

**PENNSYLVANIA
PUBLIC UTILITY COMMISSION
Harrisburg, PA 17105-3265**

Public Meeting held June 14, 2001

Commissioners Present:

John M. Quain, Chairman, Abstaining – Statement attached
Robert K. Bloom, Vice Chairman
Aaron Wilson, Jr.
Terrance J. Fitzpatrick

Joint Application for Approval of the Merger of GPU, Inc. with FirstEnergy Corp.	A-110300F0095 A-110400F0040
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Petition of Metropolitan Edison Company and Pennsylvania Electric Company, as Supplemented, For Relief Under Their Approved Restructuring Plan and the Electricity Customer Choice and Competition Act	P-00001860 P-00001861
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OPINION AND ORDER

BY THE COMMISSION:

Introduction

Now before the Commission for disposition is a Settlement Stipulation (Settlement) of Metropolitan Edison Company (Met-Ed), Pennsylvania Electric Company (Penelec) (together doing business as GPU Energy) ¹ and FirstEnergy Corp. (FirstEnergy) ² submitted in the above-captioned proceedings on June 11, 2001. The Settlement was executed by the Office of Consumer Advocate (OCA),

¹ GPU Energy is referred to in this document as GPU.

² References in this document to Companies includes Met-Ed, Penelec and FirstEnergy.

the Office of Small Business Advocate (OSBA), the Met-Ed Industrial Users Group (MEIUG), the Penelec Industrial Customer Alliance (PICA), and Citizens for Pennsylvania's Future (Penn Future) Intervenors. Additionally, letters of support for the Settlement were submitted by the International Brotherhood of Electrical Workers, Local Union Nos. 459 and 777 and the Utility Workers Union of America, Local Union No. 180. By the Settlement, the signatory parties recommend that the Commission adopt the Administrative Law Judge's (ALJ) Recommended Decision dated April 23, 2001, except as specifically modified by the Settlement, and to further adopt other matters set forth in the Settlement. In addition to requesting approval of the merger, subject to several conditions adopted by Commission Motion on May 24, 2001, the Settlement addresses and resolves various issues relating to GPU's Petition filed on November 29, 2000, and supplemented on February 9, 2001, requesting authorization to implement an interim deferral tracking mechanism for their provider of last resort (POLR) generation service (Deferral Petition).³

In adopting an Order in these proceedings on May 24, 2001, the Commission declined to address the issues raised by GPU's Deferral Petition or to resolve the issues regarding the disposition of merger savings. Although the Commission acknowledged the filing of a Settlement Stipulation by the Companies, MEIUG and PICA on May 7, 2001, the Commission also recognized

³ A more extensive history and background of these proceedings are set forth in a companion order adopted on May 24, 2001 and will not be repeated here.

that the Deferral Petition raises matters regarding issues of rate cap relief, which are of critical importance to other parties in the proceedings. Noting that the record reflected a large degree of uncertainty and disagreement over the fundamental principles that should apply in this type of case, the Commission determined to hold these matters in abeyance to afford the parties an attempt to resolve them in a Commission-facilitated collaborative. The Commission indicated that if the collaborative was unsuccessful in achieving a consensus resolution of these matters, the Commission would decide the issues no later than the Public Meeting of July 13, 2001.

Although the collaborative was not successful in arriving at a consensus resolution of these matters, several parties to the proceeding continued to negotiate, which resulted in the filing of the Settlement representing a comprehensive resolution that is now before the Commission for adjudication. This Settlement is extremely similar to the Settlement Stipulation filed on May 7, 2001, except with one important distinction. Whereas the May 7 filing would have resulted in an immediate rate increase to consumers, the Settlement pending before the Commission contains no such relief for the Companies. Additionally, this Settlement is supported by a much broader group of parties to these proceedings.

On June 11, 2001, the Commission issued a Secretarial Letter to the parties in these proceedings and to all parties in the restructuring proceedings of Met-Ed and Penelec, advising them of the filing of the Settlement. In that letter, the

Commission noted the request of the signatory parties for approval of their proposed resolution of various issues pending before the Commission for adjudication at today's Public Meeting. In inviting interested parties to respond to this Settlement by June 13, 2001, the Commission recognized that the signatories are seeking a resolution that differs from the positions previously taken in pleadings submitted to the Commission in these proceedings. The Commission also indicated that, as with the prior Settlement Stipulation, some provisions might affect or alter certain aspects of the Joint Petition for Full Settlement of the Restructuring Plans of Metropolitan Edison Company and Pennsylvania Electric Company (Restructuring Settlement) approved by Commission Order entered on October 16, 1998 at Docket Nos. R-00974008 and R-00974009.

Comments opposing provisions of the Settlement were timely submitted by ARRIPA, Bruce Mangione, Citizen Power Inc. (Citizen Power), Clean Air Counsel (Clean Air), Dominion Retail, Inc. (Dominion Retail), Mid-Atlantic Power Supply Association (MAPSA), PPL Electric Utilities Corporation and PPL EnergyPlus, LLC (PPL), The New Power Company (New Power), and York County Solid Waste and Refuse Authority (York Authority). Additionally, two signatories to the Settlement, the Companies and OSBA, submitted letters expressing support for the Settlement and urging its adoption by the Commission.

Summary of Settlement Stipulation

By the Settlement, the signatory parties recommend that the Commission adopt the ALJ's Recommended Decision dated April 23, 2001, except as specifically modified by the Settlement, and to further adopt other matters set forth in the Settlement. In addition to requesting approval of the merger, subject to several conditions adopted by Commission Motion on May 24, 2001, the Settlement addresses and resolves various issues relating to GPU's provision of provider of last resort (POLR) service and the deferral of certain costs incurred by GPU to serve POLR customers. While the Settlement is largely predicated upon consummation of the merger between FirstEnergy and GPU, some provisions are included to address the situation in which the merger fails to be consummated and is abandoned.

Initially, the Settlement establishes a mechanism by which GPU may defer for ratemaking and accounting purposes the difference between their charges to retail customers for POLR service and their actual cost of supply, beginning January 1, 2001. Assuming the merger is consummated, this net POLR deferral mechanism would continue through December 31, 2005. During the deferral period, POLR supply costs that fall below POLR charges would be used to offset, and thereby reduce, the amount of the accumulated net POLR deferrals. The net deferred POLR balance, along with carrying costs, would be carried on the Companies' books as a regulatory asset until such amounts are either recovered, or written off on December 31, 2010.

Entries in the deferral accounts would be documented in quarterly reports, subject to full review by the Commission's Bureau of Audits. Additionally, the Settlement imposes an obligation on FirstEnergy to implement a POLR supply procurement strategy that seeks to minimize the POLR supply costs, and also permits GPU to assign all or part of its POLR responsibility to an affiliate, provided that such service is provided to customers at GPU's shopping credits. Also, to facilitate the sale of generation by FirstEnergy to GPU, the Settlement provides for the elimination of the GPU Energy Genco Code of Conduct developed in the Restructuring Settlement.

Further, the Settlement sets customers' total generation rates, including shopping credits and competitive transition charges, through 2010 at the same levels established by the Restructuring Settlement, approved by Commission Order entered on October 16, 1998 at Docket Nos. R-00974008 and R-00974009. The Settlement also extends the distribution rate caps for three years beyond the dates in the Restructuring Settlement, so that these rate caps would now expire on December 31, 2007.

In addition, the Settlement increases the shopping credits for the years 2002 through 2005 above the levels contained in the Restructuring Settlement, and provides for commensurate decreases in the CTCs for those years, resulting in total generation rates remaining at the current levels. Any stranded cost balance on the books in 2010 would be recovered through a continuation of the CTC at the

2006-2010 levels, ending no later than December 31, 2015, at which time any remaining stranded costs would be written off by the Companies.

The Settlement also provides that FirstEnergy may withdraw from the NUG Trust Funds established by the Restructuring Settlement to pay for the full cost of capacity and energy payable under the NUG agreements. The provisions further emphasize that the Settlement should not be construed to affect the rights or obligations of any party under existing NUG agreements. Moreover, the Companies expressly acknowledge their obligations under the NUG contracts until their expiration.

With respect to GPU's Competitive Default Service (CDS) program established by the Restructuring Settlement, this Settlement provides FirstEnergy with the option of whether to implement GPU Energy's CDS program, in a manner and by terms set by FirstEnergy. It also allows affiliated companies, consistent with codes of conduct, to participate and maintains the requirement that successful bids be at or below the shopping credit.

Additionally, under the Settlement, FirstEnergy will deposit \$2.5 million each into Met-Ed's and Penelec's sustainable energy funds and agrees to spend \$10 million on renewable energy projects in the GPU Energy and Penn Power service territories over the next five (5) years. A wind generation-related project may receive up to \$3 million of these dollars. FirstEnergy will consult with environmental parties on how to spend these funds and will report annually to the parties to the stipulation the status of all projects.

The Settlement further provides for the development and implementation of a Demand Side Response (DSR) program by GPU Energy. The program will include the use of interval and time of use metering, and appliance control technologies. GPU Energy will submit a proposal to the parties and to the Commission and engage in a working group to revise and improve the DSR program prior to filing the proposal with the Commission for approval.

In an effort to address reliability concerns, the Settlement provides for the formation of a reliability committee comprised of GPU, the OCA, the Industrial Consumers and Commission Staff. This committee would monitor the companies reliability improvements, discuss reliability and service issues and attempt to resolve service disputes prior to seeking a resolution from the Commission.

The Settlement also removes merger conditions contained in the Motion adopted by the Commission on May 24, 2001 relating to pension fund restrictions and the filing of a plan relating to labor issues. The Settlement would retain all remaining conditions imposed by the ALJ's Recommended Decision that were adopted by the Commission's Motion.

The Settlement additionally seeks Commission approval for FirstEnergy to seek a waiver from the Securities Exchange Commission that would permit it to increase its acquisition limitation to 500% of retained earnings. Further, the Companies would have accounting flexibility to, at their option, apply other funds to the cumulative balance of stranded or deferred costs so as to lower the then

existing balance. Such accounting flexibility, however, would not be controlling in future base rate cases for the Companies.

Finally, the Settlement explains the events that would occur if the merger fails to be consummated and is abandoned. In particular, deferred POLR costs accrued from January 1, 2001 through May 31, 2001 would be written off. Also, within ten days after abandonment of the merger, the Commission would reopen the POLR proceeding to permit the submission of evidence on overall retail levels and POLR deferrals and enter a final order within ninety days of abandonment of merger. Although the Commission's determination in that proceeding would not prevent the recovery of deferrals accrued between June 1, 2001 and the date of the Commission's order, the method and timing of such recovery would be determined as part of the reopened proceeding. Moreover, any POLR costs incurred after December 31, 2001 would be subject to normal prudence determinations, as well as just and reasonable rate requirements.

Summary of Commission Action

For the reasons more thoroughly explained below in the Commission's discussion and resolution of the comments submitted by the parties opposing the Settlement, the Commission concludes that the Settlement is in the public interest and approves it without modification. Adoption of the Settlement is in the public interest for several reasons. First and foremost, it preserves the existing generation rate caps through 2010. Additionally, the Settlement raises existing shopping

credits, thereby enabling customers to have a greater opportunity of finding alternative suppliers of generation. Customers will also benefit from the extension of the distribution rate caps until December 31, 2007, three years beyond the dates in the Restructuring Settlement. Another important feature of the Settlement is the increased support by the Companies of renewable and sustainable energy projects, as well as the commitment to develop and implement additional demand side response programs that will hopefully ease GPU's POLR obligations. Finally, through the establishment of a deferral mechanism that allows GPU to carry excess POLR costs, together with interest, on its balance sheet as a regulatory asset, the Settlement adequately addresses GPU's current financial concerns and enables it to continue meeting its obligations to purchase wholesale power for its POLR customers.

Discussion and Resolution of Issues Raised by Commenting Parties

Due Process

A number of parties, including ARIPPA, Dominion Retail, PPL and York Authority, have complained that they did not have enough time to review the Settlement and offer comments to the Commission and that this constitutes a violation of their right to due process of law. Although we recognize that the time period for commenting on the particular provisions of the June 11, 2001 Settlement was brief, we do not believe that this expedited time period to file comments has resulted in any party not having an adequate opportunity to voice its

opinion on the contents of the Settlement, given the many prior opportunities to be heard in regard to the POLR issues during the course of this proceeding.

Administrative agencies are required to provide due process to the parties which appear before them. Schneider v. Pennsylvania Public Utility Commission, 83 Pa. Commonwealth Court 306, 479 A.2d 10 (1984). Generally, the due process requirement is satisfied when the parties are given notice and the opportunity to appear and be heard. Id.

These consolidated proceedings began early in November 2000 when the Companies filed a joint application for a merger. The POLR proceeding commenced shortly thereafter. Earlier this year these proceedings were consolidated. Numerous pre-hearing conferences were held and rulings on interlocutory matters were issued throughout this period. Testimony was filed regarding the merger on November 9, 2000 as well as February 9, February 23 and March 9, 2001. With regard to the POLR proceeding, testimony was filed on February 9, 14 and on March 2 and March 9, 2001. Hearings on the issues pending in both proceedings were held on March 12-16, 2001. Numerous parties submitted briefs following these hearings and ALJ Gesoff issued a Recommended Decision on April 23, 2001, to which parties filed Exceptions and Reply Exceptions.

One particular matter raised in Exceptions to the Recommended Decision filed on May 7, 2001 was the first Settlement Stipulation executed in these proceedings. As we noted previously, that pleading was in many important

respects very similar to the Settlement that is now pending before the Commission. By Secretarial Letter issued on May 9, 2001, the Commission directed parties to the proceedings to indicate in their Reply Exceptions, due on May 14, 2001, whether they accept or reject the first Settlement Stipulation. Several parties submitted comments opposing various aspects of the first Settlement Stipulation.

When we adopted a Motion on May 24, 2001 approving the merger with certain conditions, we deferred a ruling on most provisions of the first Settlement Stipulation until the parties had an opportunity to attempt to resolve these issues within the context of a Commission-facilitated collaborative. All parties to these proceedings, as well as the restructuring proceedings, were notified of the collaborative and were invited to participate. In fact, most of the parties now opposing the Settlement actively participated in those discussions. Although the collaborative convened on May 29, 2001 and met throughout that week, it was not successful in resolving these issues. Nevertheless, several parties continued to negotiate and submitted the pending Settlement on June 11, 2001. Clearly, all interested parties have been aware since the filing of the Deferral Petition on November 29, 2000 of many of the issues that were eventually resolved by the Settlement. Also, the ALJ's recommended decision addressed several of these issues. To the extent that some of the particular resolutions were not proposed until the filing of the Settlement Stipulations on May 7, 2001 and June 11, 2001,

the issues they seek to address have been pending and discussed throughout this proceeding.

The record is replete with opportunities for parties to be heard. While the comment period on the June 11, 2001 Settlement was brief, we emphasize that it was largely a modification of the earlier Settlement Stipulation, a document that had been circulated to the parties over a month before. We also note that there is no requirement that all parties must agree to a settlement before it can be filed.

After eight months the active parties were very familiar with the issues pending in these proceedings. Most of the comments demonstrate this familiarity with the subject matter. Although the review period of the particular provisions contained in the June 11, 2001 Settlement was expedited, we do not believe that any party has shown that it was prejudiced. Therefore, we are satisfied that parties' have been afforded the requisite due process of law.

Deferral Mechanism

Some parties, including MAPSA, New Power and Dominion Retail, representing the views of the marketing community, oppose the use of a deferral mechanism to permit GPU to book excess POLR costs for accounting and ratemaking purposes. Contending that the deferral mechanism established by the Settlement is flawed, they urge its rejection, in favor of an immediate increase to GPU's generation rates by the amount of approximately \$316 million, as recommended by the ALJ. These parties claim that the Commission lacks

statutory authority to permit the implementation of the proposed deferral mechanism. Also, they suggest that the creation of a deferral mechanism is unfair to shopping customers who are not causing GPU to incur excess POLR costs, and that a significant increase in the overall generation rates paid by GPU's POLR customers would be more consistent with promoting the development of a competitive market. See MAPSA Comments at 2-5; Dominion Retail Comments at 2-3; New Power Comments at 2-5. PPL claims that GPU has demonstrated no basis for a rate increase or a deferral mechanism. PPL Comments at 3.

Based upon our review of the relevant statutory provisions and the record in this proceeding, we conclude that the deferral mechanism proposed by the Settlement is appropriate and should be approved. As provided in the Settlement, the POLR amounts that are deferred, together with interest, shall be accumulated and carried on the company's balance sheet as a regulatory asset. This approval is intended to satisfy the financial accounting standards under which the Companies are permitted to maintain a deferred balance as a regulatory asset rather than being required to record it as a current expense.

Before addressing the opposing parties' substantive concerns, we note that despite their attempts to characterize the proposed deferral mechanism contained in the Settlement as an "eleventh hour" submission, the concept of such a mechanism dates back to November 29, 2000 when GPU originally filed its Petition seeking authorization to implement such a tracking device for POLR service. Several parties objected to the introduction of such a mechanism at that

time, but the Commission declined to dismiss the Petition as a matter of law.

Rather, in an Order adopted on January 24, 2001, the Commission recognized the validity of a concept that allows the Companies to obtain relief from the rate cap limitations through the use of a deferral mechanism. However, the Commission emphasized that in order to obtain relief of any kind, it was necessary for GPU to meet the requirements of Section 2804(4)(iii)(D).

Section 2804(ii) provides that the generation component of a utility's charges to customers who purchase generation from the utility, including the CTC, shall not exceed the generation component charged to the customers that was in effect at the time of the passage of the Competition Act for a period of nine years, unless the utility's stranded cost recovery terminates earlier. Under that provision, GPU's generation rates are capped at January 1, 1997 levels until December 31, 2005. Further, pursuant to GPU's Restructuring Settlement, its generation rates are capped at slightly higher levels through 2009 and 2010 for Penelec and Met-Ed, respectively. By this Settlement, all generation rates are frozen through 2010.

Section 2804(iii) permits an electric distribution utility to seek relief from these rate cap provisions. While various circumstances are specified in the statute as justifying exceptions to the rate caps, the relevant factor in this proceeding relates to the price of purchased power. In particular, Section 2804(iii)(D) provides that an electric distribution utility may seek relief from these limitations if it is subject to significant increases in the price of purchased power that are

outside the control of the utility and would not allow the utility to earn a fair rate of return.

In the record developed in this proceeding before the ALJ, evidence was submitted to demonstrate that GPU is incurring and will continue to incur significant losses in the provision of POLR service. Specifically, GPU is facing financial losses in the range of \$85 million to in excess of \$300 million for 2001 and 2002. R.D. at 130; Met-Ed/Penelec St. No. 1-PLR at 33-34. Indeed, based upon the evidence submitted by GPU, losses associated with providing POLR service can reasonably be expected to be at least \$253 million, depending upon weather, the magnitude of customer shopping and other key variables relating to the operation of the wholesale market. *Id.*

These losses, as explained by the ALJ, are the result of a combination of events. Initially, the ALJ noted that GPU owns almost no generation, due to the divestiture of its generation assets, which appeared to be a reasonable and prudent business decision at the time it was made. Also, he pointed to benefits of the generation divestiture, in that it provided a fair and simple process for quantifying stranded costs, and the net proceeds in excess of the book value of the generating assets were used to reduce GPU's overall stranded costs. R.D. at 119-122. Yet, without owning generation, GPU has had to provide POLR service to a greater number of customers than was anticipated, largely due to the failure of its competitive default service program, the return of many customers to POLR

service and the departure of several suppliers from the GPU territory. R.D. at 114-116, 121, 124-126; Met-Ed/Penelec St. No. 1-PLR at 4; Tr. 945.

As the ALJ emphasized, underlying each of these events, which together have led to GPU incurring significant losses, are volatile wholesale market prices that have been much higher than the projections of the parties to the 1998 restructuring proceeding. Specifically, the ALJ referred to evidence submitted by GPU regarding the recent magnitude and direction of energy and capacity prices in PJM, which are matters outside the control of GPU. That evidence, which shows prices between \$450/mwh and \$1,000/mwh, demonstrates increased volatility in on-peak prices in 1999 and 2000. Also, the energy forwards prices show that since September of 2000, there has been a continuing upward price trend, coupled with high volatility in the wholesale market. R.D. at 129-130; Met-Ed/Penelec St. No. 1-PLR at 8-9, 12-13, 17. While some parties have criticized GPU's supply procurement practices during that time, we agree with the ALJ that the evidence proffered by GPU regarding volatility and an upward trend of the wholesale prices since 1999 demonstrates that those forces have been the major factors contributing to the losses that GPU is incurring to serve POLR customers. R.D. at 113-118, 124-128; Met-Ed/Penelec St. No. 1-PLR at 5, 12-13, 15, 17, 20, 25, 33-34; Tr. 878-879, 902-904.

Coupled with showing that it has incurred significant costs outside its control to purchase power to supply generation to its POLR customers, GPU was also required to show that without some form of relief from the rate cap

exceptions, it would be denied the opportunity to earn a fair rate of return.

Excluding transmission and distribution revenues from its calculations of returns, GPU presented evidence showing that for the twelve months ending December 31, 2001, the potential supply losses would cause Met-Ed's rate of return to fall to 4.34%, while Penelec's rate of return would fall to 1.99%. Met-Ed/Penelec Statement No. 3-PLR at 12; ME/PN Exh. RAD-1. Since we believe that an appropriate analysis of the rate of return issue should include a consideration of transmission and distribution revenues, we are not satisfied to rely solely on these rate of return projections to support a grant of relief under Section 2804(iii)(D). Nevertheless, we believe that the evidence submitted by GPU of significant potential supply losses, combined with its showing of extremely low rates of return on its generation supply services, demonstrates the need for some form of relief from the statutory rate cap provisions. Further, we recognize the importance of preserving GPU's financial health and access to cash to the extent necessary to enable it to continue purchasing wholesale power to meet its POLR obligations. See ME/PN St. No. 5-PLR at 49.

The Settlement presents the deferral mechanism as a solution to GPU's financial dilemma. Specifically, in lieu of a generation rate increase, GPU would be permitted to use a deferral mechanism to track losses for accounting and ratemaking purposes for a limited time period, with a narrow opportunity to recover those costs within the existing rate caps, before they are written off by the Companies.

In opposing this deferral mechanism, some parties claim that the Commission lacks the requisite statutory authority to afford this type of relief. We note, however, that the statute does not prescribe the use of a certain approach in addressing a situation such as GPU has presented. Specifically, the statute does not mandate that generation rates be increased if a utility demonstrates the need for relief from escalating purchased power costs. Rather, in authorizing the Commission to grant relief from the rate cap provisions without dictating the use of a certain mechanism, the statute affords the Commission sufficient latitude to determine the appropriate method that may be employed to address the effects of wholesale power purchases on a utility's financial condition. See 66 Pa.C.S. §2804(4)(iii).

Although one way of permitting recovery would be through a generation rate increase, an equally lawful solution is to allow deferral with possible recovery of some costs at a later time, within the confines of previously-established generation rate caps. The creation of a regulatory asset through the deferral of specific costs is a traditional ratemaking tool that is available to the Commission under our general powers and ratemaking authority under Section 501 and Chapter 13 of the Public Utility Code. Moreover, it is completely consistent with the provisions of Chapter 28 of the Public Utility Code that seek to protect utilities from being financially devastated by electric restructuring or their attendant POLR obligations. See 66 Pa.C.S. §§2803 and 2804(4).

Some parties contesting the use of a deferral mechanism claim that it would improperly allow the CTC revenues, which are designed to recover transition or stranded costs, to recover excess POLR costs. While we recognize that GPU would apply CTC revenues to the payment of deferred POLR costs during the years from 2006 through 2010, we are satisfied that this constitutes a proper application of these revenues, particularly under the financial circumstances faced by GPU.

The CTCs were developed during the restructuring proceedings as a means of providing electric distribution utilities with an opportunity to recover “transition or stranded costs,” which are defined to include known and measurable costs that would be recoverable under a regulated environment but which may not be recoverable in a competitive electric generation market. Stranded costs are specifically defined by the statute to include regulatory assets and other deferred charges typically recoverable under current regulatory practice. 66 Pa.C.S. §2803 (definitions). As such, deferred POLR costs are clearly within the category of items that are recoverable under the CTC.

Moreover, while the amount of deferred POLR costs that might be recovered through the CTC has not been precisely quantified by GPU, that amount is known and measurable to a similar degree of certainty as stranded costs levels that were approved during the restructuring proceedings. GPU has provided a range of potential supply losses, based upon market forecasts, and has limited its recovery of any losses to the extent that it may not exceed the existing rate caps.

Also, under the express terms of the Settlement, any profits resulting from supply purchases would be used to offset such losses, thereby minimizing or possibly eliminating the need for the use of CTC revenues to pay for excess POLR costs.

Commentors representing the marketing community also contend that an immediate increase to generation rates would be more consistent with promoting the development of a competitive market. In particular, they note that significant increases to the shopping credit, and to the consumers' overall generation rates, would enable more marketers to enter the competitive market and make meaningful offers to consumers. We certainly recognize the value of higher shopping credits to marketers, and we emphasize that our commitment to the development of a competitive market in Pennsylvania remains unchanged. However, we are unwilling to order an immediate rate increase for GPU's consumers when a less drastic and potentially less costly method for addressing GPU's financial issues has been presented through a Settlement of several major parties representing diverse interests.

In reaching this determination, we note the countless letters received from ratepayers urging the Commission to refrain from approving a rate increase, as well as the OCA's vigorous advocacy in this proceeding opposing any relief that would result in an increase in POLR customers' rates. We are convinced that the benefits of preserving the existing generation rates and maintaining a measured transition to full competition outweigh any concerns about the use of a deferral mechanism on the ability of marketers to participate in the near-term in the

competitive market. Further, the immediate increase in shopping credits provided by the Settlement should enable some customers to receive competitive offers.

Additionally, the expiration of rate caps in 2010 under the Settlement will provide the opportunity for the competitive market to flourish. In the meantime, while the wholesale market is maturing, retail customers receiving POLR service are shielded from the volatility and upward price trends.

With respect to the assertions of some marketers regarding the unfair impact of the deferral mechanism on shopping customers, the Commission recognizes the possibility that some deferred POLR costs incurred by GPU might eventually be recovered from customers who are currently purchasing supply from the competitive market. Again, since recovery of the deferred amounts is not automatic, this possibility is merely speculative. Further, the Settlement provides an immediate benefit to shopping customers through reductions in the CTCs without the corresponding increase in the shopping credit that is reflected in the total generation charges paid by non-shopping customers. Moreover, traditional ratemaking methods have not typically resulted in customers paying only for the costs they cause, but rather have involved the use of allocation methods that seek to generally track costs by category and customer class. The allocation of stranded cost recovery was no exception, and it is not reasonable to expect that one discrete type of costs, namely excess POLR costs, will be directly allocated to one group of customers that do not even fall into particular customer class or classes.

As to the concern expressed by some marketers about the long-term effect on ratepayers of the proposed deferral mechanism, we note that approval of the mechanism does not necessarily result in the recovery of any additional costs from consumers. While the Settlement provides GPU with the opportunity to recover deferred POLR costs during the period from 2006 through 2010, no recovery will be necessary if future POLR supply costs incurred by GPU fall below the POLR charges and adequately offset the amount of the accumulated net POLR deferrals. Additionally, the recovery of any deferred amounts during the period from 2006 through 2010 will occur wholly within the parameters of the previously-established generation rate caps for that period. Any amounts that are not recovered within those generation rate caps will be written off in 2010.

Moreover, it is noteworthy that the Settlement would fix the CTCs for the period from 2010 through 2015, while the Restructuring Settlement provided for the continuation of an unknown amount of stranded cost recovery after 2010. Additionally, the Settlement terminates stranded cost recovery in 2015, whereas the Restructuring Settlement allowed such collection to continue through 2020. As a result, the amount and duration of any stranded cost recovery after 2010 are now limited, with the ceiling amount of CTC known for the entire period and the duration of that recovery shortened.

Additionally, in approving the use of the deferred mechanism described in the Settlement, we are hopeful that other aspects of the Settlement will serve to minimize GPU's excess POLR supply costs and thereby limit the extent of the

deferral. In particular, we are encouraged by FirstEnergy's commitment under the Settlement to implement a POLR supply procurement strategy that has the objective of minimizing PLR supply costs, through various means including the use of demand side management and distributed generation projects. Also, although some commentors object to the provision in the Settlement that would allow GPU to assign all or any part of its POLR responsibility to an affiliate, we view this aspect of the Settlement as furthering the objective of minimizing excess POLR supply costs, while also ensuring that customers continue receiving service at the established shopping credits.

Genco Code of Conduct

Some parties challenge the provision of this Settlement that eliminates the Generation Company (Genco) Code of Conduct that was established by the Restructuring Agreement. These parties claim that the provisions of this Genco Code of Conduct continue to be of importance to marketers. See MAPSA Comments at 9; Dominion Retail Comments at 2-3.

The Genco Code of Conduct, which is Appendix J of the Restructuring Settlement, governs transactions between the provider of last resort and affiliated entities owning generation assets. For instance, it restricts the ability of GPU to purchase generation supply on favorable terms from an affiliate. We are satisfied that the elimination of this Code of Conduct is consistent with the overall objectives of minimizing the amount of excess POLR costs incurred by GPU.

Moreover, we believe that its removal is necessary to ensure maximum flexibility to GPU in procuring reasonably priced generation supply to serve its POLR customers.

Competitive Default Service

Some parties have objected to the provision in the Settlement which provides that upon consummation of the merger, GPU's Competitive Default Service (CDS) program would not be implemented, except at FirstEnergy's option, in a manner and under terms offered by FirstEnergy so as to provide it with the flexibility and certainty needed to effectively and efficiently plan for POLR service. These parties complain that elimination of the CDS program is inconsistent with the Restructuring Settlement and is anti-competitive. They explain that with certain changes to the CDS program outlined in the Restructuring Settlement, its continuation would be of potential value to marketers. They also are concerned about the ability of affiliated companies to bid on any CDS request for proposal. See MAPSA Comments at 7; New Power Comments at 5-6; Dominion Retail Comments at 2-3.

The Restructuring Settlement established a competitive bid process by which GPU's retail POLR customers could be assigned to an alternative provider for default generation supply service, and outlined the manner and terms by which GPU was to implement the CDS program. To date, the CDS program created by the Restructuring Settlement has not produced positive results, in that no

qualifying bids have been submitted. As a result, by Order entered on March 16, 2000 at Docket Nos. P-00991770 and P-00991772, the Commission permitted GPU to terminate its initial CDS program for lack of participation. Although the Commission subsequently convened a collaborative beginning in June 2000 to address specific issues and problems with GPU's CDS program, no consensus was reached by the parties for structural changes that would alleviate the impacts of prevailing market prices in excess of GPU's generation shopping credits.

No parties are advocating for a simple continuation of GPU's CDS program, as outlined in the Restructuring Settlement. Even parties who oppose the changes in the present Settlement that would afford FirstEnergy the discretion to continue the CDS program at its option, wish to preserve only the concept of the CDS program described in the Restructuring Settlement. Clearly, for a CDS program in GPU's territory to be successful, certain modifications are necessary, and we obviously would have preferred the collaborative on this matter to have produced a consensus under which the program could be implemented. We recognize that the Settlement now before us certainly jeopardizes the continuation of the CDS program in its present form, but given its failure to date, we are satisfied that a fresh approach is appropriate.

While the marketers portray the Settlement as eliminating the CDS program, we believe that is a premature characterization. To the contrary, we view the Settlement as simply affording FirstEnergy greater flexibility with the manner in which a CDS program is structured and implemented. For instance, we

are hopeful that multi-year bids will be permitted, along with other provisions designed to attract successful bidders. As to the parties' concerns with allowing an affiliate to bid on a CDS request for proposal, we note the acknowledgement by the Companies of the applicability of our competitive safeguard regulations at 52 Pa. Code §§54.121-54.122 to these transactions, so as to prevent affiliates from receiving preferential treatment in the processing of these bids.

Nothing in the Chapter 28 of the Public Utility Code obligates an electric distribution company to competitively bid its POLR service. Although GPU committed to the implementation of such a program in its Restructuring Settlement, it has attempted without success to find alternative suppliers to provide default service to a portion of its POLR customers. Within the Restructuring Settlement is a provision requiring an annual review by the Commission, commencing on January 1, 2001, to consider whether it is in the public interest to continue the program as outlined in the Restructuring Settlement. That inquiry entails a review of the economic and practical impacts of the retail competitive bid process and seems to envision modifications, where necessary to make the program more effective. Therefore, what is contemplated by the present Settlement is not a departure from the Restructuring Settlement, but rather represents an opportunity for the implementation of a successful CDS program. To the extent that FirstEnergy fails to proceed with a CDS program that is designed to attract competitive bidders, nothing in the pending Settlement or in the statute would preclude any interested party from petitioning the Commission for

approval of a program that results in having an alternative supplier provide POLR service to GPU customers.

Extension of Rate Caps

The Settlement results in an extension of GPU's distribution rate caps for three years beyond the dates set forth in the 1998 Restructuring Settlement and caps Penn Power's distribution rates at current levels for the same period. The Companies' distribution rate caps will now expire on December 31, 2007. Additionally, the Settlement retains the transmission rate caps of GPU and Penn Power consistent with GPU's Restructuring Settlement and FirstEnergy's ATSI settlement. However, in 2005, any flex down in distribution rates that occurs prior to that time due to the transmission and distribution rate caps under the Restructuring Settlement would be removed so as to restore the distribution rates to their prior levels, until such time as new distribution rates are approved by the Commission.

MAPSA does not object to the extension of the rate caps but disagrees with the elimination of the "flex down" provision of GPU's Restructuring Settlement. Citizen Power contends that the rate caps are of little value to consumers, when parties to this proceeding have asserted that GPU is currently earning an excessive return on its T&D assets.

We believe that consumers will benefit from the extension of the companies' transmission and distribution rate caps. The additional three years of

rate stability will allow the companies to perform long term system planning and enable the companies to implement coordinated system improvements, resulting in a safe and more reliable transmission and distribution system. Furthermore, the Commission agrees with the ALJ's determination that an extension of the Companies' transmission and distribution rate caps is a reasonable mechanism for addressing the issue of merger savings. R.D. at 63.

While the Restructuring Settlement tied the flex down provision to the length of the transmission and distribution rate caps, we do not believe it is appropriate to do so here. GPU's Restructuring Settlement provided that during the rate cap period, if GPU's transmission charges or rates were increased then there would be a corresponding decrease in GPU's distribution rates. In accordance with the Restructuring Settlement, this condition is set to expire in 2004. We find that, despite the three year rate cap extension contained in this Settlement, the flex down provision should terminate in accordance with the Restructuring Settlement in 2004. Electric competition in Pennsylvania does not and can not operate in a vacuum. The continuation of the flex down provision would unduly restrict the companies' ability to properly respond and react to the changes in the wholesale markets, overseen by the Federal Energy Regulatory Commission. Therefore, we find that the elimination of the flex down provision in 2004 is consistent with the GPU's Restructuring Settlement and is necessary and appropriate to allow the companies' to respond to requirements beyond the scope of this proceeding.

NUG Trust Funds

This Settlement amends the manner in which the NUG Trust Funds established in the Restructuring Settlement can be used. GPU's 1998 Restructuring Settlement required that both Met-Ed and Penelec create and maintain separate NUG Trust Funds. These funds were established as the depository for the placement of net proceeds from GPU's divestiture after payment of non-NUG stranded costs plus any over-recoveries from GPU's CTC for NUGs in excess of above-market NUG costs.

Specifically, the Settlement permits FirstEnergy to withdraw from the NUG Trust Funds to pay for the full cost of capacity and energy payable under the NUG agreements. Previously, under the terms of the Restructuring Settlement, Met-Ed and Penelec were limited to withdrawals from the NUG Trust Fund to pay for only actual above-market NUG costs, i.e. stranded costs. Further, the Settlement provides that through 2010 FirstEnergy will apply CTC revenues to costs in the following order of priority: Met-Ed and Penelec POLR costs that exceed generation cost to customers, non-NUG stranded costs, and NUG costs.

Then, from 2010 through 2015, FirstEnergy may apply CTC revenues to NUG and/or non-NUG stranded costs. Per the Settlement, beginning in January 1, 2001, NUG stranded costs will be reconciled against the higher of actual market prices or the applicable generation shopping credit, provided that Met-Ed's and Penelec's respective POLR load is at least equal to their respective NUG capacity.

Lastly, the Settlement contains FirstEnergy's express acknowledgement of Met-Ed's and Penelec's obligations under the NUG contracts until their expiration. Moreover, FirstEnergy agrees to adhere to the Restructuring Settlement provision requiring that each company's NUG Trust funds shall only be applied to that company's costs.

ARRIPA strongly opposes amending the Restructuring Settlement provision to allow Met-Ed and Penelec to use their NUG Trust Funds to pay for the full cost of NUG power beyond the companies' "stranded costs". ARRIPA at 23. Initially, ARRIPA argues that the record in this proceeding does not support allowing GPU to use the NUG Trust Funds as a cash source. Further, ARRIPA contends that by allowing the Companies' to use the NUG Trust Funds to now pay for both stranded costs and market costs will result in the earlier depletion of the Trust Funds.

In support of its argument, ARRIPA states that the NUG Trust Funds are currently under collecting NUG stranded costs under the CTCs, and to allow the use of the NUG Trust Funds for any other purpose would already expose the NUG contracts "to unwarranted financial risk." ARRIPA at 24. GPU's current under collection, coupled with the elevated appropriation of CTC revenues to POLR and non-NUG costs ahead of NUG costs violates the terms of the Restructuring Settlement and results in no CTC revenues being applied to NUG stranded costs until at least 2010. ARRIPA at 25.

In accord with ARRIPA, the York Authority asserts that if the Commission approves the requested amendment, the result is the abrogation of the benefit the York Authority bargained for in the 1998 Restructuring Settlement. York Authority at 6. Further, the York Authority asserts that making the Trust Funds available to Met-Ed and Penelec for non-NUG-related costs, dissipates the Trust Funds and lessens the financial assurance of the NUGs to receive payments under the NUG contracts over the remaining life of those contracts. Id.

The Commission recognizes the sensitivity surrounding the NUG Trusts and the underlying contracts that gave rise to this tracking mechanism in the Restructuring Settlement. Further, the Commission continues to support the NUGs' desire to ensure that they receive the compensation owed to them by Met-Ed and Penelec under their existing contracts. With that said, the Commission accepts the Settlement provisions which allows Met-Ed and Penelec to access the NUG Trust Funds to pay for the full cost of capacity and energy payable under the NUG agreements.

In accepting the provision, the Commission finds that the amendment provides for the portion of a NUG payment that exceeds the higher of the capped generation rate or the market price is recoverable out of stranded costs. While this provision amends the 1998 Restructuring Settlement as to use of the NUG Trust Funds, it does not alter or revoke Met-Ed's and Penelec's responsibilities and obligations under the existing NUG contracts. Moreover, the primary purpose of the NUG Trust Funds is to ensure that Met-Ed and Penelec have a cash source

from which to pay their respective NUG stranded costs. While the Settlement provides FirstEnergy with flexibility in withdrawing from the NUG Trusts, the flexibility is not unbridled, and in fact, this provision facilitates the payments owed to NUGs under the existing contracts.

Moreover, despite some parties' arguments to the contrary, the amendment does not place the NUGs in a less secure position than they were under the Restructuring Agreement. The existing NUG contracts remain unchanged – Met-Ed and Penelec are not relieved from any of their obligations to perform under these agreements. Further, while some parties rely heavily on the current under collection of the NUG Trust Funds, this reliance is clearly overstated. The NUG Trust Funds and the corresponding tracking mechanisms were put into place in 1998. At that juncture, the NUG contracts were priced above market. However, the recent surge in wholesale generation costs has resulted in the NUG contracts being an asset to the companies' in meeting their POLR obligations. In addition, these parties fail to recognize the substantial economic benefits to be gained by the successful merger of GPU and FirstEnergy – a larger and more financially secure payor.

Environmental and Efficiency Initiatives

The Settlement requires that FirstEnergy deposit \$2.5 million into both Met-Ed's and Penelec's Sustainable Energy Funds. The Sustainable Energy Funds were established in GPU's Restructuring Settlement and were to be funded

until 2005 by a one-time payment of \$12 million. Then, in 2005, consistent with the removal of the original transmission and distribution rate caps, these funds were to be funded via the companies' transmission and distribution rates. The Settlement postpones this funding mechanism until 2008 to correspond to the newly established rate cap periods.

Additionally, FirstEnergy will spend \$10 million on cost-effective renewable energy projects in the GPU Pennsylvania and Penn Power service territories over the next five (5) years. FirstEnergy has committed to consult with some environmental parties to obtain suggestions on where to commit these funds, but has stated its intent to investigate a wind generation-related project which may receive up to \$3 million. Further, FirstEnergy will consult with environmental parties on how to spend these funds and will report annually to the parties to the stipulation the status of all projects.

Also, FirstEnergy commits to preserve the existing universal service programs operated by Met-Ed, Penelec and Penn Power. Additionally, FirstEnergy agrees to maintain the universal funding levels for Met-Ed and Penelec consistent with the Restructuring Settlement. Moreover, should FirstEnergy want to eliminate or alter any of the universal service programs, it must notify the parties to this proceeding and is contingent upon Commission approval.

In addition to new sustainable and renewable energy funding commitments, the Settlement provides for Met-Ed and Penelec and assisted by the parties, to

develop and implement Demand Side Response (DSR) programs beyond those which are already in place in their service territories. The DSR program will be designed to maximize the cost-effective reduction of peak load, thereby reducing GPU's exposure to high POLR energy costs. Additionally, the DSR program shall include the use of interval and time of use metering, and appliance control technologies and, if feasible, will be open to all customer classes.

GPU will submit a proposal to the parties and to the Commission within 120 days after consummation of the merger. Then, GPU will engage in a working group with interested parties to revise and improve the DSR program prior to filing the proposal with the Commission for approval. The Settlement establishes Summer 2002 as the target operational date for the DSR program.

In its comments on the environmental provisions, MAPSA states its concern that FirstEnergy's commitment to \$10 million on renewable projects or activities requires that the Commission exert additional control over the use of these funds. Specifically, MAPSA requests that a collaborative be established among the parties to this proceeding to reach an agreement as to the proper development and implementation of these programs. The Clean Air Council contends that postponing the use the transmission and distribution adder to fund the Sustainable Energy Funds, despite the additional \$5 million in up front funding, results in a net reduction in funding. Further, the Clean Air Council finds the new funding commitments contained in the Settlement for renewable projects

to be too vague and provide FirstEnergy too much discretion in applying these funds.

While we understand the concerns raised by MAPSA and the Clean Air Council, we decline to modify the terms of the Settlement. This provision of the Settlement clearly provides consumers with immediate benefits as they resurrect and provide substantial additional funding to the Sustainable Energy Funds. Further, FirstEnergy's commitment to spend \$10 million on renewable projects not only expands the renewable energy initiatives in GPU's service territory, but introduces renewable energy funding to the Penn Power service territory.

Further, the development and implementation of a DSR program by GPU represents a new commitment by the companies which should assist in their POLR obligations. Moreover, the DSR program is consistent with the goals of the recently established Commission DSR working group.

In approving the Settlement, it is the Commission's expectation that the funds will be directed to the areas and in the manner intended by the Settlement and GPU's Restructuring Settlement. Should any party feel aggrieved at any point or maintain that these funds are being misdirected in some way, they are free to return to us for appropriate consideration and, if need be, corrective action.

SEC Waiver Approval

The Settlement requests Commission approval for FirstEnergy to seek a waiver from the Securities Exchange Commission, permitting First Energy to

increase its acquisition limitation to 500% of retained earnings. In its comments, Dominion Retail states that the Commission lacks the authority to approve an increase in FirstEnergy's debt ceiling without holding hearings to examine whether it is in the public interest. Dominion Retail at 4. We disagree. The Commission has determined that the merger of FirstEnergy and GPU is in the public interest with the parties' acceptance of the merger conditions. Since the waiver that FirstEnergy intends to request of the SEC necessarily flows from our conditional approval of the merger, we approve of FirstEnergy's seeking the requisite SEC waiver. Of course, whether the waiver is ultimately granted will be for the SEC to determine.

GPU Energy Stand-Alone Relief Absent Merger

If GPU and FirstEnergy do not consummate the merger, the Settlement provides for the POLR proceeding to be reopened before Administrative Law Judge Gesoff. Further, absent the merger, Met-Ed and Penelec have agreed that the deferred POLR costs accrued from January 1, 2000 through May 31, 2001 will be written off. Then, within 10 days after abandoning the merger, the Commission will reopen the POLR proceeding and permit evidence on overall retail levels and POLR deferrals prospectively. The Commission will enter final order in this proceeding within 90 days of abandonment of merger. The subsequent Commission determination, however, will not prevent recovery of deferrals accrued between June 1, 2001 and the date of the Commission's Order, except that

POLR costs incurred after December 31, 2001 will be subject to normal prudence and just and reasonable rate requirements. Also, the method and timing of recovery will be determined as part of reopened proceedings.

Citizen Power objects to the process outlined above because, in the case of a failed merger, GPU would receive guaranteed cost recovery of POLR costs from June 1, 2001 until the Commission issues a final determination. It is Citizen Power's contention that this recovery mechanism will result in customers paying for GPU's errors and provides no incentive for GPU to mitigate its POLR costs. MAPSA asserts that GPU should not be permitted to recover POLR costs from shopping customers consistent with its arguments opposing the deferral mechanism. ARRIPA also opposes the process set forth in the Settlement to address the POLR issue in the event of a failed merger. In its comments, ARRIPA states that the parties, including GPU, have fully litigated this matter and the Commission should not approve a plan that provides for the potential for further litigation but that the Commission should decide these issues on the record developed in this proceeding.

Again, the Commission declines to modify the Settlement. The process established in this provision is in the public interest as it provides a road map to all the parties in the event that the merger between GPU and FirstEnergy is not consummated. Despite the contentions of some of the parties, we find that the process outlined above is necessary and lawful. The majority of the provisions contained in the Settlement are contingent upon the successful acquisition of GPU

by FirstEnergy. The signatories to the Settlement are correct for establishing a process going forward in case the merger fails, as time will likely be of the essence. And, should this occur the parties and the Commission requires a definitive process for resolving the POLR proceeding.

The Commission is cognizant of Citizen Power's concerns regarding the potential impact on consumers' should the merger fail. However, we are convinced that it is necessary to allow GPU to recover any deferred POLR costs from June 1, 2001 until we enter a final order in the reopened POLR proceeding. Our decision to allow this limited recovery is based upon GPU's financial problems which were identified during this proceeding. Additionally, we are aware of the current volatility of the wholesale market and must ensure that GPU is able technically and financially, to meet its statutorily mandated obligation to provide electric service to its then customers. The Settlement mitigates consumer exposure by requiring GPU to write off POLR costs from January 1, 2001 to May 31, 2001. Moreover, all POLR costs incurred by GPU after December 31, 2001 are subject to a prudence review and the just and reasonable rate requirements will be applied to all utility expenditures.

As to some parties' opposition to the reopening of the POLR proceeding should the merger not be consummated, we disagree and find that should the merger fail, the proceeding must be reopened. We are unable to foretell the future and therefore can not predict if or when the merger may or may not occur as we are but one of the numerous regulatory bodies that must review this merger

proposal. While it is likely that if the merger process were to be unsuccessful shortly after our disposition in this proceeding, that the current record would likely be suitable but we need not and indeed we can not determine that at this juncture. Should the merger continue its way toward approval and not fail until some time out, a new review, although properly truncated to 90 days, is justified and reasonable.

Conclusion

For the foregoing reasons, we believe that adoption of the Settlement is in the public interest and we approve it without modification. In addition to containing numerous provisions benefiting consumers, it also addresses GPU's current financial situation in a fair and appropriate manner; **THEREFORE, IT IS**

ORDERED:

1. That the Settlement Stipulation filed on June 11, 2001 is in the public interest and is approved without modification.
2. That the deferral accounting and subsequent recovery mechanism for the accumulated difference between the charges to retail customers for provider of last resort service and the actual supply costs incurred by Metropolitan Edison Company and Pennsylvania Electric Company, together with carrying costs, beginning on January 1, 2001, as proposed by the Settlement Stipulation, is hereby approved.

3. That the Recommended Decision of Administrative Law Judge Larry Gesoff is adopted, as modified by the Settlement Stipulation.
4. That the Exceptions and Reply Exceptions of the parties are granted in part and denied in part consistent with this Order.
5. That the Order adopted by the Commission on May 24, 2001, in these proceedings is amended as necessary to adopt and implement the provisions of the Settlement Stipulation.

BY THE COMMISSION,

James J. McNulty
Secretary

(SEAL)

Order Adopted: June 14, 2001

Order Entered: June 20, 2001