening a technical conference in a section 203 proceeding in light of evidence of significant transmission constraints and significant screen failures in numerous time periods).

market.⁴² We find that the Pennsylvania Advocate has failed to justify why PJM West should be treated as a separate submarket based on this standard. The Pennsylvania Advocate bases its argument on the fact that PJM West is a major trading hub in PJM and that Applicants will have a significant concentration of low-cost generation in that area. It did not cite any evidence, such as binding transmission constraints or price separation data, to support the existence of a separate PJM West submarket. We have carefully considered the Pennsylvania Advocate's argument, and the Commission is not aware of any evidence that there is a binding transmission constraint that would warrant PJM West being considered a separate market. The Commission has in the past noted that binding transmission constraints within PJM are west to east, rather than east to west,⁴³ which means that generators in PJM East are not constrained from the remainder of PJM. Accordingly, absent sufficient evidence of transmission constraints or price separation that would prevent suppliers from all of PJM from selling into PJM West, there is no basis for requiring Applicants to perform a separate analysis of PJM West, and we find no evidence in this record or otherwise that PJM West is a separate submarket within PJM.⁴⁴

53. In addition, we affirm that Applicants' analysis is complete and that they provided all appropriate analyses of geographic and product markets. Regarding the Pennsylvania Advocate's request for an analysis of the competitive procurement market, we note that the low-cost generation they are concerned with is already being considered as part of the analysis of PJM provided by Applicants. The DPT analysis looks at Applicants' generation at a variety of price points, and thus these low-cost generators are already accounted for in Applicants' studies. Additionally, with regard to the proposed Norton Energy Storage Project, the Pennsylvania Advocate is correct that the Commission has previously indicated that, as part of its merger analysis, it will consider current and reasonably foreseeable developments.⁴⁵ But here Applicants have noted that there is not yet a timeframe for the construction of the Norton Energy Storage Project and thus there

⁴² *AEP Power Marketing, Inc.*, 124 FERC ¶ 61,274, at P 24-25(2008).

⁴³ *Id.*

⁴⁴ We also note that Applicants prepared an analysis of a "Midwest" market, which included PJM West along with eastern portions of the Midwest ISO. While the Commission did not use this analysis in making its determinations, this analysis did provide additional evidence that there would likely not be competitive concerns raised if the PJM West market was analyzed.

⁴⁵ Order No. 642, FERC Stats. & Regs. at 31,918.

is no evidence in the record showing that development of the project is a foreseeable and reasonably certain to occur.⁴⁶

54. In response to answers of the Joint Consumer Advocates and Citizen Power, we note that Applicants do not cite our prior orders to argue that we should approve their transaction because we have approved other transactions where screen failures occur. They cite them to show that where there are a limited number of screen failures, the Commission will consider whether those failures represent systematic screen failures that suggest that the transaction would create or enhance the merged company's ability to exercise market power. We also note that the Joint Consumer Advocates base their claim that the proposed transaction raises market power issues on the Pennsylvania Advocate's protest. As we explain above, that protest does not provide analysis indicating the presence of systematic screen failures.

55. We further note that Citizen Power is incorrect in its claim that screen failures trigger a need for an evidentiary hearing regardless of their degree. The Commission has never held that the mere existence of a screen failure makes a hearing necessary. As shown above, the Commission has on numerous occasions found that screen failures of the type under consideration here can be shown not to raise market power concerns without setting the matter for hearing. Finally, while Citizen Power disagrees with Applicants' contention that no material issues of fact that require a hearing have been presented, it does not identify any such material issues of fact. Instead, Citizen Power simply asserts that the fact that screen failures occur in off-peak periods is not sufficient to confirm that the proposed transaction does not raise market power issues. However, as noted above, off-peak screen failures do not by themselves establish that a proposed transaction will adversely affect competition.⁴⁷ Thus for an off-peak screen failure to establish the existence of a material issue of fact that necessitates an evidentiary hearing, it should be accompanied by some additional factor(s) that suggest that the failure is indicative of a potential problem. Citizen Power has failed to provide such a showing, and we therefore deny its request for a hearing.

2. Effect on Competition – Vertical Market Power

a. Applicants' Analysis

56. Applicants state that neither FirstEnergy nor Allegheny owns natural gas pipeline or distribution assets. They also argue that the transmission facilities that each of them

⁴⁶ *Oklahoma Gas and Electric Company*, 105 FERC ¶ 61,297, at P 32 (2003).

⁴⁷ *See supra* P 49.

own are under the operational control of Commission-approved RTOs. Applicants state that the only potential upstream ownership issue that the proposed transaction raises results from FirstEnergy's ownership of a 50 percent interest in a joint venture that owns the output of the Signal Peak coal mine in Roundup, Montana. However, Applicants state that their analysis of the relevant electricity markets demonstrates that they are not highly concentrated, and they argue as a result that no vertical market power concern exists regardless of FirstEnergy's share of the total Powder River Basin coal production.⁴⁸ Applicants thus conclude that no vertical market power issues are raised by the proposed transaction.

b. Commission Determination

57. Transactions that combine electric generation assets with inputs to generating power (such as natural gas, transmission, or fuel) can harm competition if the transaction increases a firm's ability or incentive to exercise vertical market power in wholesale electricity markets. For example, by denying rival firms access to inputs or by raising their input costs, a firm created by the transaction could impede entry of new competitors or inhibit existing competitors' ability to undercut an attempted price increase in the downstream wholesale electricity market. Applicants have shown that the proposed transaction does not raise any of these concerns.

3. Effect on Rates

a. Applicants' Analysis

58. Applicants state that the proposed transaction will not have an adverse impact on transmission rates or on rates for captive, long-term wholesale requirements customers. They also make a "hold harmless" commitment, stating that for a period of five years they will not seek to include merger-related costs in their filed transmission revenue requirements or their wholesale requirements rates unless they can demonstrate merger-related savings equal to or in excess of the merger-related costs. Applicants state that the Commission has approved similar commitments regarding the effect of a proposed transaction on rates in the past.⁴⁹

⁴⁸ Application at 34-35.

⁴⁹ Application at 35 (citing *Ameren Corp.*, 108 FERC ¶ 61,094, at P 68 (2004); *Great Plains Energy Inc.*, 121 FERC ¶ 61,069, at P 48 (2007)).

b. Protests and Comments

59. Citizen Power states that it is concerned about the impact of the proposed transaction on rates. It also states that the Commission should set this matter for a full evidentiary hearing. The Joint Consumer Advocates and Pennsylvania Advocate each request that the Commission ensure that Applicants' hold harmless proposal is enforceable and administratively manageable. Each further argues that the Commission should require Applicants to demonstrate, in future rate proceedings that claimed costs are not attributable to the merger.

c. Answers

60. In response to the Joint Consumer Advocates and Pennsylvania Advocate, Applicants state that the Commission has on several occasions found the type of commitment they propose to be adequate.⁵⁰ Applicants maintain that the Commission has available to it adequate methods for ensuring that the commitments it approves are enforceable and manageable, and there is thus no need to impose any additional requirements.

61. The Joint Consumer Advocates state in their answer that Commission access to Applicants' books and records does not ensure that Applicants will honor their hold harmless commitment, and the Commission should require Applicants to demonstrate in future rate proceedings that costs they seek to recover in rates do not include costs attributable to the merger.

d. Commission Determination

62. We accept Applicants' commitment to hold transmission and wholesale customers harmless from costs related to the proposed transaction. We accept Applicants' hold harmless commitment, which we interpret to include all transaction-related costs, not only costs related to consummating the transaction. We note that nothing in the application indicates that rates to customers will increase as a result of transaction-related costs created by the proposed transaction. The Commission will be able to monitor the Applicants' hold harmless commitment under the books and records provision of PUHCA 2005 and its authority under section 301(c) of the FPA, and the commitment is fully enforceable based on the Commission's authority under section 203 of the FPA.

63. If Applicants seek to recover transaction-related costs through their wholesale power or transmission rates they must submit a compliance filing that details how they

⁵⁰ Answer at 20.

are satisfying the hold harmless requirement. If Applicants seek to recover transaction-related costs in an existing formula rate that allows for such recovery, then that compliance filing must be filed in the section 205 docket in which the formula rate was approved by the Commission, as well as in the instant section 203 docket.⁵¹ We also note that, if the Applicants seek to recover transaction-related costs in a filing whereby it is proposing a *new* rate (either a new formula rate or a new stated rate), then that filing must be made in a *new* section 205 docket as well as in the instant section 203 docket.⁵² The Commission will notice such filings for public comment. In such filings, Applicants must: (1) specifically identify the transaction-related costs they are seeking to recover, and (2) demonstrate that those costs are exceeded by the savings produced by the transaction, in addition to any requirements associated with filings made under section 205. Such a hold harmless commitment will protect customers' wholesale and transmission rates from being adversely affected by the proposed transaction. These requirements should address the concerns of the Joint Consumer Advocates and Pennsylvania Advocate.

64. Accordingly, in light of these considerations and requirements, we find that the proposed transaction will not adversely affect rates.

65. Finally, Citizen Power has not identified a material issue of fact concerning the impact of the proposed transaction on rates, and we therefore reject its request for a full evidentiary hearing regarding the impact of the proposed transaction on rates.

4. Effect on Regulation

a. Applicants' Analysis

66. Applicants state that FirstEnergy and Allegheny are subject to the Commission's authority under PUHCA 2005. They also state that each of their public utility subsidiaries will remain a jurisdictional public utility after the proposed transaction closes, and there will be no change in the Commission's jurisdiction over them. Applicants thus conclude that the proposed transaction will not have an adverse effect on Commission jurisdiction. Applicants also state that the proposed transaction will not have an effect on state regulation.

⁵¹ In this case the filing would be a compliance filing in both the section 203 and 205 dockets.

⁵² In this case the filing would be a compliance filing in the section 203 docket, but a rate application in the section 205 docket.

b. Commission Determination

67. We find no evidence that either state or federal regulation will be impaired by the proposed transaction. The Commission's review of a transaction's effect on regulation focuses on ensuring that it does not result in a regulatory gap at the federal or state level.⁵³ We find that the merger will not create a regulatory gap at the federal level because the Commission will retain its regulatory authority over the companies after the transaction. The Commission stated in the Merger Policy Statement that it ordinarily will not set the issue of the effect of a transaction on state regulatory authority for a trial-type hearing where a state has authority to act on the transaction. However, if the state lacks this authority and raises concerns about the effect on regulation, the Commission stated that it may set the issue for hearing, and that it will address such circumstances on a case-by-case basis.⁵⁴ We note that no party alleges that regulation would be impaired by the proposed transaction, and no state commission has requested that the Commission address the issue of the effect on state regulation.

5. Cross-subsidization

a. Applicants' Analysis

68. Applicants assert that the proposed transaction will not result in, at the time of the proposed transaction or in the future, cross-subsidization of a non-utility associate company or the pledge or encumbrance of utility assets for the benefit of an associate company. Specifically, Applicants state that the proposed transaction will not affect the public utility subsidiaries of the merged company as separate legal entities. It involves only a stock-for-stock merger that does not call for any transfers of any facilities of the traditional public utility associate companies of FirstEnergy or Allegheny. Moreover, Applicants state that the Commission has and will continue to have the ability to provide ongoing protection against cross-subsidization through its authority over the rates, terms, and conditions of service associated with all jurisdictional transmission facilities owned by FirstEnergy and its Allegheny subsidiary, as well as through its authority over the merged company as a public utility holding company. Applicants further state that because the proposed transaction does not affect any state utility commission's jurisdiction over any subsidiary of FirstEnergy or Allegheny, the ability of all state commissions to address cross-subsidization issues will be unaffected by the proposed transaction.⁵⁵

⁵³ Merger Policy Statement, FERC Stats. & Regs. at 30,124.

⁵⁴ *Id.* at 30,125.

⁵⁵ Application, Exhibit M - Affidavit of Mark Clark at P 7.

69. Applicants verify that the transaction will not result in: (i) any transfer of facilities between a traditional utility associate company that has captive customers or that owns or provides transmission service over jurisdictional facilities, and an associate company; (ii) any new issuances of securities by a traditional public utility associate company that has captive customers or that owns or provides transmission service over jurisdictional transmission facilities, for the benefit of an associate company; (iii) any new pledge or encumbrance of assets of a traditional public utility associate company that has captive customers or that provides transmission service over jurisdictional transmission facilities, for the benefit of an associate company; or (iv) any new affiliate contract between a non-utility company and a traditional public utility associate company that has captive customers or that owns or provides transmission service over jurisdictional transmission facilities, other than non-power goods and services agreements subject to review under sections 205 and 206 of the FPA. Further, Applicants and their affiliates disclose their existing pledges and encumbrances of utility assets, as required under Order No. 669-A and 18 C.F.R. § 33.2(j)(1).

b. Commission Determination

70. Based on the facts as presented in the application, we find that the transaction will not result in cross-subsidization or the pledge or encumbrance of utility assets for the benefit of an associate company. We note that no party has argued otherwise. When a controlling interest in a public utility is acquired by another company, whether a domestic company or a foreign company, the Commission's ability to protect public utility customers adequately against inappropriate cross-subsidization may be impaired unless it has access to the acquirer's books and records. Section 301(c) of the FPA gives the Commission authority to examine the books and records of any person who controls, directly or indirectly, a jurisdictional public utility insofar as the books and records relate to transactions with or the business of such public utility. In addition, the merged company will be subject to record-keeping and books and records requirements of PUHCA 2005. The approval of this transaction is based on such ability to examine books and records.

D. Accounting Analysis

71. Applicants provided proposed accounting entries recording the effects of the merger transaction on the books of Allegheny's jurisdictional public utilities (Allegheny subsidiaries). Applicants state the proposed transaction will be accounted for as an acquisition of Allegheny by FirstEnergy in accordance with the Financial Accounting Standards Board's Accounting Standard Codification (ASC) Topic 805, Business Combinations. Applicants state that under ASC Topic 805, all identifiable assets acquired, liabilities assumed and any non-controlling interest of the acquired company will be recorded at their fair value. Applicants explain that for purposes of determining fair value, the carrying value of the Allegheny subsidiaries' assets and liabilities represents fair value with the exception of long-term debt. Therefore, Applicants'

proposed accounting does not include adjustments to the Allegheny subsidiaries' assets and liabilities for Commission accounting and reporting purposes, with the exception of a fair value adjustment, net of deferred taxes, increasing the balance of long-term debt in Account 224, Other Long-Term Debt.⁵⁶ The proposed accounting also amortizes the fair value adjustment of long-term debt to Account 427, Interest on Long-Term Debt, over the term of the related debt. Applicants state that the adjustments to long-term debt will not impact rates, because recovery of the cost of long-term debt is obtained indirectly through the allowed cost-based rate of return applied to the rate base in future rate proceedings. Applicants therefore do not propose recording regulatory assets or liabilities as offsets to fair value adjustments of long-term debt.

72. We accept the proposed accounting to account for the merger as a business combination under ASC Topic 805 and recognize the carrying value of the Allegheny subsidiaries' assets and liabilities, other than long-term debt, as their fair value. We also do not take exception with the proposed accounting related to the fair value adjustment to long-term debt. However, we recommend the Allegheny subsidiaries record the fair value adjustment and the related amortization to interest expense using a separate sub-account of Account 224 and Account 427, respectively. Additionally, the Allegheny subsidiaries must disclose in the notes to the financial statements of their FERC Form 1 the nature and amount of the fair value adjustment to long-term debt and the related amortization to interest expense.

73. Applicants also estimate that they will incur transaction costs of roughly \$120 million, and each jurisdictional subsidiary is charging transaction costs to Account 923, Outside Services, as they are incurred. The Commission has previously determined that merger transaction costs are considered non-operating in nature and should be recorded in Account 426.5, Other Deductions.⁵⁷ Account 426.5 includes miscellaneous expense items which are non-operating in nature.⁵⁸ The Commission has also determined that

⁵⁶ Application at Appendix 1.

⁵⁷ See, e.g., *Midwest Power Systems, Inc. and Iowa-Illinois Gas and Electric Company*, 71 FERC ¶ 61,386, at 62,509 (1995); *MidAmerican Energy Company and MidAmerican Energy Holdings Company*, 85 FERC ¶ 61,354, at 62,370 (1998); *Wisconsin Electric Power Company*, 74 FERC ¶ 61,069, at 61,192 (1996).

⁵⁸ The Commission's accounting regulations provide for the classification of non-operating expenses in Accounts 426.1 through 426.5. The Note to the Special Instructions of these accounts states, "The classification of expenses as non-operating and their inclusion in these accounts is for accounting purposes. It does not preclude Commission consideration of proof to the contrary for ratemaking or other purposes."

post-merger transition costs should be charged to the appropriate operating expense account as incurred.⁵⁹ Accordingly, the jurisdictional subsidiaries should record all merger-related costs in Account 426.5 or the appropriate operating expense account as discussed above.

74. Applicants must provide proposed final accounting for the transaction within six months of the date that the transaction is consummated consistent with Electric Plant Instruction No. 5, Electric Plant Purchased or Sold.

E. Other Considerations

75. The Joint Consumer Advocates and the Pennsylvania Advocate each requested that the Commission set this matter for a full evidentiary hearing. Applicants responded by arguing that no issues of material fact have been raised, and the Commission's analysis of the merger can be conducted on the basis of the information included in the Application.

76. The Commission finds that, as discussed above, the Application presents sufficient information to render a decision and that no issues of material fact have been raised that require a hearing. The Pennsylvania Advocate identifies Applicants' statements that coal plants are not suitable for withholding as raising a material issue of fact that requires a hearing. We have addressed the Pennsylvania Advocate's contentions on that issue above and have rejected them. They therefore raise no issues that require an evidentiary hearing. The Joint Consumer Advocates raise a number of issues concerning the proposed transaction and describe some of them as requiring "further analysis."⁶⁰ However, the Joint Consumer Advocates do not identify any of the matters that they see as raising concerns as matters involving a material issue of fact that requires an evidentiary hearing for resolution.

77. Finally, information and/or systems connected to the bulk power system involved in this transaction may be subject to reliability and cyber security standards approved by the Commission pursuant to FPA section 215. Compliance with these standards is mandatory and enforceable regardless of the physical location of the affiliates or investors, information databases, and operating systems. If affiliates, personnel or investors are not authorized for access to such information and/or systems connected to

⁵⁹ See, e.g., *Sierra Pacific Power Company and Nevada Power Company*, 87 FERC ¶ 61,077, at 61,335 (1999); *American Electric Power Company and Central and Southwest Corporation*, 85 FERC ¶ 61,201 at 61,822 (1998).

⁶⁰ Joint Consumer Advocates Protest at 4.

the bulk power system, a public utility is obligated to take the appropriate measures to deny access to this information and/or the equipment/software connected to the bulk power system. The mechanisms that deny access to information, procedures, software, equipment, and the like, must comply with all applicable reliability and cyber security standards. The Commission, North American Electric Reliability Corporation, or the relevant regional entity may audit compliance with reliability and cyber security standards.

The Commission orders:

(A) The proposed transaction is hereby authorized, as discussed in the body of this order.

(B) Applicants must inform the Commission within 30 days of any material change in circumstances that departs from the facts the Commission relied upon in granting the application.

(C) The foregoing authorization is without prejudice to the authority of the Commission or any other regulatory body with respect to rates, service, accounts, valuation, estimates or determinations of costs, or any other matter whatsoever now pending or which may come before the Commission.

(D) Nothing in this order shall be construed to imply acquiescence in any estimate or determination of cost or any valuation of property claimed or asserted.

(E) The Commission retains authority under sections 203(b) and 309 of the FPA to issue supplemental orders as appropriate.

(F) Applicants shall make any appropriate filings under section 205 of the FPA, as necessary, to implement the proposed transaction.

(G) Applicants shall notify the Commission within 10 days of the date on which the transaction is consummated.

(H) Applicants shall account for the transaction in accordance with Electric Plant Instruction No. 5 and Account 102, Electric Plant Purchased or Sold, of the Uniform System of Accounts and consistent with the body of this order. Applicants shall submit their final accounting entries within six months of the date that the transaction is consummated, and the accounting submissions shall provide all the accounting entries and amounts related to the transaction along with narrative explanations describing the entries.

(I) If Applicants seek to recover transaction-related costs through any existing formula rate or any new rate (either a new formula rate or a new stated rate), they must first submit an informational filing to the Commission that details how they are satisfying the hold harmless requirement. In particular, in such a filing, Applicants must:

- (1) specifically identify the transaction-related costs they are seeking to recover; and
- (2) demonstrate that those costs are exceeded by the savings produced by the merger.

By the Commission.

(S E A L)

Kimberly D. Bose,
Secretary.

Document Content(s)

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