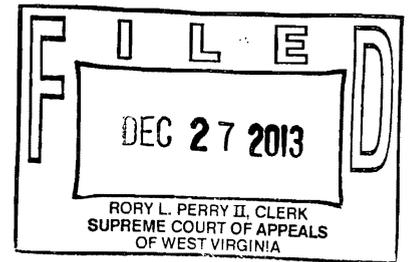


IN THE SUPREME COURT OF APPEALS
OF WEST VIRGINIA
CHARLESTON



West Virginia Citizen Action Group,
Petitioner

vs.) No. 13-1126

Public Service Commission of West Virginia;
Monongahela Power Company
and The Potomac Edison Company,
Respondents

**STATEMENT OF REASONS OF THE PUBLIC
SERVICE COMMISSION OF WEST VIRGINIA**

Richard E. Hitt, General Counsel
WV Bar No. 1743
201 Brooks Street, P.O. Box 812
Charleston, West Virginia 25323
Telephone: 304-340-0450
rhitt@psc.state.wv.us
Counsel for the Public Service Commission

December 27, 2013

TABLE OF CONTENTS

	PAGE
Table of Authorities	ii
Statement of the Case	1
Summary of the Argument	13
Oral Argument	15
Standard of Review	15
Argument	16
1. The allowance of a recovery of an acquisition adjustment neither violates universally recognized principles of cost base reatemaking or past Commission precedent	17
A. Other state authority regarding acquisition adjustments	18
B. West Virginia Commission precedent regarding acquisition adjustment	22
2. The Commission Order does not violate the merger stipulation or the merger order that approved the merger of FirstEnergy with Allegheny Energy Inc.	26
3. The reasoning of the Commission in placing conditions on the recovery of the \$257 million acquisition adjustment does not bar Commission approval of the transaction in the conditional recovery of the \$257million acquisition adjustment	33
4. <u>W. Va. Code</u> §24-2-12 does not require an inquiry as to whether there were arms-length negotiations between the parties.....	35
Conclusion	40

TABLE OF AUTHORITIES

COURT DECISIONS

<u>Boggs v. Public Service Commission</u> , 154 W.Va. 146, 174 S.E.2d 331 (1970)	39
<u>Broadmoor/Timberline Apartments v. Public Service Commission of West Virginia</u> , 180 W.Va. 387, 376 S.E.2d 593 (1988)	16
<u>Burch, et al. v. Nedpower Mount Storm, LLC</u> , 220 W.Va. 443, 647 S.E.2d 879 (2007)	31
<u>Chesapeake and Potomac Telephone Company West Virginia v. Public Service Commission</u> , 171 W.Va. 494, 300 S.E.2d 607 (1982)	32
<u>Central West Virginia Refuse Inc. v. Public Service Commission</u> , 190 W.Va. 416, 438 S.E.2d 596, Syllabus Pt. No. 4 (1993)	31
<u>Harrison Rural Electric Association Inc. v. Public Service Commission</u> , 190 W.Va. 439, 438 S.E.2d 782, Syllabus Pt. No. 2 (1993)	32
<u>Mountain Communities for Responsible Energy v. Public Service Commission</u> , 222 W.Va. 481, 665 S.E.2d 315 (2008)	16, 31, 39
<u>New Martinsville, et al. v. Public Service Commission</u> , 229 W.Va. 353, 729 S.E.2d 188 (2012)	16
<u>United Fuel v. Public Service Commission</u> , 154 W.Va. 221, 174 S.E.2d 304, Syllabus Pt. No. 3 (1969)	31, 35, 37, 39
<u>West Virginia Citizens Action Group v. Public Service Commission</u> , 175 W.Va. 39, 330 S.E.2d-849 (1985)	39
<u>West Virginia Highlands Conservancy Inc., et al. v. The Public Service Commission of West Virginia</u> , 206 W.Va. 633, 527 S.E.2d 495 (1998).....	37, 38, 39

ADMINISTRATIVE DECISIONS

<u>Frontier Communications</u> , PSC Case No. 09-0871-T-PC, Final Order, May 12, 2010	36
<u>Golden Heart Utilities, Inc.</u> , U-02-13, Order of the Commission of Alaska, March 19, 2003.....	19, 20

Monongahela Power Company, et al., PSC Case No. 10-0713-E-PC,
Final Order, December 16, 201026, 27, 28, 29, 30

Monongahela Power Company and The Potomac Edison Company,
PSC Case No. 12-1571-E-PC, Final Order, October 7, 2013 passim

Philadelphia Suburban Corp., Docket No. 02-11-14, Order of the Connecticut
Dept. of Utility Control, April 23, 200320

Willow Spring Public Service Corporation, PSC Case No. 12-0217-S-PC,
Final Order, January 8, 201323, 24

STATUTES

W. Va. Code §24-1-1(b)9, 31

W. Va. Code §24-2-3.....31

W. Va. Code §24-2-12.....passim

RULES AND REGULATIONS

Rules and Regulations for the Government of Electric Utilities,
150 CSR 3, Rule 2.4 17

STATEMENT OF THE CASE

The Petitioner, West Virginia Citizens Action Group (WVCAG), was the only party, among numerous parties representing a broad spectrum of interests, that opposed a Joint Stipulation and Agreement for Settlement (Joint Stipulation) of the parties to the Commission proceeding that is the subject of appeal. The Joint Stipulation recommended that the Commission approve the acquisition of one hundred percent (100%) of the ownership of the Harrison power plant by Monongahela Power Company.¹

On November 16, 2012, Monongahela Power Company and the Potomac Edison Company (MP/PE) filed a Petition for Approval of a Generation Resource Transaction and Related Relief (Petition). Based on projections of capacity requirements and resources, as detailed in the 2012 Resource Plan filed with the Commission in an earlier case, PSC Case No. 11-1274-E-P, MP/PE identified a significant deficit in generation capacity available to serve the electric demand of its West Virginia customers. To address that deficit, MP/PE filed the Petition in this case proposing a generation resource transaction that would increase the net installed capacity of MP/PE by 1,476 megawatts (1,189 MW of unforced capacity).² The Petition sought the prior consent and approval of the Commission permitting MP/PE to enter into the transaction pursuant to W.Va. Code §24-2-12.

¹ Monongahela Power Company, a West Virginia utility, operates 100% in West Virginia. The asset acquisitions at issue is a transfer to Monongahela Power. Potomac Edison is a multi-state utility with about 25% of its operations in West Virginia. Although Monongahela Power and Potomac Edison are separate corporations, the Commission combines their costs in West Virginia, sets rates applicable to all of their customers in West Virginia and regulates the operations of the two corporate entities as though they were a single company. References to operations herein are references to the combined operations. Although the ownership of Harrison will be 100% undertaken by Monongahela Power, since the power supply will be used to serve the combined load, and costs will be assigned to the combined operations in West Virginia, reference to the Harrison acquisition applies to both companies.

² Unforced capacity is lower than installed capacity because it takes into account outages and prior performance. The MP/PE capacity deficit in 2013 is 938 MW. The proposed transaction results in a small surplus of 151 MW that will meet capacity requirements through 2018. MP/PE Petition at 13; MP/PE Exhibit MBD-D(Delmar) at 8.

The Transaction consists of (i) acquisition by MP/PE of the 79.46 percent ownership interest currently held by Allegheny Energy Supply Company, LLC (AE Supply) in the Harrison Power Station (Harrison), resulting in MP/PE being the sole owner of Harrison, (ii) acquisition by AE Supply of the 7.69 percent ownership interest held by MP/PE in the Pleasants Power Station (Pleasants), resulting in AE Supply being the sole owner of Pleasants, (iii) approval of certain Affiliated Agreements, and (iv) implementation of a temporary base rate surcharge to recover the ongoing net capital and operating costs related to the transaction, effective upon closing the transaction and to remain in effect until new base rates are placed into effect (Transaction).

The MP/PE net investment in the Transaction is approximately \$1.1 billion. MP/PE contended that without immediate rate relief through a surcharge to provide for recovery of and on this investment and to cover the additional expense to operate Harrison, MP/PE would not proceed with the Transaction. MP/PE asserted that the surcharge would be offset by reductions in rates for purchased capacity and energy established in annual ENEC cases.³ MP/PE sought Commission approval of the Transaction in its entirety, including the Harrison acquisition, the Pleasants sale, certain affiliate agreements described in the Petition, the surcharge, and the associated ENEC rate adjustments.⁴ MP/PE further asserted that the Transaction was necessary,

³ ENEC rates are established in an annual rate proceeding, exclusive of base rate costs, that deal with costs and revenues associated with MP/PE generation, purchased power, and wholesale power sales and transmission revenues and costs.

⁴ In addition to the Asset Swap Agreement between Mon Power and AE Supply filed with the Commission on April 22, 2013, the "Affiliate Agreements" include (i) a Revised Amended Mutual Assistance Agreement among Mon Power, First Energy Generation Corp. (FE GenCo), and various other First Energy affiliates providing that FE GenCo would provide all staffing and operation services for generating stations owned by Mon Power, including Harrison; (ii) an Assumption and Indemnity Agreement between Mon Power and AE Supply, through which Mon Power will assume repayment and related obligations of AE Supply in respect of a \$73.5 million Note secured by certain facilities at Harrison; and (iii) a promissory note to be executed by Mon Power in favor of AE Supply to reflect the Mon Power repayment obligation under an expected bridge financing during the interim period between the Closing and the completion of permanent financing by Mon Power. Forms of these three agreements were provided in Exhibit J of the Petition.

prudent, and reasonable, and satisfied all of the requirements of W.Va. Code §§24-2-12, 24-2-2, and 24-2-3. MP/PE requested a final order by April 15, 2013. MP/PE included with the Petition the prefiled direct testimony of five witnesses: Michael B. Delmar, Thomas A. Pezze, Thomas Houlihan, Kevin G. Wise, and Steven R. Staub. These witnesses supported various aspects of the relief requested in the Petition.

The Commission granted interventions that established party status to numerous parties representing a diverse array of interests. Those parties include the Consumer Advocate Division of West Virginia (the interest of residential customers), the West Virginia Citizen Action Group (a public interest group), the West Virginia Energy Users Group (large industrial customers), the Utility Workers Union of America AFL-CIO and Local 304 (utility workers), the Sierra Club (environmental issues), the Independent Oil and Gas Association of West Virginia (independent oil and gas producers), the West Virginia Oil and Natural Gas Association (entities associated with oil and gas industry), the West Virginia Coal Association (companies involved with coal production), the West Virginia State Building and Construction Trade Council, AFL-CIO (construction workers) and the Recording Secretary of the I.B.E.W. Local 2357 (electrical workers). Commission Staff (the public interest) is automatically considered a party to Commission cases.

On May 29-31, 2013, the Commission conducted three days of public hearing, receiving testimony from twenty-three witnesses. The parties that initially opposed the Transactions, as filed, included Commission Staff, the Consumer Advocate Division, the WVCAG, the West Virginia Energy Users Group and the Sierra Club.

Following the submission of post-hearing initial and reply briefs, a Joint Stipulation was filed in the case that urged the Commission to approve the proposed Transaction as modified in

the Joint Stipulation. All of the parties to the case, including the parties initially opposed to the Transaction, with the exception of WVCAG, joined in the Joint Stipulation. The West Virginia Oil and Natural Gas Association and the Independent Oil and Gas Association were not parties to the stipulation, but each indicated that it took no position regarding the Joint Stipulation. WVCAG was the only party that opposed the Joint Stipulation.

Although attached to the Commission Order and summarized therein (Final Order, pages 7-11), a brief overview of the highlights of the Joint Stipulation is appropriate, particularly since WVCAG has minimized or ignored its many benefits.

The Joint Stipulation proposed that MP/PE be permitted to increase jurisdictional rate base by \$858,270,388 to reflect the acquisition of the Harrison plant. The recommended increase includes an acquisition adjustment of \$257 million, but the amount is a reduction of \$332 million from that proposed in the original petition. Joint Stipulation, paragraph 11 (g.)(1)(A). The parties agreed that MP/PE should be permitted to recover a full return of and on the resulting Harrison rate base and agreed not to ask the Commission to reduce the rate base in future rate filings. Joint Stipulation, Paragraph 11 (g.)(2)(C). The stipulating parties also recommended the establishment of a surcharge to existing rates that would allow MP/PE to recover a return, plus related expenses, on the increased rate base. The annual revenue requirement of the surcharge was estimated to be \$113.4 million. Joint Stipulation, Paragraph 11 (h.). The parties also recommended that MP/PE be permitted to amortize the gain from its sale of interest in Pleasants, estimated to be \$25.3 million, over the expected sixteen month duration of the surcharge, or an annual amortization of \$19 million. Joint Stipulation, Paragraph 11 (g.)(1)(B). The parties agreed that at the same time the surcharge commences, MP/PE would reduce ENEC rates by an estimated \$129.5 million annually to reflect the additional revenues

and costs from the additional generation. Joint Stipulation, Paragraph 11(i.). These rates would remain unchanged until January 1, 2015.⁵

The Joint Stipulation also required that MP/PE would hire fifty new employees (to improve quality of service). Additional commitments and benefits, the cost of which will not be recovered from customers, include a \$2.3 million credit to the bills of industrial and large commercial customers (to enable them to make further investments in processes or jobs); retirement of \$100,000 of renewable energy credits (to encourage additional purchases from renewable generation); contributions over five years of \$500,000, each, to the Dollar Energy Fund (to assist low income customers in the payment of electric bills), the West Virginia Office of Economic Opportunity (to fund residential home weatherization improvements), and the Governor's West Virginia Kids First Initiative (to support energy efficiency in public schools). Further commitments include the redirection of annual \$250,000 in rates from a weatherization program to low income energy assistance; further expansion of existing energy efficiency programs by increasing the targeted savings and by utilizing a request for proposal; addressing future capacity shortfalls in excess of 100 megawatts by issuing a request for proposal from both supply-side and demand-side resources and maximizing the use of West Virginia coal burned at Harrison. Joint Stipulation, paragraph 11.

As explained in the Commission order,

There are three significant differences between the terms of the Joint Stipulation and the Transaction proposed in the Petition.

1. The first category of Transaction differences relates to how the Joint Stipulation will reduce the rate base valuation of Harrison that will be used for establishing West Virginia jurisdictional revenue requirements, both for purposes of the

⁵ The amortization of Pleasants is reflected in the recommended surcharge, and when combined with the ENEC reduction, the result is a slight decrease in rates. If it were not included, the rate impact on customers, including the ENEC reduction, would be a slight increase.

Surcharge and for future base rate cases. Kevin G. Wise, Director, Rates and Regulatory Affairs for First Energy Service Company, explained at the September 13, 2013 hearing that the rate base initial valuation for the 1,576 Harrison MW acquired from AE Supply would be \$565 per/kW (including Construction Work in Progress (CWIP)), rather than the \$776 per/kW proposed in the Petition. This reduction represents a lower jurisdictional rate base amount of approximately \$332 million. Tr. IV (Wise) at 38-39.

2. The second category of Transaction differences between the Petition and the Joint Stipulation relates to rate impacts associated with the Surcharge and corresponding ENEC reduction. Not only will the lower rate base amount specified in paragraph 11(g)(1) of the Joint Stipulation be used in the Surcharge calculation, paragraph 11(h) of the Joint Stipulation provides that the return on equity used in the Surcharge rate will be reduced from the 10.5 percent rate requested in the Petition to a 10.0 percent rate, and the income tax expense component will be calculated at a twenty-five percent rate rather than the higher rate proposed in the Petition.

These changes served to reduce further the annual revenue requirement associated with the Surcharge to approximately \$113.4 million from the \$193 million level contemplated in the Petition. When combined with the shortened amortization period for recognition of the gain on the Pleasants sale and the reduction in the ENEC rates of an estimated \$129.5 million to reflect lower purchased power costs and net margins from off system sales associated with the additional generation capacity, at Closing customers under all rate schedules will immediately experience a decrease in rates. Based on the stipulated allocations of the revenue requirement changes among rate schedules, the net decrease for Rate Schedules K and PP (large industrial customers) is five percent and the net decrease for all other rate schedules is 1.5 percent. Joint Stipulation Ex. E.

3. The third category of Transaction differences between the original Petition and the terms of the Joint Stipulation relates to new or expanded employment, financial, energy efficiency and capacity acquisition commitments. These include (i) a commitment to increase employment in West Virginia by fifty employees, mostly in the distribution sector; (ii) a two-year rate credit for Rate Schedules K and PP customers; (iii) a \$100,000 retirement of renewable energy credits to spur the development of renewable energy resources; (iv) three separate \$500,000 contributions over a five-year period for the purposes of low-

income energy assistance, home weatherization assistance, and to spur energy efficiency initiatives in public schools in MP/PE service territories; (v) increased energy efficiency targets; and (vi) a commitment to develop an RFP for capacity resources in the future. In addition, MP/PE are committed to file to redirect and reflect in rates a \$250,000 per year customer-funded contribution, currently directed to weatherization, to Dollar Energy or an alternative low-income energy assistance agency. Joint Stipulation at paragraph 11.

Order at 14-15.

On September 13, 2013, the Commission held a separate evidentiary hearing on the Joint Stipulation. MP/PE presented Kevin G. Wise to sponsor the Joint Stipulation on behalf of the stipulating parties. Mr. Wise explained the material terms of the Joint Stipulation and responded to examination from counsel for various parties and from the Commission. Stephen Baron for West Virginia Energy Users Group, William B. Raney for the West Virginia Coal Association, Scott Pedigo for the UWUA and Cheryl Ranson for Staff presented testimony in support of the Joint Stipulation. The scheduled witness for CAD could not attend the hearing, but Counsel for CAD indicated its support for the Joint Stipulation. Through the admission of Catherine Kunkel's supplemental testimony, WVCAG presented testimony in opposition to the Joint Stipulation, and WVCAG cross-examined all of the other witnesses. At the conclusion of hearing, the parties declined the opportunity to present closing statements in lieu of briefing, and the case was submitted for decision.

Mr. Wise outlined the reasons why the Transaction, as modified by the Joint Stipulation, was in the public interest. These included the acquisition of needed capacity for MP/PE to resolve its capacity shortage; increased employment; economic development support to large industrial customers through lower rates; assistance to low-income customers in paying electric bills; residential home weatherization assistance; commitments to energy efficiency in schools;

support for renewable energy; commitments to expand funding for energy efficiency programs; and an increased tax base for the State. In addition, Mr. Wise focused on the strength and high value of the Harrison asset. September 13, 2013 Transcript at 28-58. Mr. Wise agreed that the reduction in rate base of \$352 million was the most significant change compared to the request in the Petition. Transcript at 68. He testified that the intent of the industrial rate reduction was to provide money for investment and jobs. Transcript at 32. Mr. Wise testified that because of the significant benefits in the Joint Stipulation, the stipulating parties withdrew their opposition to recovery of a \$257 million acquisition adjustment and recommended that it be allowed and recovered in rates. Transcript at 133-134.

Other witnesses for the stipulating parties provided their own bases for Commission approval. Stephen Baron, witness for the West Virginia Energy Users Group, focused on the reduced rate impact of the acquisition (as compared to the initial proposal of MP/PE), the ratemaking arrangements for industrial customers and the economic stability credit. Transcript at 95-100. Mr. Baron emphasized that the cost of acquiring Harrison, at \$565 per Kw, compared to a single cycle gas turbine, at \$700-750 per Kw, made the transaction a “reasonable and appropriate” acquisition. Transcript at 102. Mr. Pedigo, the UWUA witness, works at the Harrison station and cited the need for additional employees there to continue appropriate levels of plant maintenance. Transcript at 162-166. William B. Raney, the WVCA witness, stressed the value of West Virginia coal and the added benefits to the State and its citizens of continued West Virginia coal production and, particularly its use in West Virginia generation facilities. Transcript at 147-149 and 157-161. Cheryl Ranson, Director of the Commission’s Utilities Division, noted that the reduced acquisition price that would be included in rate base was significant to Staff and that the increased employment commitments would enable MP/PE to

improve the quality of service delivered to customers. Transcript at 167-176. Counsel for CAD stated for the record that CAD supported the Joint Stipulation. Transcript at 202-203.

Following the hearing on the Joint Stipulation, the Commission issued its final order in this matter that approved the Transaction as modified by the Joint Stipulation with certain conditions. In addition to a consideration of the Joint Stipulation and the benefits contained therein, the Commission also independently reviewed the evidence to determine the need for capacity, the reasonableness of the acquisition of Harrison given other alternatives, the effect of the Transaction upon the public and the need to otherwise condition the Transaction. In reviewing the Transaction, the Commission is guided by the statutory test in W. Va. Code §24-2-12: (i) the terms and conditions thereof are reasonable, (ii) neither party thereto is given an undue advantage over the other, and (iii) do not adversely affect the public in the State. In deliberations and decisions, the Commission has the further responsibility to appraise and balance (i) the interests of current and future utility service customers, (ii) the general interests of the State's economy, and (iii) the interests of the utilities. W. Va. Code §24-1-1(b).

Virtually every witness to testify about the subject agreed that the market risk inherent with the large MP/PE capacity deficit was unacceptable and had to be addressed. Order at 24. The Commission order concluded that there was a need for additional capacity and the proposed Transaction was a reasonable plan to acquire the capacity. Order at 25.

The Commission further concluded that Harrison was a good and valuable asset, having a relatively low operating cost and was equipped with an array of pollution control equipment. Order at 25. Harrison would continue to be a proven contributor to the State economy and well-being of North-Central West Virginia. Harrison consumes more than five million tons of locally mined coal on an annual basis. The Transaction would provide continued support of the West

Virginia coal industry, preserve jobs for West Virginia miners, and benefit the overall economy. Order at 25-26.

Another benefit of the Transaction is the elimination of risk associated with MP/PE minority ownership of Harrison. The Commission found that there are risks of minority ownership of jointly-owned plants that did not exist prior to the development of competitive power markets. Order at 31. AE Supply, the majority owner, as an entity competing in the market, may have a different strategy than MP/PE regarding future capital investments needed to comply with environmental regulations. Order at 32. The Commission Order cited, as an example, the recently announced decision to close a power plant instead of investing in additional emissions controls - AE Supply's decision to deactivate Hatfield's Ferry near Masontown, West Virginia. The announced reason for the shutdown of the plant is that the additional investment to comply with new EPA regulations is too high.⁶ Hatfield's Ferry is similar in size and vintage to Harrison. Order at 33. Neither the Petitioner, WVCAG, or any other party rebutted the utility testimony regarding the risk of minority ownership. Commission regulation of 100% of Harrison as a rate base utility asset will also enhance the ability of the MP/PE to support the West Virginia coal mining industry and help preserve mining jobs over the long term.

Considering the evidence of the alternative costs to MP/PE if it does not acquire Harrison, the benefits of the power supply from Harrison, and the offsetting margins expected from sales into the PJM market from excess capacity, the Commission determined that departing from net original cost rate base valuation and allowing a \$257 million acquisition adjustment for ratemaking purposes, as proposed by the Joint Stipulation, may be reasonable and in the best interest of West Virginia consumers. The Commission made this determination fully aware that

⁶ EPA's regulations known as MATS (Mercury and Air Toxics Standards).

there could be future federal legislation or regulations that could increase the net cost of generation at Harrison to such an extent as to offset the benefits to utility customers. Concerned with future uncertainty regarding carbon emissions and the margins on sales into the PJM market, the Commission decided to further safeguard the public interest and established certain conditions for approval of the Transaction, as modified by the Joint Stipulation. Order at 34-36. The Commission established these conditions as a hedge against the risk to rate-payers and to provide for an equitable sharing of risks. The Commission explained,

Because of the uncertainties, however, related to carbon emission costs and market prices, the Stipulating Parties have not demonstrated that a final decision to allow a \$257 million Acquisition Adjustment in rate base on a permanent basis subject to unrestricted rate recovery is reasonable and will not adversely affect the public. Based on the record in this case, approving the inclusion of only the \$257 million Acquisition Adjustment in rate base is reasonable as long as there is some mechanism in place for sharing of the risk of future carbon costs, market prices, or other factors that might diminish the value of Harrison to AE Supply if it retained ownership, and that would likewise reduce the value of Harrison to Mon Power if it acquired ownership.

The West Virginia customers of MP/PE should not solely bear that risk. In order to provide for an equitable sharing of risks, the Commission will approve the Transaction as modified by the Joint Stipulation, subject to certain additional conditions.

Order at 34-35.

The Commission imposed the following conditions in its approval of the proposed transaction, as modified by the Joint Stipulation.

- If FirstEnergy does not make additional equity investment to offset the decline in equity caused by the write off of the \$332 million acquisition adjustment disallowed in rates, MP/PE must agree not to pay and FirstEnergy must agree that it will not receive dividends from MP/PE until the equity to total capital ratio of MP/PE returns to forty-five percent.

- If the FERC determines that the purchase price paid by MP/PE exceeds the fair market valuation of Harrison, the portion of the \$257 million acquisition adjustment that exceeds fair market value will be returned to MP/PE in cash, and a refund will be credited to the acquisition adjustment account.

- Since a significant benefit of the plant is the expectation of profits from off-system sales, the proceeds of which are credited to the benefit of rate-payers, the Commission will periodically review the return associated with the \$257 million dollar acquisition adjustment and the amount of achieved net margin from off-system sales. If the monthly accumulation of return allowed in rates exceeds fifty percent of the achieved net margins from off-system sales, a prospective adjustment credit will be imbedded in prospective base rates. In other words, that difference will be returned to rate-payers. Order at 35-36.

The Order further directed that before the Transaction could proceed, MP/PE and FirstEnergy would have to agree with the conditions by written verified statements filed with the Commission. FirstEnergy and MP/PE have done so.

The Commission Order did not grant its consent and approval regarding a revised amended mutual assistance agreement between the MP/PE and its affiliates. Noting various concerns with the proposed agreement, the Commission stated that it would issue a separate order assigning the review of that agreement to a new case number.

Following the issuance of the Commission's final order, the WVCAG filed an appeal with this Court alleging the following assignments of error:

A. The Commission's approval of any acquisition premium in the rate base attributable to the Harrison power plant purchase violated universally recognized principles of 'cost-based'

rate making, and the Commission's own consistency applied precedent in prior cases.

B. The Merger Stipulation incorporated into the Commission 2010 decision approving the merger of FirstEnergy and Allegheny Energy, expressly prohibited the pass through to W. Va. rate payers of 'any acquisition premium' associated with the merger transaction.

C. The Commission findings that likely future carbon costs and speculative price projections barred the unconditional pass-through to West Virginia rate payers of either a \$589 or a \$257 million 'acquisition adjustment,' also barred PSC approval of the 'conditional' pass through of a \$257 million markup over the original cost of Harrison.

D. In the absence of any substantial evidence that the Harrison sale was the product of 'arms length negotiations,' the PSC's approval of the Harrison purchase violates W.Va. Code §24-2-12 prohibition against 'undue advantage' in inter-affiliate transactions.

WVCAG Petition at 1.

SUMMARY OF ARGUMENT

The WVCAG attempts to elevate general regulatory policy to a legal maxim. As a result, WVCAG makes the erroneous argument that the Commission's approval of the recovery, in rates, of any acquisition adjustment violates universally recognized principles of cost-based ratemaking and the Commission's own consistently applied precedent in prior cases. The Petitioner has mined other state decisions for snippets of statements of general principle, which it then equates to inflexible legal principle. The WVCAG's contention is refuted by a more thorough review of the state decisions and Commission precedent that it cites. A review of the cases cited by WVCAG demonstrates that, contrary to the WVCAG erroneous argument, the recovery of an acquisition adjustment is frequently allowed – usually when it is shown that the acquisition adds value or benefits to the public served.

The assertion that the Commission's decision violates the 2010 Commission Order that incorporated the merger stipulation approving the merger of FirstEnergy and Allegheny Energy, is also in error. The 2010 merger order did not contemplate nor was it intended to apply to the future acquisition by the West Virginia utilities of the ownership interest in Harrison of AE Supply, an entity that is not a West Virginia utility. As explained by the Commission in its Order, the only application that the language could have had at the time that it was submitted to the Commission was to prohibit a pass through of any acquisition adjustment associated with a write-up of the assets owned by West Virginia utilities, at the time of the transfer, which would result in higher rates to West Virginia rate-payers.

The third assignment of error contends that the same concerns that prompted the Commission to condition the transaction, uncertainty regarding future carbon costs and uncertainty as to future margins from system sales, should bar Commission approval of the "conditional" pass-through of the acquisition adjustment. This argument not only ignores the purpose of the conditions set forth in the Commission's Order, but also, blatantly mischaracterizes the Commission discussion and ignores the express language of W. Va. Code §24-2-12. The language of that statute expressly allows the Commission to condition a transaction associated with granting its prior consent and approval for the utility to enter into the transaction. WVCAG's argument is tantamount to stating that when reviewing any proposed transaction under W. Va. Code §24-2-12, if the Commission finds it necessary to condition the transaction, it should disapprove the transaction. That is not the law. It also ignores the express language of the statute that the Commission may, when it deems necessary, attach conditions to a transaction.

Finally, the WVCAG fabricates a legal standard that it attempts to equate to one of the factors that the Commission must consider when reviewing a transaction subject to W. Va. Code §24-2-12. WVCAG argues that in the absence of what it deems any substantial evidence that the Harrison sale was a product of arms-length negotiations, subsequent approval of the transaction violates W. Va. Code §24-2-12 prohibition against undue advantage. Stated simply, there is no “special test” in the statute regarding transactions among affiliates. Furthermore, the statute does not mention the need for arms-length negotiations. Undue advantage does not mean whether one of the parties had a superior bargaining position to the other in the negotiation. It means instead under the transaction as negotiated, whether one of the parties is given an undue advantage over the other. That is the language of the statute, and the question is necessarily addressed in the Commission’s analysis of the overall transaction. That is, whether the terms and conditions of the transaction are reasonable and do not adversely affect the public in the State.

ORAL ARGUMENT

The Court has issued a scheduling order setting the matter for oral argument.

STANDARD OF REVIEW

The standard of review applied by this Court to a Commission order has been frequently stated.

The detailed standard for our review of an order of the Public Service Commission contained in Syllabus Point 2 of Monongahela Power Co. v. Public Service Commission, 166 W.Va. 423, 276 S.E.2d 179 (1981), may be summarized as follows: (1) whether the Commission exceeded its statutory jurisdiction and powers; (2) whether there is adequate evidence to support the Commission’s findings; and, (3) whether the substantive result of the Commission’s order is proper.

This Court has also explained that,

“ ‘An order of the public service commission based upon its finding of facts will not be disturbed unless such finding is contrary to the evidence, or is without evidence to support it, or is arbitrary, or results from a misapplication of legal principles.’ United Fuel Gas Company v. The Public Service Commission, 143 W.Va. 33, [99 S.E.2d 1 (1957)].” Syllabus Point 5, in part, Boggs v. Public Service Comm’n, 154 W.Va. 146, 174 S.E.2d 331 (1970).

Syllabus Point 1, Broadmoor/Timberline Apartments v. Public Service Commission of West Virginia, 180 W.Va. 387, 376 S.E.2d 593 (1988); Syllabus Points 1 and 2, New Martinsville, et al. v. Public Service Commission, 229 W.Va. 353, 729 S.E.2d 188, (2012).

In discussing the review of a Commission Order to determine whether the Commission has abused or exceeded its authority, the Court has held:

“In reviewing a Public Service Commission order, we will first determine whether the Commission’s order, viewed in light of the relevant facts and of the Commission’s broad regulatory duties, abused or exceeded its authority. We will examine the manner in which the Commission has employed the methods of regulation which it has itself selected, and must decide whether each of the order’s essential elements is supported by substantial evidence. Finally, we will determine whether the order may reasonably be expected to maintain financial integrity, attract necessary capital, and fairly compensate investors for the risks they have assumed, and yet provide appropriate protection to the relevant public interests, both existing and foreseeable. The court’s responsibility is not to supplant the Commission’s balance of these interests with one more nearly to its liking, but instead to assure itself that the Commission has given reasoned consideration to each of the pertinent factors.” Syllabus Point 2, Monongahela Power Co. v. Public Service Commission, 166 W.Va. 423, 276 S.E.2d 179 (1981).

Syllabus Point 1, Mountain Communities for Responsible Energy v. Public Service Commission, 222 W.Va. 481, 665 S.E.2d 315 (2008).

ARGUMENT

Three of WVCAG’s four assignments of error relate to the recovery of an acquisition

adjustment. The assignments of error will be discussed seriatim as presented in the Petition.

- 1. The allowance of a recovery of an acquisition adjustment neither violates universally recognized principles of cost base ratemaking or past Commission precedent.*

It is helpful to have a clear understanding of what constitutes an acquisition adjustment and how it is treated for accounting purposes.

The Commission rules for the regulation of electric utilities provides that all electric utilities are required to maintain their books and records in accordance with the “uniform system of accounts” established by the Federal Power Commission, as published in Title 18 C.F.R. parts 101 and 104, and in effect as of January 1, 1977. Rules and Regulations for the Government of Electric Utilities, 150 CSR 3, Rule 2.4.

The uniform system of accounts requires that the acquisition of electric plant be recorded in detailed plant accounts at original cost and any amount paid in excess of original cost be recorded in a separate account. The plant accounts should record electric plant at the net original cost incurred by the person who first devoted the property to utility service. If that original cost is not known, it should be estimated. Any difference between the net original cost of electric plant and the amount actually paid for the plant must be recorded in a separate account entitled Electric Plant Acquisition Adjustments. The \$257 million which is the acquisition adjustment referenced in the Commission Order and the Petition, represents the difference between the amount allowed in rate base for recovery from rate-payers and the original net book value of the plant.⁷ The uniform system of accounts gives instruction as to how the acquisition price is to be booked for accounting purposes. It gives no direction as to the circumstances under which an

⁷ Allegheny Energy Supply acquired part of its interest in Harrison from both Pennsylvania and West Virginia utilities. When FirstEnergy merged with Allegheny Energy Supply, GAAP accounting required FirstEnergy to establish that plant on its books at fair value. The value of the Harrison plant was established on the books of AE Supply at \$1.24 billion. The Acquisition Adjustment of \$257 million represents the difference between the amount conditionally allowed in rate base, by the Commission Order, and the original net book value of the plant.

acquisition adjustment can or should be allowed in rates.

A. Other state authority regarding acquisition adjustments

The dollar amount of the acquisition adjustment, \$257 million, is not an issue. WVCAG contends that the Commission was wrong as a matter of law in its conditional approval of any rate recovery of that acquisition adjustment. WVCAG selectively cites decisions by other state regulatory commissions regarding acquisition adjustments in support of its erroneous contention that the Commission conditional allowance of the acquisition adjustment “violates” universal principles of “cost-based-ratemaking.” WVCAG Petition, fn 12.

Contrasted with the wording of its assignment of error, the WVCAG vacillates in its argument and states in its Petition that a regulatory commission can allow an acquisition adjustment in rates but only when the utility can show “the existence of extraordinary circumstance.” Petition at 27. WVCAG is correct that state commissions, including the West Virginia Commission, can, and do, allow the recovery of acquisition adjustments in rates. The test, however, is not the “existence of extraordinary circumstances.” As will be shown in the following discussion, the test actually varies from state to state which, in most of the states included in WVCAG’s argument, is a matter of regulatory policy established by the particular state commission rather than by state statutes.

The authority cited by WVCAG in its footnotes 12 and 13, when studied in detail, actually refute its assertions that the West Virginia Commission violated universally established principles regarding cost based ratemaking by allowing a conditional recovery of the acquisition adjustment.⁸ Not only are acquisition adjustments allowed, but certain states compare fair value

⁸ Footnote 12 contains cites to twenty-one other state regulatory decisions or state laws. As an addendum to its Petition, the WVCAG has supplied links for the string cite contained in footnote 12. Unfortunately, many of those links do not lead directly to the decisions in the states, however, some do and many of these decisions can be found through Lexis search.

to purchase price instead of comparing the original book cost to purchase price. This, of course, is totally within the domain and regulatory policy of individual states.

The first “authority” cited by WVCAG, the Alaska statute and commission decision, illustrates the critical error and selective bias in WVCAG’s argument. WVCAG has presented a quotation from the Alaska decision, that suits its purpose, but has omitted the result of the actual decision. The WVCAG includes this quote from the Alaska order that refers to a state statute:

This statute states a well-accepted ratemaking principle that acquisition adjustments will not generally be allowed in a utility’s rate base because the ratepayers should not be required to pay the cost of speculation in utility assets. We have recognized an exception to the general rule against acquisition adjustments when the rate payers will benefit, and the utility has demonstrated specific, tangible benefits in an amount at least equal to the cost of the acquisition adjustment. We have disallowed acquisition adjustments when alleged benefits are speculative or derived from causes other than the acquisition.

WVCAG Petition, p. 27, fn 12.

Immediately prior to the quote provided by WVCAG, the Alaska Commission cited the statute that provides in pertinent part that:

In determining the value for rate-making purposes of public utility property used and useful in rendering service to the public, the Commission shall be guided by acquisition cost or, if lower, the original cost of the property to the person first devoting it to public service...

Golden Heart Utilities, Inc., U-02-13, Commission of Alaska Order at 7, March 19, 2003.

Immediately following the quote provided by WVCAG in its Petition, the Alaska Commission stated and determined that:

In this case, we are persuaded that the acquisition of CUC was necessary for ratepayers of both GHU and CUC to enjoy benefits of consolidation and savings from the pipe replacement technology of U-Liner North, Inc. Although we cannot compute with certainty the amount of the benefits to ratepayers, we are

persuaded that the benefits are tangible, not speculative, and that they are likely to exceed the actual costs to ratepayers of paying for a return on and return of the acquisition premium over thirty years. We therefore approve the acquisition adjustments agreed to in the stipulation. In the year 2004 rate case agreed to by the parties, and future rate case of GHU and CUC, the respective acquisition adjustments with appropriate amortization will be included in the rate base.

Alaska Order at 8 (emphasis added). Acknowledging the “guidance” provided by statute, the Alaska Commission clearly viewed the issue of allowing rate recovery of the acquisition adjustment as being within its discretion. Although it acknowledged that it could not compute the benefits to rate-payers with certainty, it allowed recovery of the acquisition adjustment.

The Connecticut decision, cited by WVCAG, and the language quoted by the WVCAG from that decision, actually demonstrate that acquisition adjustments are not based on original book value in Connecticut and that rate recovery of an acquisition adjustment could be allowed. As expressed in the language quoted by WVCAG, the Connecticut Department of Public Utility Control (Department) uses the purchase method of accounting to account for a transaction. The purchase method classifies any difference between the purchase price and the value of the assets (rather than original book value) as an acquisition adjustment. In the case cited by WVCAG, the Department determined that the value of the asset could very well result in an acquisition loss. Consequently, the recovery of the acquisition adjustment was not allowed. Philadelphia Suburban Corp., Docket No. 02-11-14, Order of the Connecticut Dept. of Utility Control at 9-10, April 23, 2003.

WVCAG next quotes language from a rule adopted by the Florida Commission that would allow a positive acquisition adjustment to be recovered in rates upon the showing of the “existence of extraordinary circumstances.” Whether the purchase price was made as part of arms-length transaction is listed as an example of what might be considered in determining

whether extraordinary circumstances exist. Interestingly, the WVCAG has incorporated the Florida rule for two propositions advanced in its Petition - the need to demonstrate “extraordinary circumstances” and to show arms-length negotiations. As later discussed, WVCAG errs in its efforts to apply these concepts to West Virginia. Simply by reviewing its express language, the Florida rule does not bar the recovery of acquisition adjustments in all situations.

The Illinois statute cited is legislative direction regarding the valuation of electric power generation plant for the purposes studying the impact of deregulating generation upon taxing districts in the state. In the Indiana case cited, although the Indiana Commission determined that the applicant had not met its test for recovery of an acquisition adjustment, the Indiana Commission nevertheless allowed in rate base a much higher “fair value” rate base (much higher than original cost). Again, these decisions do not support the contention that there is a universal bar to the recovery of acquisition adjustments.

An examination of the remaining state authority cited by WVCAG shows that the majority of the other states allow recovery of acquisition adjustments. Each state, however, has its own standard of what must be shown to justify such a recovery – Kansas (must show extraordinary circumstances); Kentucky (unless the utility can prove with conclusive evidence that the overall operations and financial conditions of the utility have benefited from acquisitions at prices in excess of net book value); Louisiana (recovery of an acquisition premium falls within the discretion of this Commission); Michigan (only where rate-payers receive a net benefit from the change in ownership); Montana (must be a showing of good cause); Oregon (when the benefits of the acquisition outweigh the increase to customers rates resulting from an acquisition adjustment); South Carolina (the acquisition generates savings); Virginia (a finding of net benefit

to the rate-payer); Washington (upon a showing that the acquisition confer benefits commensurate with the premiums paid); Wisconsin (a showing of sufficient system or economic benefits resulting from the acquisition).

These different state policies demonstrate, contrary to WVCAG assertion, that there is no universal principle of law prohibiting recovery of acquisition adjustments in rates. The policies regarding rate recovery vary from state to state, but in the majority of states cited by the WVCAG, acquisition adjustments can be recovered upon certain showings. In addition, some states use different methods of determining whether an acquisition adjustment exists. Although the majority compare original book cost to the purchase price, some compare the value of the asset purchased to the purchase price.

B. West Virginia Commission precedent regarding acquisition adjustments

WVCAG next argues that the Commission has violated its own precedent by allowing the conditional recovery of an acquisition adjustment. The Petition states that the “rules adopted state by state by regulatory Commissions across the United States reflect these principles. And the same rule has been adopted in the long line of West Virginia PSC decisions.” Petition at 27. It is unclear what rule WVCAG maintains has been adopted by the Commission. Its assignment of error maintains that any allowance of acquisition adjustment is illegal *per se*. That is clearly not the case. However, WVCAG also cites to a treatise by Bonbright, Danielson and Kamerschen for the proposition that “rate base adjustments are generally not made unless the utility can demonstrate actual, distinct and substantial benefits to all affected ratepayers.” Petition at 27. Obviously, this quote directly contradicts the WVCAG assertion that the Commission Order violates legal precedent barring the recovery of acquisition adjustments. Given the snippets taken from past Commission decisions, WVCAG apparently contends that it

is the policy of the Commission not to allow acquisition adjustments under any circumstances. Petition at 30, fn 13. An examination of the cited decisions demonstrates that is not the case.

In the Frontier decision, cited by WVCAG, Frontier sought to acquire the stock of Verizon. The Commission established as a condition that any premium associated with the acquisition of stock would not be recovered from West Virginia customers. The Mountaineer Village case did not require a decision regarding the recovery of an acquisition adjustment because the issue was not before the Commission in that particular case. The remainder of the precedent cited, with the exception of Willow Spring, are motor carrier cases. In motor carrier cases, it is fairly common for transfers to take place at cash values higher than the existing book value of the motor carrier. The Commission has treated those acquisitions as goodwill and generally has not allowed the recovery of purchases in excess of book value in rates.

In discussing the Commission's decision in Willow Spring Public Service Corporation, the WVCAG selectively quotes from the Commission decision, however, once again, it fails to inform the Court of the import of the analysis and decision. Charles Town proposed to acquire the sewer system assets of Willow Spring for a price of \$1.44 million. Staff maintained that the utility had a negative book value while Willow Spring contended that the book value of the utility was \$693,443. In the Willow Spring decision, following Conclusion of Law No. 3 which the WVCAG quotes in its Petition, the Commission stated in Conclusion of Law No. 5 that

Absent adequate sufficient justification, the Commission will not approve the public utility acquisition price that is significantly in excess of the net book value of the utility assets to be acquired. See, Jefferson County Public Service District, Case No. 97-0102-PSWD-PC.

In Conclusion of Law No. 8, the Commission deemed it appropriate that the acquisition adjustment be recovered in this case: given the "combination of the operational efficiencies to

be gained and the public interest that will be served by eliminating one small utility and merging it into a larger utility, as well as the lower facilities costs for Charles Town to serve WVU Hospital.” Willow Spring Public Service Corporation, PSC Case No. 12-0217-S-PC, Final Order, Conclusions of Law No. 5 and 8, January 8, 2013.

Thus, the Willow Spring decision does not support WVCAG’s contention. Furthermore, the Willow Spring decision does not establish the burden, argued by WVCAG, of proving the “existence of extraordinary circumstances.” The Commission policy requires “adequate and sufficient justification.” Willow Spring, Conclusion of Law No. 5. In allowing the acquisition adjustment in Willow Spring, the Commission Order stated:

Similar to the evidence in the Jefferson County Case, there was evidence presented in this case that efficiencies will be gained by consolidation in that elimination of one small utility through merger with a larger utility serving a wider territory will serve the public interest. There is also testimony that future service to WVU Hospital, if it is provided by Charles Town, can be accomplished more economically if Charles Town owns Willow Spring. [cites omitted] There is also testimony that Charles Town will operate the former Willow Spring assets at a much lower cost.

Willow Spring Order at 6.

In the Order, *sub judice*, the Commission summarized the benefits of Harrison by pointing to factors established in the record. Harrison is a high value asset that can adequately meet MP/PE’s compelling need for additional capacity. The plant will continue to be a proven contributor to the economy and well-being of North Central West Virginia. The plant uses West Virginia coal and will help to preserve mining jobs over the long term. Harrison has low operating costs, historically high capacity factors, installed environmental controls and ongoing plans for additional controls for MATS compliance. The additional capacity will generate expected profits from future system sales. The risk associated with minority ownership of

generation will be eliminated. If MP/PE does not acquire Harrison, its alternatives involve higher costs. Commission Order at 24-33. Furthermore, for reasons stated in the Order and Statement of the Case, the Commission established conditions associated with recovery of the acquisition adjustment. All of these factors, including the provisions in the Joint Stipulation, constitute “adequate and sufficient justification” for the conditional allowance of the acquisition adjustment associated with the approved transaction.

Not only does the precedent cited by WVCAG not support its argument, the regulatory decisions cited in the WVCAG Petition involve situations where a state regulated utility is being acquired at a premium by another entity to serve the same customers. If an entity is already regulated by a state regulatory authority for rate purposes, it already has an established rate base value included in its overall cost of service which determines the amount of rates charged to customers of that entity. In such cases, it is easy to understand why a state regulatory authority is generally not going to allow a write-up the value of the rate base unless there are offsetting benefits to rate-payers.

This case, however, is completely different. It involves the acquisition by a West Virginia utility of a valuable electric plant which is not already in any West Virginia utility’s rate base and is not presently dedicated to serve West Virginia utility customers. The appropriate focus of the inquiry as to what amount should be recovered in West Virginia rates is a determination of the value of the plant to the utility and its rate-payers. The seller understandably expects to receive a fair market value for the plant. If a purchase, even at a price above original cost book value, is a reasonable and cost effective alternative for a West Virginia utility, it would be unreasonable for the Commission to deprive the utility and its rate-payers of the opportunity to acquire needed plant capacity at a fair value by applying a rigid rule that

would limit rate recovery to original book value. As conditioned by the Commission, the amount to be added to rate base associated with the Harrison transaction is \$858.3 million (that includes a \$257 million acquisition adjustment). That cost is less than the cost of comparable natural gas generation. It is a fair value, supported by the parties to the Joint Stipulation, and is considerably less than the independent values determined by KPMG in 2011 of \$1.164 billion and the value determined by Navigant in 2012 of \$1.333 billion.⁹

In summary, for the reasons stated in the Commission's Order as supported by the record in the proceeding, the determination that there should be the opportunity for a conditional recovery of the acquisition adjustment by the utilities is not violative of any universal legal principles regarding cost-based ratemaking or of prior Commission precedent.

2. The Commission Order does not violate the merger stipulation or the merger order that approved the merger of FirstEnergy with Allegheny Energy Inc.

The WVCAG contends that the Commission decision regarding the conditional recovery of an acquisition adjustment violates the merger stipulation and the Commission Order that approved the acquisition of Allegheny Energy Inc. and its subsidiaries, including Mon Power and Potomac Edison, the two West Virginia utilities, by FirstEnergy Corp. Monongahela Power Company, et al., PSC Case No. 10-0713-E-PC, Final Order, December 16, 2010. The merger stipulation among the parties to the merger case contains the following provisions:

Non-Recovery of Acquisition Premium/Goodwill. First Energy agrees 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.

⁹ "At the time of the FirstEnergy/Allegheny Energy merger in 2011, the value of Harrison to AE Supply was initially determined by KPMG and projected to May 1, 2013 as \$1.164 billion. Navigant, an independent company hired by Mon Power in 2012 to estimate the same value, determined the value as of December 31, 2012 to be \$1.333 billion or approximately \$170 million more than the proposed sale price. Co. Exhibit Ex. TH-D (Houlihan) at 7; MP/PE Ex. 1 at 13 and at Ex. H.1 at 6." Commission Order at 25.

and

No Regulatory Assets Related to Merger Accounting. Mon Power and Potomac Edison will not establish or record on their books any new regulatory assets related to merger accounting.

Merger Stipulation, Case No. 10-0713-E-PC, Commission Order, Ex. A at 8. (December 16, 2013) The Commission approved the merger conditioned on the commitments in the merger stipulation.

When this case was contested at hearing, some of the parties contended that the proposed purchase price of \$1.2 billion for the Harrison interest violated the merger stipulation because it included a \$589 million acquisition adjustment, which MP/PE proposed to recover from West Virginia rate-payers in its entirety. Subsequent to the evidentiary hearing, as previously described in the Statement of the Case, the parties abandoned this argument, except for WVCAG, and requested that the Commission approve the Transaction with a total purchase price of \$858 million which included an acquisition adjustment of \$257 million.

Because WVCAG continued with its argument that the reduced purchase price with the \$257 million acquisition adjustment violated the merger stipulation, the Commission determined that it was necessary to address the issue in detail in its order. Commission Order at 19-23. The Commission decision on this issue included the following discussion:

The intent of the Merger Stipulation was to prevent First Energy and MP/PE from requesting an increased West Virginia jurisdictional rate base valuation related to the First Energy purchase price of Allegheny Energy in excess of book value at the time of the merger. Thus, we expected that the Merger Stipulation would assure all parties that Mon Power (and West Virginia rate base assets of Potomac Edison) would remain unchanged regardless of the amount paid by First Energy for Allegheny Energy. Pursuant to the Merger Stipulation, First Energy could not push down or allocate any return requirement or expenses that would be intended to compensate it for the excess purchase price of Allegheny Energy. The Commission has found no evidence in

the record that indicates the value of the current assets of MP/PE have been impacted by the Merger-related accounting entries.

The Merger Stipulation was not intended and could not reasonably be extended to apply to all possible future affiliated asset transfers, such as the Transaction, that would have to come before us for approval. We believe that First Energy always was free to request a sale of assets to Mon Power at any price. Of course, this could not happen without approval of the Commission, and the Commission would be free to deny the request if it believed that the purchase price was unfair or unreasonable. In the alternative, if it was shown to be in the public interest, the Commission could approve the purchase even at a price in excess of net original cost, but disallow all or a portion of the resulting Acquisition Adjustment for ratemaking purposes.

The Commission consented to the First Energy/Allegheny Energy merger under W.Va. Code §24-2-12 subject to the commitments of the stipulating parties in that case. Although we conclude that the provision does not apply to this Transaction, the effect of the argument that the Merger Agreement is violated by the Transaction is to contend that the Commission is precluded from determining whether it is in the public interest for MP/PE to acquire Harrison at a price that exceeds net original book value. [footnote omitted] We believe that the contention that the Merger Stipulation from Case No. 10-0713-E-PC binds our efforts in this and future cases is inconsistent with the delegation of Legislative authority that is the heart of the public utility regulatory scheme in place.

The Transaction we are considering in this proceeding is a request for Mon Power to purchase an asset (Harrison) at a price that exceeds its net original cost as reflected on the books of AE Supply. Mon Power divulged that fact from the time of its Petition by showing that the journal entry to record the purchase includes an Acquisition Adjustment of nearly \$600 million. Mon Power did not attempt to hide that fact by pretending that the appropriate net Plant In Service balance on AE Supply books was \$1.2 billion and there would be no Acquisition Adjustment.

We may not even be facing this issue had Mon Power not attempted to shed favorable light on the \$1.2 billion purchase price for Harrison by announcing that it was merely paying the book value of Harrison as recorded on the books of AE Supply. Because Mon Power described the purchase as being at book value, once Parties recognized that the referenced book value

included the merger-related fair value adjustment, the perception of a violation of the Merger Stipulation was born.

The fact is, the Transaction was not dictated, controlled, or dependent on the fair value adjustment made at the time of the merger. AE Supply was asking a price it felt was justified by the benefits the acquisition would bring to Mon Power, and MP/PE were asking that they be allowed to pay that price which included an Acquisition Adjustment. That request was not a violation of the Merger Stipulation.

Order at 22-23.

WVCAG attempts to argue its assignment of error two different ways. Faced with the reality that the merger stipulation does not contain a specific provision about the future transfer of AE Supply's ownership interest in Harrison to MP/PE, WVCAG attempts to argue that it should be apparent that if the parties to the merger stipulation had thought this was a possibility, they would have placed such a provision in the merger stipulation prohibiting any recovery of a possible future acquisition adjustment. Not only is this idle speculation on the part of WVCAG, it is squarely refuted by the fact that parties to the merger stipulation signed a stipulation in this case that recommended rate recovery of \$257 million of the acquisition adjustment.¹⁰

WVCAG also attempts to apply contract law to the merger stipulation. Petition at 32-34. WVCAG contends that the Commission is contractually bound to its merger order and the merger stipulation entered in 2010. There is no legal precedent or justification for this contention. Although the Commission held that the plain language of the merger stipulation does not apply to the subsequent transfer of AE Supply's interest in Harrison to the West Virginia utilities, the Commission also found that WVCAG's contention, that the merger stipulation from Case No. 10-0713-E-PC binds its regulatory role and functions in this and future

¹⁰ Parties who signed the merger stipulation, which also signed the Joint Stipulation in this case, include the utilities, Commission Staff, Consumer Advocate Division, West Virginia Energy Users Group, Utilities Workers Union of America, AFL-CIO, Local Union No. 2357 of the International Brotherhood of Electric Workers, and West Virginia State Buildings and Construction Trade Council, AFL-CIO.

cases, is patently inconsistent with the delegation of legislative authority that is the heart of the public utility regulatory scheme created by the Legislature and as interpreted by this Court.

Commission Order at 22-23. In its Order, the Commission explained that:

We undertook an extensive discussion of the Legislative History of the utility ratemaking authority and the ratemaking processes of the Public Service Commission of West Virginia as a part of our analysis in Century Aluminum of West Virginia, Case No. 12-0613-E-PC, (Order issued October 4, 2012) (Century Order). See discussion, generally at Century Order at 5-15. As we said in the Century Order:

[T]he Court has consistently and emphatically held that the Commission is the sole authority to determine the public interest in utility regulatory matters. In 1914, the Court stated “it is not for the reviewing court to substitute its judgment for that of the Commission on question of expediency, or as to what would be the best in the interests of the petitioner, or of the public served. On all such question, we think the Legislature intended the judgment of the Commission should prevail.”

Century Order at 14. United Fuel Gas Co. v. Public Serv. Comm’n, 73 W. Va. at 591, 80 S.E. at 939; Mountain State Water Co. v. Kingwood, 122 W.Va. 374, 9 S.E.2d 532 (1940); C&P Telephone Co. v. City of Morgantown, 144 W.Va. 149, 107 S.E.2d 489 (1959); State ex rel WDA v. Northern Wayne County PSD 195 W.Va. 135, 464 S.E.2d 777 (1995); South Charleston v. Public Serv. Comm’n, 204 W.Va. 566, 514 S.E.2d 622 (1999); West Virginia Citizens Action Group v. Public Serv. Comm’n, 175 W.Va. 39, 300 S.E. 2d 849 (1985).

Order at 22-23, fn 5.

This Court has held that:

“The Public Service Commission was created by the Legislature for the purpose of exercising regulatory authority over public utilities. Its function is to require such entities to perform in a manner designed to safeguard the interests of the public and the utilities. Its primary purpose is to serve the interests of the public. *Boggs v. Public Service Commission*, 154 W.Va. 146, 174 S.E.2d 331 (1970).” Syllabus Point 1, *West Virginia-Citizen Action*

Group v. Public Service Comm'n, 175 W.Va. 39, 330 S.E.2d 849 (1985).

Syllabus Point 4, Mountain Communities for Responsible Energy v. Public Service Commission, 222 W.Va. 481, 65 S.E.2d 315, (2008)

The Court has recognized the Commission's role in an application under W.Va. Code §24-2-12 to apply the statutory test of (i) whether the terms and conditions thereof are reasonable, (ii) neither party thereto is given an undue advantage over the other, and (iii) do not adversely affect the public in the state.¹¹ Syllabus Point 3, United Fuel v. Public Service Commission, 154 W.Va. 221, 174 S.E.2d 304, (1969). The Court has acknowledged the legislative direction provided in W.Va. Code §24-1-1(b) that the Commission is charged with the responsibility for appraising and balancing (i) the interest of current and future utility service customers, (ii) the general interest of the state's economy, and (iii) the interest of the utilities subject to its jurisdiction in its deliberations and decisions. Burch, et al. v. Nedpower Mount Storm, LLC, 220 W.Va. 443, 647 S.E.2d 879, (2007).

The Commission exercises its legislative and regulatory authority and duty within the context of the record made in each case. As the Court has recognized "when the Public Service Commission is exercising its rate-making authority under W.Va. Code §24-2-3 (1983), its decisions are not subject to the doctrines of *stare decisis* or *res judicata* simply because rate-making is the legislative function." Syllabus Point 4, Central West Virginia Refuse Inc. v. Public Service Commission, 190 W.Va. 416, 438 S.E.2d 596, (1993). Although the application in this proceeding requested prior consent and approval of a proposed transaction involving a

¹¹ The phrase "do not adversely affect the public in the state" is awkward. It could modify either "terms and conditions" or the proposed "transaction." The distinction is immaterial, because either reading is consistent with this Court's holdings that the Commission's primary purpose is to protect the public interest. An acceptable reading of the statute is that the Commission can grant its prior consent if the terms and conditions of the transaction are reasonable, give neither party an undue advantage and do not adversely affect the public.

transfer of utility plant, it also involved a request for rate-making relief, i.e., the proper determination of rate base as a result of the transaction and the establishment of a base rate increment to recover a return on and of its investment. If, based on a record, the Commission determines that proposed transfer at a particular price is a good value to the utilities as well as its rate-payers, it makes no sense to ignore that value and limit the asset acquisition or the ratemaking therefore to original book value as opposed to a fair value as determined by the Commission. The sale may not happen if the seller does not receive market value or the purchaser is not compensated for its investment. That result would prevent the utility and its rate-payers from acquiring a valuable asset.

The plain language of the merger stipulation was not intended to apply to a future sale to a West Virginia utility, MP/PE, of an asset owned by an entity not regulated as a West Virginia utility. Alternatively, the merger order and the merger stipulation does not control future commission decisions. The Commission's determination that it is in the public interest for the transaction to take place at the stipulated price subject to the additional conditions imposed by the Commission is supported by the record in this case. As the Court has stated, "this Court will not substitute our judgment for that of the Public Service Commission on controverted evidence." Syllabus Pt. No. 2, Chesapeake and Potomac Telephone Company West Virginia v. Public Service Commission, 171 W.Va. 494, 300 S.E.2d 607 (1982); Syllabus Point 2, Harrison Rural Electric Association Inc. v. Public Service Commission, 190 W.Va. 439, 438 S.E.2d 782, (1993).

3. *The reasoning of the Commission in placing conditions on the recovery of the \$257 million acquisition adjustment does not bar Commission approval of the transaction in the conditional recovery of the \$257 million acquisition adjustment*

The WVCAG argues that the same findings that led the Commission to condition the recovery of the \$257 million acquisition adjustment also barred the Commission from approving the conditional recovery of the \$257 million acquisition adjustment. That is directly contrary to the provisions of W. Va. Code §24-2-12, is a circular and disingenuous argument, and ignores the context of the Commission's reasons for imposing conditions.

Given the level of capacity deficiency that existed, MP/PE presented evidence on the cost of new coal-fired generation, new nuclear generation and new gas-fired generation. The Commission Order found that the levelized cost of Harrison is lower than the lowest cost alternative, which is natural gas generation. Order at 26-28. In addition, the Commission found that because of the lower capacity increments of natural gas combined-cycle units and because of the relatively high cost of generation per MWh, both of which contribute to lower expected capacity factor of a natural gas unit, it is less likely that there would be excess capacity from a gas plant that could be sold in the off-system sales market compared to excess capacity from a coal generation facility. Therefore, in any cost analysis comparing natural gas to coal fired generation, the cost to customers of a coal-fired plant will be a net cost, after crediting off-system sales margins against the cost of new capacity and generation. Furthermore, the Commission Order, as previously discussed in detail the many benefits of the Harrison plant. Order at 24-33.

The Commission recognized the future uncertainty of carbon emission regulation, the cost thereof, and the possible negative impact higher generation costs may have on margins from future off-system sales. By necessity, the consideration of conflicting testimony regarding future events, and how to mitigate the risks, involves the regulatory judgment of the Commission. The

Commission established conditions as a hedge to ratepayers regarding recovery of the \$257 million acquisition adjustment.¹² The Commission established the conditions to insure an appropriate and adequate sharing of risk as to future market conditions. Order at 35.

The WVCAG attempts to impair the Commission's exercise of judgment in the carrying out of its authority and duties. The WVCAG effectively argues that if the Commission believes it is necessary to impose conditions to a transaction, the Commission should disapprove the transaction. The specific language of W. Va. Code §24-2-12, however, expressly provides that the Commission can attach to a proposed transaction "such conditions as it may deem proper." The WVCAG argument is contradictory to the express language of the Code.

In its zeal to persuade the Court, WVCAG speculates that, if MP/PE has a future inability to recover all of the allowed acquisition adjustment, financial markets would downgrade future bond issues leading to higher debt costs. WVCAG argues that this would be, *per se*, an adverse effect on the public fatal to the transaction requiring disapproval under W. Va. Code §24-2-12. Petition at 40.

There are critical errors in this argument. There is absolutely no record support for the contention that financial markets will downgrade MP/PE bonds if it is unable to fully recover the acquisition adjustment. Furthermore, even if it was certain, that would not be sufficient reason to absolutely deny the transaction. Instead, the higher interest rates would simply be another factor to be balanced against the positive benefits of the transaction in assessing whether the transaction would adversely affect the public interest.

¹² This is discussed in the Commission Order at 26-29.

4. *W. Va. Code §24-2-12 does not require an inquiry as to whether there were arms-length negotiations between the parties.*

WVCAG assigns as error the contention that “in the absence of any substantial evidence that the Harrison sale was the product of ‘arms-length negotiations’ the Commission’s approval of the Harrison purchase violates W. Va. Code §24-2-12 prohibition against ‘undue advantage’ in inter-affiliate transactions.” The WVCAG argument, that permeates its Petition, has no foundation in W. Va. Code §24-2-12.

The Commission Order found that the un rebutted testimony by MP/PE refuted WVCAG’s assertion that there was an unfair negotiation advantage. In its Order, the Commission looked at the end result of the transaction, stating that:

Although WVCAG contends that its principal objection to the Joint Stipulation is that the price is too high, the evidence shows that both the significant agreed-upon reduction in the rate base amount, and the ultimate cost of Harrison that will flow through customer rates as conditioned herein, are reasonable.

Order at 34.

The WVCAG has simply fabricated a legal standard. There is absolutely no mention of a requirement in the statute that a petitioner under W. Va. Code §24-2-12 must show by substantial evidence that the sale was the product of arms-length negotiations. The statute contains no statutory standard unique to affiliated transactions. Affiliated transactions like the other listed transactions within W. Va. Code §24-2-12 are subject to the same legal test. A showing that (i) terms and conditions of the proposed transaction are reasonable and (ii) that neither party thereto is given an undue advantage over the other and (iii) do not adversely affect the public and the state. W. Va. Code §24-2-12. United Fuel Gas Company et al. v. Public Service Commission, 174 S.E.2d 304, 315 and 317 (1969).

WVCAG peppers its Petition with musings regarding, for example, the historical need for monopoly regulation, dealings between affiliates and the development of the Public Utility Holding Company Act, the motives of FirstEnergy to sell AE Supply's interest in Harrison, and no paper was produced showing the nature of negotiations, all of which it argues supports its fabricated legal standard. WVCAG cites absolutely no West Virginia law to support its interpretation of W. Va. Code §24-2-12.

The express words used in W. Va. Code §24-2-12 are enough for a determination of this issue, and, understandable, there have been relatively few cases before this Court regarding transactions under W. Va. Code §24-2-12, much less a direct determination of what the terms of the test mean. WVCAG equates arms-length negotiations to the language that requires a showing that neither party to the transaction “is given an undue advantage over the other.”

The statutory provision uses the present tense of the verb “is.” The test is whether one of the parties to the proposed transaction is (present tense) given an undue advantage over the other, not whether a party was (past tense) given an undue advantage during a negotiation process. The Commission considers whether a party is given an undue advantage in the overall context of the other interrelated statutory provisions regarding whether the terms and the conditions of the transactions are reasonable and whether the transaction adversely affects the public and the state. The Commission has previously found that these statutory elements are intertwined. In a recent decision approving Frontier's acquisition of Verizon, the Commission stated

[t]erms and conditions are subject to review of the Commission and the entire resulting Transaction is evaluated from the standpoint of whether the proposed Transaction will adversely affect the public interest.

Frontier Communications, PSC Case No. 09-0871-T-PC, Final Order at 9, May 13, 2010.

The question of whether one party had an advantage over the other in actual negotiations would prove very difficult to assess and frankly, is immaterial. The motives of the seller are immaterial. The question that the Commission addresses and determines is what was the result of negotiations, specifically, what is the proposed transaction and does it serve the public interest.¹³

This Court has had relatively limited opportunity to address the standards contained in W. Va. Code §24-2-12. In the past forty-five years, the statute was considered in the case of United Fuel Gas Company v. Public Service Commission, 154 W.Va. 221, 174 S.E.2d 304 (1969) and West Virginia Highlands Conservancy Inc., et al. v. The Public Service Commission of West Virginia, 206 W.Va. 633, 527 S.E.2d 495 (1998). The United Fuel case involved a proceeding before the Commission that sought prior consent and approval of a proposed corporate realignment of affiliates under W. Va. Code §24-2-12, which the Commission denied. Although the transaction was one driven by inter-corporate decisions, the Court did not perceive such dealings as giving one party an undue advantage over the other. Instead, the Court determined that the Commission erred in withholding its consent and approval and in the process, observed that:

The proposed realignment plan is not a transaction between independent competing utilities but instead is an inter-corporate transaction between subsidiaries of Columbia Gas Systems Inc. a parent registered holding company and is a prerogative of management, which, however, is subject to regulation by the state in the interest of the public served by a public utility.

United Fuel, 174 S.E.2d at 316.

The Court went on to find that,

¹³ If quality or nature of negotiations are relevant to the Commission decision, which they are not, it would seem more important to examine the negotiations that lead to the Joint Stipulation, since the Commission approved the Transaction as modified by the Joint Stipulation, with additional conditions. Those negotiations were extensive and included WVCAG. September 13, 2013 Transcript at 22 and 26.

The proposed realignment plan involved in this proceeding is a proper inter-corporate agreement, which is a legitimate function of management, and under the evidence in this case, which as to the benefits to the public to be derived from the realignment is not controverted, the Commission should have given its consent and approval to its consummation by the Petitioners.

174 S.E.2d at 317 (emphasis added).

Although not directly addressing the question of “undue advantage,” the Court in its decision stresses and emphasizes that the main issue in a W. Va. Code §24-2-12 proceeding is a question of whether the public interest will be served by approval of the transaction.

The Highlands Conservancy decision upheld the Commission decision that it lacked jurisdiction to review a particular real property transaction under W. Va. Code §24-2-12. The majority decision, however, held that even if the Commission had jurisdiction, it could not withhold consent because of negative environmental impact. The Court stated that

This is because the Commission’s function under *West Virginia Code §24-2-12* does not entail withholding consent for real estate sales based on a negative environmental impact. The limited nature of the Commission’s duty under that statutory provision is simply to examine the proposed sale in terms of how it will impact on the provision of utility services to the consumers of this state. Quite simply, the Commission cannot, based on its limited review functions, address the environmental concerns that are the crux of the Conservancy’s decision to litigate this matter.

527 S.E.2d at 503 (emphasis added). WVCAG argues that the transaction must be denied because of the lack of “arms-length negotiations,” a concept not found in W. Va. Code §24-2-12 or part of the legal test set forth therein. The proper focus is the proposed transaction that is presented to the Commission and an assessment of the impact of the transaction on the public interest.

The United Fuel and the Highlands Conservancy decisions are entirely consistent with holding of the Court that the primary purpose of the Commission is to serve the interest of the public. Boggs v. Public Service Commission, 154 W.Va. 146, 174 S.E.2d 331 (1970), West Virginia-Citizens Action Group v. Public Service Commission, 175 W.Va. 39, 330 S.E.2d 849, Syllabus Pt. 1 (1985); Mountain Communities for Responsible Energy et al. v. Public Service Commission of West Virginia, 222 W.Va. 481, 665 S.E.2d 315, Syllabus Pt. No. 4 (2008). If the transaction gives one party an “undue advantage” over the other, that advantage is going to manifest itself by adversely affecting the public in this State through unreasonable terms and conditions. The Commission found neither in this case and properly approved the proposed transaction as modified by the Joint Stipulation and as further conditioned by the Commission Order.

Finally, in an apparent effort to bolster its legal arguments, the WVCAG completely misstates the financing of the transaction. WVCAG contends that FirstEnergy has taken an undue advantage at the expense of its West Virginia subsidiary “whose rate payers over many decades built up cash reserves in excess of \$1 billion.” WVCAG then contends that the “removal of \$1.1 billion cash from the balance sheet” of MP/PE weakens its “financials and jeopardizes its credit rating. Petition at 41.

This description of the financing of the acquisition is wrong, and WVCAG should know better. Uncontroverted testimony in the case explained that the net cost of the transaction was \$1.102 billion. This amount paid to AE Supply was not coming from a pile of cash built up of revenues from West Virginia rate-payers. The transaction is to be financed by a combination of debt and equity. At closing, FirstEnergy Corp., would make an equity contribution to MP/PE of approximately \$529 million. MP/PE would issue approximately \$573 million of long term

debt.¹⁴ MP/PE Ex. SRS-D (Staub) at 3-4. This infusion of new equity and cash from the issuance of new debt is the source of the consideration to be paid by MP/PE for the acquisition. The write-off of \$332 million does not involve cash – it will reduce equity and plant value that would have been entered on MP/PE’s book on the date of closing. There is a potential impact of this accounting on the leverage, or debt/equity ratio of MP/PE. The Commission, however, recognized that and addressed that potential impact by imposing a condition that FirstEnergy maintain a minimum of a 45% equity ratio investment in MP/PE or, if the equity ratio falls below that level, forgo, dividends until that ratio is achieved.

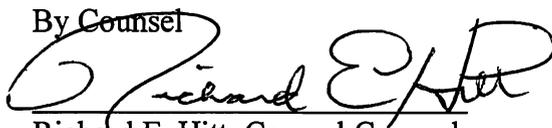
In return, MP/PE acquired AE Supply’s ownership interest in the Harrison plant, valued in excess of \$1 billion by KMPG and Navigant and in excess of \$800 million by the Stipulating Parties.

CONCLUSION

For the foregoing reasons, the Commission respectfully requests that the Court affirm the Commission’s Order granting prior consent and approval for MP/PE to enter into the proposed transactions, as modified by the Joint Stipulation, and as further conditioned by the Commission Order.

PUBLIC SERVICE COMMISSION OF
WEST VIRGINIA

By Counsel



Richard E. Hitt, General Counsel
WV Bar No. 1743
201 Brooks Street, P.O. Box 812
Charleston, West Virginia 25323
Telephone: 304-340-0450
rhitt@psc.state.wv.us

¹⁴ Interim financing was anticipated to account for possible timing differences related to the receipt of regulatory approval and closing.

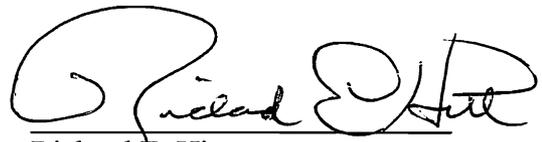
CERTIFICATE OF SERVICE

I, Richard E. Hitt, General Counsel for the Public Service Commission of West Virginia, do hereby certify that copies of the foregoing Statement of Reasons has been served upon the following counsel of record via First Class United States Mail Postage Prepaid on this 27th day of December, 2013:

Christopher L. Callas, Esq.
Counsel, Mon Power and PE
JacksonKelly PLLC
PO Box 553
Charleston, WV 25322

Gary A. Jack, Esq.
Senior Corporate Counsel
Monongahela Power Company
5001 NASA Boulevard
Fairmont, WV 26554

William V. DePaulo, Esq.
Counsel, West Virginia Citizen Action Group
179 Summers Street, Suite 232
Charleston, WV 25301



Richard E. Hitt