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SUPREME COURT OF APPEALS
OF WEST VIRGINIA

Case No. 13-1126

IN THE SUPREME COURT OF APPEALS OF WEST VIRGINIA

REPLY BRIEF

WEST VIRGINIA
CITIZEN ACTION GROUP

PETITION FOR SUSPENSION
OF PLURALITY OPINION AND ORDER OF
PUBLIC SERVICE COMMISSION
DATED OCTOBER 7, 2013
IN CASE NO. 12-1571-E-PC

Granting Petition To Transfer Electric Generating Assets
Between Affiliates At A Price Including A
Quarter Billion Dollar "Acquisition Premium"

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A. The pass through of $257 million of "acquisition premium" can be avoided by appellate relief, and this case is, therefore, not moot.

Initially, Mon Power argues that the Harrison transaction was "closed" on October 9, 2013, and that WVCAG's failure to timely seek a stay of the transaction makes it impossible to "un-ring" the closing bell. The PSC Order under review here was not issued until 6:10 PM on October 7, 2013, a time frame that would have required WVCAG to file a motion for stay, and the PSC (or this Court) to decide the motion, within something on the order of 54 hours if the closing did not occur until 11:59 PM on October 9, 2013. WVCAG respectfully submits, this short time frame for filing a stay is patently unreasonable.

Moreover, the primary legal error which WVCAG has complained of is the PSC's approval of a transaction which will permit Mon Power, in future rates, to pass through a full $257 million of "acquisition premium" in the rates charged to customers in the future. But, as the PSC noted on page one of its October 7, 2013 decision, the first impact of the transaction is a rate reduction. Clearly, no part of the $257 million has been extracted from the West Virginia rate payers in the 90+ days that have passed since the issuance of the October 7, 2013 decision. Nothing will happen in the few months required to complete this Court's review that cannot be "trued-up" by the PSC in later proceedings. However, the PSC-approved pass through of $257 million of "acquisition premium" over the next twenty years remain demonstrates that this case is far from moot.

B. No credible alternative is offered to the general rule of "cost-based" utility regulation

Mon Power, for the first time in the Reply Brief filed before this Court, argues that the real test applicable in this proceeding is the reasonableness of "asymmetric pricing" which "does not turn on whether there is a premium or 'acquisition adjustment' to be paid. Response Brief at p. 26. Mon Power argues the reasonableness of allowing the $257 million "acquisition premium" to be passed through to ratepayers based on its own test of "asymmetric pricing" ("whether the cost is equal to or less than the market price"). This so-called "litmus test" is nowhere mentioned in the Plurality Order's justification for allowing the pass-through of the Acquisition Adjustment to customer rates.

By contrast, the PSC in its Statement of Reasons acknowledges the general rule of cost-based regulation, even while asserting that many jurisdictions, including West Virginia, have narrowly drawn exceptions to the general prohibition of inter-affiliate markups. The PSC's Statement of Reasons acknowledges that WVCAG also recognized the exceptions to the general rule, but recites the exceptions to the general rule as though WVCAG had somehow denied their existence. Statement of Reasons at 18.

The issue in each case is whether exceptions to the general rule of cost-based regulation apply, not whether they exist. Here no plausible basis for any exception is cited by any party in favor of departing from cost-base analysis for the Harrison plant.

C. Harrison offers no purported "benefits" that justify departure from the general rule of cost-based utility regulation.

The PSC asserts in its Statement of Reasons that the general benefits of the Harrison transaction provide "adequate and sufficient justification" for allowing the acquisition adjustment to be included in rates and, like Mon Power, recites the core arguments in favor of the Harrison acquisition, without tying those benefits to any special benefit that would warrant departure from the general rule of cost-based regulation, i.e., imposition of a quarter billion dollar acquisition premium. Statement of Reasons at 24-25.

Yet the purported benefits of Harrison were not compelling enough to persuade all three of the Commissioners that the transaction should occur *at all*, let alone to justify the pass-through of a quarter-billion dollar mark-up to ratepayers. According to dissenting Commissioner Palmer:

> I believe the evidence presented in this case is more convincing that the Companies and their customers are better protected if the Companies continue to use wholesale market purchases as a hedge against the significant risks associated with acquisition of the Harrison plant. Rushing into the expensive, long-term commitment proposed in the Joint Stipulation without a more thorough evaluation of other options, including the potential construction of a new natural gas combined cycle plant or the acquisition of part or all of an existing natural gas-fired power plant, is unreasonable.

App. Vol. II at 1010 (emphasis added).

1) Mon Power's dubious claim of energy and capacity shortfall does not justify the acquisition of grossly excessive Harrison capacity at a price including a quarter billion dollar acquisition premium.

Both Mon Power and the Commission emphasize Mon Power's capacity position (their capacity shortfall and the ability of Harrison to meet this shortfall) without discussing Mon Power's energy needs.[1] Response at 20; Statement of Reasons at 24. Mon Power has a relatively small shortfall in energy, despite their larger shortfall in capacity.[2] App. Vol. I 249. The purchase of a baseload plant like Harrison saddles Mon Power with significant excess

[1] "Capacity" refers to the total power that a power plant is capable of producing, measured in megawatts (MW).

[2] WVCAG witness Kunkel challenged Mon Power's method of forecasting its future capacity shortfall. WVCAG App. Vol. I 402. In their rebuttal, Mon Power initially claimed that PJM had "agreed" that Mon Power's methodology provided a reasonable forecast, but after intervenors contacted PJM to confirm this statement, Mr. Delmar changed his rebuttal to read that PJM had stated that Mon Power's methodology "could" have resulted in an accurate load forecast. App. Vol. II at 659-664. The Plurality Opinion's statement that Kunkel withdrew her testimony is inaccurate; Kunkel, a physicist trained at Princeton, Cambridge and Berkeley, testified that Mon Power's numbers could not be "confirmed," the core test applied to any hypothesis in science. That testimony is a far cry from withdrawal; it is the harshest criticism a scientist can offer for a proposition.

energy for well over a decade.[3] As stated by CAD witness Harris, Mon Power is "buying a school bus when [they] need a sedan." App. Vol. II at 782.

Excess capacity and energy to sell is a benefit of the transaction, only if the cost to ratepayers of purchasing that excess capacity and operating it to generate electricity is less than the revenues obtained by selling that excess on the wholesale market. As former PSC Consumer Advocate Billy Jack Gregg testified, off-system sales declined steadily from 2008 through 2012. In his testimony, Gregg traced the volumes of electricity in MWh generated, compared to retail sales, and noted the swing from an excess of generation (from all sources) over sales of 1.9 million MWh in 2008, to a deficit of generation over sales of -4.0 million MWh in 2012.

	2008	2009	2010	2011	2012
Generation	14,580,445	10,288,895	7,085,321	10,620,702	8,559,327
PURPA	1,478,701	1,252,541	1,272,038	1,075,837	1,278,907
Total w/ PURPA	16,059,146	11,541,436	8,357,359	11,696,539	9,838,234
Retail Sales	14,125,296	13,599,754	13,513,929	14,190,459	13.1.8 59,644
Generation-Sales	1,933,850	-2,058,318	-5,156,570	-2,493,920	-4,021,410

Commenting on these figures, Witness Gregg observed that: "In other words, the Companies purchased PJM power when it was cheaper than running some of Mon Power's marginal plants." App. Vol. I at 222. The downward trend in demand was also noted by FirstEnergy CEO Anthony Alexander who on November 5, 2013 openly admitted FirstEnergy was engaged in an overall effort to *reduce* – not increase -- capacity because of the weak

[3] Mon Power's shortfall in energy generation is 2,639 GWh in 2013, growing to 6,029 GWh in 2026. App. Vol. 1 at 38. After the proposed transaction (net 9,694 GWh), Mon Power would have 6,015 GWh of excess energy in 2014, declining to 3,665 GWh in 2026. This represents 37% excess above what Mon Power need to purchase from PJM to serve their load in 2014, declining to 20% excess in 2026. App. Vol. I at 356.

product prices. See p. 19, *infra*.

As stated by CAD witness Hornby:

> Customers may never receive a cumulative net savings from the Harrison capacity if some or all of the Companies' key assumptions prove to be even somewhat incorrect. Those key assumptions include the capacity factor of Harrison ..., wholesale market prices and the cost of complying with future carbon emission regulations.

CAD Exh. JRH-D at 24-25.

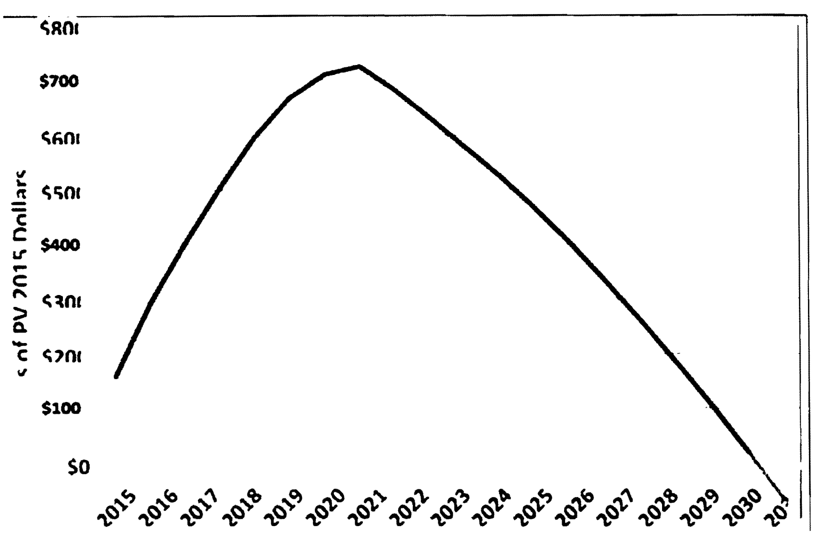
The economics of the transaction did not improve materially with the lower purchase price approved in the Plurality Opinion. App. Vol. II at 823.

Dissenting Commissioner Palmer concluded that "the imposition on ratepayers of a large, long term fixed cost for twenty-five years regardless of whether the Harrison acquisition proves cost-effective, will expose ratepayers to an unreasonable level of risk. It is likely that an adequate evaluation and exploration of alternatives would result in a capacity solution that would reduce that level of risk." App. Vol. II at 1007.

2) The "LCOE" analysis of Harrison, which stated costs as an annual "average," masked the nearly $500 million risks in actual year-to-year cash flow through 2021.

The Plurality Opinion finding that Harrison is the lowest cost alternative for Mon Power is totally dependent on the results of Mon Power's so-called "levelized cost of energy" analysis (LCOE). An LCOE analysis sums the present value of all of the costs associated with a power plant (capital costs, fuel, operations and maintenance, etc) over a twenty year period, calculates the average annual cost required to achieve the same present value, and divides this annual levelized cost by the total amount of energy produced each year, to arrive at a levelized cost, stated as an annual *average* cost, in dollars per megawatt-hour. App. Vol. 1 at 257-258 and App. Vol. II at 665. The initial result, in this case, for the Harrison purchase was an LCOE of $74/MWh, This cost, like all LCOE costs, was stated as an average cost over the twenty year period.

WVCAG criticized the use of the LCOE calculated "average" cost because it disregards actual annual cash flows and, thereby, masks the real risk of the different alternative options. As an illustration of this point, WVCAG witness Schlissel compared the year-by-year cash flows underlying Mon Power's LCOE of $74/MWh for Harrison with the cash flows underlying its LCOE of $75/MWh for the alternative of relying on PJM market purchases. Using all of Mon Power's data and assumptions Schlissel's analysis revealed that Harrison purchase ran up a cumulative $722 million *deficit* vis a vis the market purchase option in every year through 2022, and only crossed over to a surplus vis a vis the market option in 2033, i.e., the twentieth year after purchase. App. Vol I. at 381. Schlissel's graphic depiction of the cumulative higher cost of the Harrison Plant acquisition vis a vis continuing to purchase electricity from PJM markets was as follows:



Following WVCAG's cross examination of Mon Power witness Delmar regarding this graphic -- in which WVCAG insisted that the inverted curve showed Mon Power was taking a $722 million risk over a twenty-year period and only at the very end of that period might realized the grand advantage of exactly "one buck" per MWh -- PSC Chairman Michael Albert candidly asked Mr. Delmar to "make me feel better about that." May 30, 2013 Transcript at 65.

Even with the $332 million reduction in cost passed through to ratepayers, agreed to in the August 2013 Stipulation and approved in the October 7, 2013 Plurality Opinion, Harrison is still more expensive than market purchases in every year through the cross over in 2021. App. Vol II at 823. This risk is only reduced marginally by the factors identified by the Commission at App. Vol. II at 930.

3) The "LCOE" overstated the cost of the natural gas plant alternative to Harrison and, as a consequence, erroneously concluded that Harrison was the lowest-cost alternative to obtaining increased generation capacity.

The October 7, 2013 Order acknowledged WVCAG's argument that Harrison was the least cost alternative was totally dependent on Mon Power's preposterous "zero" projected cost for carbon emissions, and a seriously flawed assumption of a 25% "capacity factor"[4] for the natural gas plant alternative to Harrison.

In response to criticisms that Mon Power's LCOE included no carbon costs, the PSC in its October 7, 2013 order recites that it had recalculated the impact on both Harrison and a natural gas plant (which emitted roughly half as much CO_2 as a coal-fired plant), assuming a $20/ton carbon cost beginning in 2022, and an increased natural gas plant capacity factor of 50%. App. Vol. II at 938.

[4] A plant's "capacity factor" is used to convert from capacity to energy: it compares the plant's actual generation during a year with the generation that the plant would produce if it operated at 100 percent power for all hours of the year. A high capacity factor plant operates frequently; a plant with low capacity factor operates infrequently.

According to the Plurality Opinion's recalculation, the comparative results were as follows: Harrison's cost increased $70/MWh[5] to $81/MWh by the addition of carbon costs. By contrast, the cost of a natural gas plant decreased from $115/MWh to $83/MWh, after the capacity factor was increased to 50%, even with the addition of carbon costs. App II at 938.

However, the Plurality Opinion erred in its recalculations of the comparative cost of a natural gas plant. In fact, the cost of a natural gas plant, operated at a 50% capacity factor and after inclusion of $20/ton CO_2, declines to $80.5/MWh,[6] not the $83 figure[7] calculated by the PSC. This $80.5/MWh cost is lower than the $81/MWh[8] cost (adjusted to include the same $20/ton CO2 carbon cost) associated with Harrison. In short, a correct recalculation of comparative costs, to reflect carbon costs and increased gas plant capacity, totally reverses the Plurality Opinion's core finding that the Harrison purchase was the least expensive alternative available to Mon Power; construction of a natural gas plant was the least expensive option.

The October 7, 2013 Plurality Opinion's error was its failure to include in the calculation of the cost of a natural gas plant, the changes in the tax rate and rate of return on equity agreed to in the August 2013 joint stipulation in this case (the same matters for which the PSC criticized WVCAG witness Kunkel's costs analysis). See App. II at 930. Correctly, the PSC recalculated cost of Harrison with the assumptions derived from the Joint Stipulation that return on equity would decline from 10.5% to 10.0%, and that taxes would decline from 40% to 25%. However, in recalculating the cost of the natural gas alternative, the PSC left the return on equity at 10.5% and taxes at 40%, both of which overstated the cost of a natural gas

[5] The initial $74/MWh cost in Mon Power's 2012 petition was reduced to $70/MWh as a result of the $332 million reduction in the rate base amount agreed to in the August 2013 Joint Stipulation. App. Vol. II at 938.

[6] Appendix III at 5.
[7] Appendix III at 4.
[8] Appendix III at 3.

return on equity at 10.5% and taxes at 40%, both of which overstated the cost of a natural gas plant. The confidential spreadsheets demonstrating the error are submitted to this Court as Addendum III to this Reply under seal.[9]

In short, Harrison is not the lowest cost alternative for additional generation, even under the assumptions adopted by the Plurality Opinion.[10]

Numerous other criticisms were leveled against Mon Power's LCOE model, but as Commissioner Palmer noted, the failure to adequately assess the natural gas alternative was critical:

> [I]t is unreasonable for Mon Power, located in the heart of the Marcellus Shale, to move forward with such an undiversified resource portfolio, especially when it failed to conduct a legitimate analysis and balancing of risks associated with potential natural gas generation (either owned or purchased from the market), beyond the problematic LCOE analysis...

App. II at p. 1008.

4) Harrison is not a "crown jewel" entitling FirstEnergy to extract any acquisition premium.

The description in Mon Power's Response of the Harrison power plant as the "crown jewel" of Mon Power's regulated generation capacity disregards all objective criteria. In his

[9] Mon Power's confidential exhibits (Excel spreadsheets with algorithms embedded) were produced in discovery in Mon Power's Resource Planning Review, Case No. 11-1274-E-P. All of the recalculations referred to in this Reply brief reflect the substitution of one input for another, in the fields indicated, with results generated by Mon Power's underlying algorithm, and presumably the same methodology the PSC itself would have used to perform the recalculations referred to in the October 7, 2013 Plurality Opinion. The original Harrison calculation (Appendix III at 1018) was admitted into evidence, under seal, on September, 2013, App. Vol. II at 883, and both it and the original natural gas plant calculation (Appendix III at 1019) were filed with the Commission at the time of discovery in Case No. 11-1274-E-P. The two recalculations (Appendix III at 1020 and 1021) reflect the addition, respectively, of carbon costs and an increased natural gas capacity factor. The corrected natural gas plant cost calculation (Appendix III at 1022) substitutes the 25% tax rate and the 10% return on equity (agreed to in the August 2013 joint stipulation in this case), and applied by the PSC in its recalculation of the cost of Harrison (Appendix III at 1020).

[10] Apart from the LCOE analysis for new construction, Mon Power never attempted to obtain costs for the purchase of an existing natural gas plant.

> I would consider Pleasants the preferable asset for four principal reasons: (1) Pleasants is the younger plant and its scrubber was built as an integral part of the plant rather than added on; (2) Pleasants' location on the Ohio River gives it access to a wider range of reasonably priced coal supplies; (3) Harrison is overly dependent on a single coal supplier; and (4) future environmental compliance costs appear lower at Pleasants. Related to this last point is the fact that the physical location of the Pleasants plant is less space constrained than the Harrison plant, which should make it easier to construct any future modifications needed at Pleasants.

App. Vol. I at 233.

And PSC's Statement of Reasons calls into serious question more the very high values calculated in FirstEnergy's commissioned appraisals by citing the very recent shutdown of the Hatfield's Ferry plant, a supercritical coal plant which the PSC statement concedes is "similar in size and vintage" to Harrison. Statement of Reasons at 10.

PSC's reliance in its Statement of Reasons upon the analysis in *Willow Spring Public Service Corporation,* PSC Case No. 12-0217-S-PC, Jan. 8, 2013 does not alter this result. That case, which reinforced the general rule against acquisition adjustment, and approved an exception to the rule based upon unique efficiencies accomplished by the acquired asset and the economies achieved by joint management. No efficiencies, unique or otherwise, are identified in the Harrison transaction, and the plant is proposed to be operated by FirstEnergy subsidiary, FE GenCo, exactly as it was before the acquisition. App. Vol II at 947-948.

D. The 2010 Merger Stipulation explicitly barred "any acquisition premium."

The first sentence of ¶ 15 (h) of the 2010 Merger Stipulation provided that "FirstEnergy will make no attempt to recover through the rates of Mon Power or Potomac Edison in West Virginia Merger transaction costs, which include: purchase price goodwill," (App. Vol. I at 24-25).This obligation repeated in ¶ 15 (j)'s agreement that "in future base rate proceedings of Mon Power or Potomac Edison in West Virginia, the regulatory capital structure used for Mon Power and Potomac Edison will not reflect any acquisition premium or "goodwill" associated with the Merger transaction." (App. Vol. I at 25).

Mon Power's statement that the 2010 Merger Stipulation cannot be read to preclude future affiliate transactions that "independently" require PSC approval, ignores the beginning point of this entire proceeding; under W. Va. Code § 24-2-12 (f), *all* affiliate transactions require "independent" commission approval. If Mon Power's analysis is correct, there are no future transactions subject to the Joint Stipulation, notwithstanding the broad reservation in ¶ 15 (h):

> Joint Petitioners believe that this reflects an exhaustive list of Transaction Costs; however, the other Parties reserve the right to see whether there are other incurred costs that might fit within such category and advocate in the next base rate case that such costs should be disallowed as non-recoverable Transaction Costs.

(App. Vol. I at 24-25)(emphasis added).

Mon Power's Response also disregards the plain language of the 2010 Merger Stipulation itself, and argues from the PSC plurality opinion's divination of the purported "intent" of the stipulation. WVCAG's argument -- that the PSC cannot speculate on the intent of the Merger Stipulation in the absence of some ambiguity – is not addressed, other than to describe it as a "contract" argument. It was a contract right up to the point where the PSC incorporated it into the final order approving the 2010/2011 merger; now it is a commission order; indeed, it is the law of the case.

Undeterred Mon Power simply defends the PSC's use of "current assets" and "the time of the merger" as though those terms are lifted straight from the 2010 Merger

Stipulation itself. In fact, they nowhere appear in the stipulation but appear only as a necessary concoction to avoid the plain language of the stipulation, incorporated into the PSC's 2010 merger order.

Based on this shaky foundation, Mon Power leaps to the conclusion that the PSC cannot be shackled in the exercise of its regulatory authority and, had it anticipated that the (patent) restrictions of the 2010 Merger Stipulation "many years down the road" would bar the pass through of acquisition adjustment "no matter how valuable the asset might have become on the market" it would never have approved it. Response at 30.

No evidence is cited for this totally speculative conclusion. The fact is that the PSC *did* approve the 2010 Merger Stipulation and incorporated it into the order concluding the 2010/2011 merger case. And the assertion that the PSC would not have adopted any stipulation so intended is directly contradicted by dissenting Commissioner Palmer's observation that:

> While the Joint Stipulation as modified by the Majority reduces or mitigates some of the negative impacts included in the original Generation Resource Transaction and the Joint Stipulation, it fails to completely protect ratepayers from the write-up that the parties to the Merger Stipulation foresaw and attempted to prevent. Therefore, any amount over original cost net book value passed on to ratepayers in this case violates the Merger Stipulation and Commission policy, and is unreasonable.

App. Vol. II at 1005.

Moreover, this is manifestly *not* an example of "many years down the road;" it's a bare 34 months later; and based upon an accounting entry only FirstEnergy seeks a $589 million profit in the asset acquired from Allegheny Energy less than three years ago.

Mon Power's Response feebly dismisses the PSC's total rewrite of Mon Power petition[11] with the observation that the "confusion" is understandable given that "[t]hese are complex concepts in a highly arcane area in which the Companies and the Commission must work." Response at p. 26.

The reality is that Mon Power had no "confusion" about what it was undertaking in its 2012 petition; it fully recognized what it had agreed to do – and agreed *not* to do – in the 2010 Merger Stipulation. Specifically, they agreed to make " no attempt to recover through the rates of Mon Power or Potomac Edison in West Virginia Merger transaction costs, which include: purchase price goodwill"... and further agreed that "future base rate proceedings of Mon Power or Potomac Edison in West Virginia, the regulatory capital structure used for Mon Power and Potomac Edison will not reflect any acquisition premium or 'goodwill' associated with the Merger transaction." App. Vol. I at 24-25.

Mon Power's 2012 petition engaged in the verbal contortions necessary to mask its violation of the "no attempt" language of the 2010 Merger Stipulation by calling the $589 million markup of Harrison an "acquisition adjustment," a patent fiction summarily rejected by all three commissioners below. App. Vol. II at 933 and 1003.

Now that the PSC's October 7, 2013 plurality opinion has done for Mon Power what Mon Power itself agreed not to do -- included in the regulatory capital structure used for Mon Power a $257 million acquisition premium associated with the 2010 Merger transaction -- Mon Power feels free to defend the PSC-blessed breach of the 2010 Merger Stipulation, a matter it

[11] The PSC's Monday morning coaching included the observations, noted in WVCAG's brief, that: 'It is unfortunate that from the initial filing, Mon Power have confused the difference between Mon Power inheriting an Acquisition Adjustment that is "necessary" or created solely because of the fair-value adjustments made by AE Supply at the time of the FirstEnergy/Allegheny Energy Merger (that would be contrary to the Merger Stipulation) and a request to sell an asset to Mon Power at a price in excess of the net original cost book value. This confusion comes from Mon Power initially **appearing** to claim that the justification for the purchase price of Harrison is the fair value of the plant recorded on the AE Supply books at the time of the Merger. (App. Vol. II at 940) (emphasis and bolding added).

could not, with a straight face, undertake in the first instance in its 2012 petition for approval of the asset transfers. The fact that the PSC disregards the limits of its 2010 merger order is no ground for this Court to approve the action.

Finally, nothing in the 2013 Harrison Stipulation suggests that the signatory intervenors made anything more than a litigation risk analysis in agreeing to a $330 million reduction of the amount of "acquisition adjustment" that could be passed through to West Virginia rate payers from the initially proposed $589 million adjustment to the $257 million adjustment agreed to in the August 21, 2013 stipulation in this case. The fact that this decision was a matter of litigation risk analysis – and not a wholesale acquiescence in the position asserted by Mon Power – is embedded in the Harrison Stipulation itself which explicitly disclaimed any determination that the 2010 Merger Stipulation had, or had not been, violated:

> <u>[T]hé Parties specifically represent that the Settlement does not include any recommended finding on or resolution of the question of whether the Transaction violates the Merger Stipulation, in whole or in part</u>.

(App. Vol. II at 977)(emphasis added).

The 2013 Harrison Stipulation, in and of itself, is in no way persuasive on the merits of the issue before this Court: viz.: whether the pass through of a $257 million "acquisition adjustment" violates the 2010 Merger Stipulation's bar on the pass through of "<u>any</u> acquisition premium."

<u>E. The purported perils of minority ownership simply do not exist.</u>

The PSC Statement of Reasons repeats the totally frivolous assertion made in the Plurality Opinion that no party "rebutted the utility testimony regarding the risk of minority ownership." Statement of Reasons at 10. In fact, CAD had entered into evidence an order from the Federal Energy Regulatory Commission (FERC) to rebut part of Mon Power's argument on minority ownership risk. In the FERC case, FirstEnergy sought a waiver from FERC's affiliate restrictions in order to allow the same set of employees to dispatch power plants, such as Harrison, that are jointly owned by merchant and regulated subsidiaries. FirstEnergy represented to FERC that "there will be no harm to Mon Power's captive customers" from allowing joint economic dispatch. App. Vol. II at 599. The FERC order states:

> According to the FirstEnergy Companies, ... FE Solutions does not have any incentive to offer or dispatch jointly-owned facilities out of economic merit, since such behavior would hurt FE Solutions and AE Supply on a pro-rata basis.

Id. (footnotes omitted).

This evidence was simply ignored by the Commission in its October 7, 2013 order, and in its more recent Statement of Reasons.

F. Mon Power $257 million "acquisition premium" represents a 66:1 return on the $3.9 million worth of purported "benefits" to WV from August 2013 Harrison Stipulation

The PSC's October 7, 2013 order recited various benefits accruing from the stipulation primary among them the reduction by $332 million (from the originally proposed premium of $589 million to $257 million) of the acquisition premium that could be passed through to West Virginia rate payers. Included in the purported benefits to West Virginia flowing from the stipulation in this case was the commitment of Mon Power (or its affiliates within FirstEnergy) to create fifty (50) new jobs in the state above the 1,684 jobs in existence on June 30, 2013.

On cross examination at the September 30, 2013 hearing on the Stipulation, Mon Power witness Wise testified that no side agreements or interpretation existed, and that the Stipulation stood as it read. He further acknowledged that he did not know if 50 jobs or more had been created in West Virginia by Mon Power (or by its FirstEnergy affiliates who collectively employ more than 16,000) between the June 30 reference date and September 30 (which would reduce the new job commitment to zero); that there was no requirement in the Stipulation that the jobs be full-time jobs, that there was no requirement in the Stipulation that the jobs be permanent, and that the relatively low-paying, unskilled job of cutting trees qualified to satisfy the fifty job commitment. Transcript of September 13, 2013 hearing at 71-79.

Mon Power witness Wise further testified that the cumulative value of all other benefits provided by the joint stipulation was $3.9 million, of which $2.6 million dollars were allocated to the largest commercial electric consumers in the state,[12] Mon Power's payback for the $3.9 million dollars in "benefits" to West Virginia was 66:1.

G. Condition 3 of the October 7, 2013 plurality opinion added no protection not already available in ENEC proceedings.

Mon Power argues that Condition 3, by limiting the recovery of the stipulated $257 million acquisition premium to detailed performance standards was an improvement over the August 2013 stipulation and characterizes the "flow back" of 50% of the revenues from Harrison to ratepayers as "gravy on top." Response at 32.

Mon Power's "gravy" argument is disingenuous in that it ignores the fact that revenues from power sales *always* flow back to customers through ENEC rates. This flow back is not some sort of special bonus implemented by Condition 3, as the Companies imply. Rather, as stated by Commissioner Palmer, "This [Condition 3's] attempt to shield ratepayers is

[12] The characterization of these so-called "economic stability credits" were anything other than a simple financial discount for the largest industrial users, was contradicted by the fact that those users had to do nothing to obtain them, and the funds freed up by the discounts were not subject to any restrictions. Transcript of September 13, 2013 hearing at 83.

commendable but somewhat ineffective because it will offset the rate impact of the transaction with off-system sales margins that would otherwise have been used to lower the ENEC costs charged to ratepayers." App. Vol. II at 1002. In short, the October 7, 2013 Plurality Opinion's "Rube Goldberg"-inspired Condition 3 provides no incremental benefit which would warrant the pass through of a $257 million acquisition premium.

H. WVCAG's "fabricated" its arms length analysis out of PSC precedent

If WVCAG has engaged in any "fabrication" it is fabrication based upon unambiguous holdings of PSC cases decided over many decades. Those decisions include the following three cases, all cited in WVCAG's initial brief:

- *War Telephone Co., Case No. 98-1001-T-PC*: "As for the second element of W. Va. Code §24-2-12's test for approval of the subject transactions, the Commission concludes that no party to the transactions is given an undue advantage over another. The asset purchase agreement among WTC, Colonial, WarTel and TN, as well as the service agreement between WarTel and TN, appear to have been negotiated at **arms-length** and do not, on their face, give **undue advantage** to any party"

- *Hope Gas, Inc., Case No. 99-0462-G-PC*: "The language "neither party thereto is given an **undue advantage** over the other" has been interpreted to mean that the transaction was negotiated at **arms length**."

- *Citizens Telecommunications-WV, Case No. 00-0628-T-PC, Sept 2, 2000:* "In light of the petition and the attached exhibits, the August 15, 2000 testimony filed by the Petitioners and the Staff recommendation, it appears that the merger agreement was negotiated at **arms'-length** between these two subsidiaries of Citizens Utility Company; neither Petitioner gains an **undue advantage** as a result of the merger; and the proposed merger does not appear to be adverse to the public interest,"

Neither of the two cases on "undue advantage" cited in the PSC Statement of Reasons even discuss the undue advantage standard; one simply alludes generally to the requirement that there be no undue advantage,[13] and the other is silent on the topic. [14]

I. Mon Power's own witnesses established the absence of arms length dealing.

Mon Power, who bore the burden of proof, grandly argues that WVCAG produced no evidence of undue advantage, while simultaneously admitting that no documentation – *none whatsoever* – exists regarding the negotiations of this $1.1 billion acquisition. All of the circumstantial evidence in this case contradicted the PSC conclusion that "arms-length" negotiations occurred. Mon Power witnesses Mr. Delmar and Mr. Szwed – neither of whom were employed by Mon Power -- testified that they made no attempt to negotiate a smaller ownership stake in Harrison (which would have better matched the Companies' actual energy needs) (App. Vol. II at 652); that they made no attempt to use the issue of the potential Merger Stipulation violation to negotiate a lower purchase price (which should have been known to FirstEnergy management) (App. Vol. II at 655), and that they did not attempt to negotiate the transaction as a stock deal (which, if successful, would have resulted in substantial tax benefits to ratepayers) (App. Vol. II at 727).

The assertion by West Virginia Energy User Group (WVEUG) Witness Baron that the failure to structure the Harrison transaction as a stock deal versus an asset sale was cited, not for the fact that the structure guaranteed the $411 million tax benefit, but rather for the

[13] *United Fuel Gas Company v. Public Service Commission*, 154 W.Va. 221, 174 S.E.2d 304 (1969), employs the phrase "undue advantage" four times – once in syllabus point 3 on page 305, twice on page 315, and once on page 317. In each instance the reference is part of a general recitation of the controlling criteria; in no instance is there even a suggestion that the meaning of the phrase, or its application in the case, was disputed in the case.

[14] *West Virginia Highlands Conservancy Inc., et al. v. The Public Service Commission of West Virginia*, 206 W. Va. 633, 527S.E.2d 495 (1998), does not involve a merger or a transaction between affiliates; instead the case was the outcome of the infamous sale by Allegheny Energy of Black Water Canyon to a private real estate developer and timbering firm. The words "undue advantage" do not appear in the case.

proposition that no one even sought that benefit on Mon Power's behalf.[15]

Finally, in an open-to-the-public, November 5, 2013 quarterly "investment call," CEO Alexander openly admits that FirstEnergy's overriding need is to *decrease*, not increase, electric generation capacity, and casually dismisses Mon Power's core argument before the PSC that additional capacity was needed to "hedge" the possibility of substantial price increases at any time in the near future.[16]

> As you know, our competitive operations have been challenged not by operational performance, but by capacity in energy markets that do not support investment in, or in some instances, the operation of generating units. While we can debate for reasons this is occurring, the fact is, power prices have been weak for the last couple of quarters and we may be facing continued soft power prices for at least the next several years. As a result, we began to reposition our competitive business in 2012 and now through a series of even more aggressive actions have better positioned this business for the future. For example, we have reduced the size and mix of the fleet by closing and selling competitive units . **Last month, we closed the Hatfield and Mitchell Power plants and we expect to complete the sale of certain hydro assets later this year.** In addition, we completed the Harrison and Pleasants transfer this quarter. **As a result of these actions, we reset our annual retail sales target to about 100 million-megawatt hours, which fits into our overall strategy to sell at retail about 25% more than our fleet produces.**

http://seekingalpha.com/article/1808342-firstenergy-management-discusses-q3-2013-results-earnings-call-transcript?page=1 -- last visited January 10, 2013.

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[15] And Mon Power's claim that there was no evidence that such a stock transaction could be structured is nothing more than an *ipsa dixit*. Under Section 351 of the Internal Revenue Code both AES and Mon Power could have – tax free – contributed their respective shares of the Harrison power plant to a newly-formed Harrison Corporation, and their respective shares of the Pleasant power plant into a newly-formed Pleasant Corporation. Mon Power could then have swapped its shares of the newly-formed Pleasant Corp. for AES's shares in the newly-formed Harrison Corp. Because both parties would be continuing to operate the business, the exchange would not be subject to the exclusion from tax-free treatment in Section 1033 of the IRC for like-kind exchanges of stock.

[16] If as a result of this appeal the case is remanded for any further evidentiary hearing, WVCAG fully intends to call FirstEnergy CEO Anthony Alexander as an expert witness.

Alexander's comments strongly suggest that the testimony and exhibits from Mon Power's witnesses-- the entire evidentiary presentation at the PSC -- were fraudulent. The October 7, 2013 Plurality Opinion will burden West Virginia rate payers with the purchase – at a $257 million markup -- of a totally unnecessary, discarded electric generation plant, merely as a convenience to FirstEnergy.

IV. Conclusion

WVCAG respectfully requests that this Court vacate the October 7, 2013 order.

Respectfully submitted,

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V. Certificate of Service

I hereby certify that I delivered a copy of this Reply Brief, by hand and/or US mail, postage prepaid, on or before the 16th day of January 2014, to the following:

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