January 14, 2002

Via Hand Delivery
Honorable Diana Sukovich, ALJ
Office of Administrative Law
185 Washington Street
Newark, NJ 07102

RE: I/M/O the Petition of Atlantic City Electric Company, Conectiv Communications, Inc. And New RC, Inc. For Approval Under N.J.S.A. 48:2-51.1 and N.J.S.A. 48:3-10 of A Change in Ownership and Control
BPU Docket No. EM01050308
OAL Docket No. PUC 04036-01

Dear Judge Sukovich:

Enclosed please find an original and a copy of the reply brief filed on behalf of the Division of the Ratepayer Advocate in the above-referenced proceeding.

Copies are also being provided to all parties via hand delivery or regular mail.

We are enclosing one additional copy of the materials transmitted with a stamped self-addressed envelope. Please stamp and date the copy, as filed, and return in the enclosed envelope. Thank you for your consideration and assistance.

Respectfully submitted,

BLOSSOM A. PERETZ, ESQ.
RATEPAYER ADVOCATE

By: _____
Andrew K. Dembia, Esq.
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encl.
c: Service List

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

I/M/O THE PETITION OF ATLANTIC CITY ELECTRIC COMPANY, AND CONECTIV COMMUNICATIONS, INC.) AND NEW RC, INC. FOR APPROVAL UNDER N.J.S.A. 48:2-51.1 AND N.J.S.A. 48:3-10 OF A CHANGE IN OWNERSHIP AND CONTROL	**OAL Docket No: PUC-04036-01** **BPU Docket No: EM01050308**

REPLY BRIEF OF THE DIVISION OF THE RATEPAYER ADVOCATE

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POINT I

JOINT PETITIONERS' INITIAL BRIEF CONFIRMS THAT THE PROPOSED MERGER IS NOT IN THE PUBLIC INTEREST BECAUSE ATLANTIC'S CUSTOMERS WOULD NOT RECEIVE ANY MERGER-RELATED COST SAVINGS. THEREFORE, THE BOARD SHOULD NOT APPROVE THE MERGER WITHOUT THE CONDITION THAT ATLANTIC ACCURATELY QUANTIFY AND PASS ALL OF THE FORECASTED NET MERGER SAVINGS TO ITS CUSTOMERS BY WRITING-OFF ALL OR PART OF THE DEFERRED BALANCE EFFECTIVE ON THE DATE THE MERGER IS CONSUMMATED.

The section of Atlantic City Electric Company ("ACE" or "Atlantic"), Conectiv and New RC, Inc.'s ("Joint Petitioners") initial brief discussing the proposed merger's impact on rates consists of little more than the same unsubstantiated "no impact" claims made in their filed testimony. *JPIB*, pp. 16-21[1]. Moreover, Joint Petitioners do not dispute that they have not filed any detailed analysis of merger-related savings or costs with Your Honor and the Board. T61:L24 - T62:L6. As Board Staff correctly stated in its brief, "Joint Petitioners are committed to spending over $30 million to determine the 'fairness' of the price paid for Conectiv's stock. Ratepayers deserve a 'detailed' study to determine the 'fairness' of their sharing in the yet to be quantified synergy savings." *SIB*, p. 27. Thus, it is uncontroverted that Joint Petitioners have failed to satisfy their burden of proof. Therefore, since there is insufficient evidence on merger costs or benefits, the Board cannot determine whether the merger will have a negative or positive impact on Atlantic's rates. *See RAIB*, pp. 57-62, *SIB*, pp. 7-13 and Appendix A, paragraph 1. As New Jersey Board of Public Utilities' Staff ("Board Staff") succinctly concluded:

> With the information provided in this matter, Staff is unable to determine whether there will be no adverse impact on rates. It is reasonable to assume that a $2.2 billion purchase amount and a $543

[1] Joint Petitioners' initial brief will be cited as "JPIB"; Staff's initial brief as "SIB"; and the Ratepayer Advocate's initial brief as "*RAIB*."

> million premium paid by PEPCO for Conectiv would warrant a detailed merger savings study. *SIB*, p. 12.

Faced with their own lack of proofs of the proposed merger's impact on Atlantic's rates, Joint Petitioners resort to circular and self-contradictory arguments. First, they argue that because the Joint Petitioners have not proposed a rate increase due to the merger, the Board should approve their Joint Petition. *JPIB* p. 16. This argument is simply irrelevant. The Board's long established precedent in merger cases is to require the New Jersey utility to pass through net merger savings to ratepayers. See, Conectiv Merger Order pp. 7-8; GPU Merger Order Attachment A, p. 4; and Rockland Merger Order p. 15. The Joint Petitioners' plan to maintain the current rates is insufficient to legitimize such a massive and expensive undertaking as this merger.

To support the Joint Petitioners' untenable position to maintain current rates without any rate reduction, their brief refers to the "benefits of substantial rate decreases" that the customers are now enjoying because of the Restructuring Order. *JPIB* p. 16. There are several arguments against considering the rate caps as benefits that are relevant in this case. First, the EDECA rate reduction requirements pre-date the merger agreement, and the statutory rate reductions are entirely separate from and unrelated to the merger. The Board long-ago established both the level and source of Atlantic's EDECA-mandated rate reductions. Second, the merger's impact on rates will last far longer than the statutory rate reductions, which end on August 1, 2003. Third, it is uncontroverted that Atlantic is accruing cost deferrals (i.e., BGS energy costs, NUG contract costs, and other costs) during the EDECA transition period. *I/M/O Atlantic City Electric Company -- Rate Unbundling, Stranded Costs and Restructuring Filings*, BPU Docket Nos. EO97070455, EO07070456 and EO97070457, Order dated March 30, 2001. Therefore, EDECA's rate reductions are little more than a temporary credit that

Atlantic's customers will have to pay back, with interest, starting in August 2003. In contrast, the Joint Petitioners concede that merger-related cost reductions, if achieved, would be long-lasting reductions to Atlantic's cost of service. See T228:L14-24. Accordingly, the temporary (and ultimately illusory) EDECA-mandated rate reductions are irrelevant to this case.

Joint Petitioners further argue that, because Atlantic is required to make an unbundled rate filing by mid-2002 under the Board's restructuring order, any merger-related cost reductions will necessarily be included in the Company's cost of service as part of that filing. *JPIB,* p. 19. This claim ignores three salient facts. First, it is not entirely clear that Atlantic will file a full base rate case by August 1, 2002. The Board's restructuring order only states that the utility must "make a filing, no later than August 1, 2002, as to the proposed level of all unbundled rate components beginning August 1, 2003 . . ." *Atlantic Restructuring Order* p. 73. The Atlantic Restructuring Order does not state that this filing must be a full base rate case, with a new, current cost of service study. In fact, nothing in the Board's restructuring order would prevent Atlantic from making a cursory filing seeking to leave its current regulated rates (i.e., distribution rates, SBC, and MTC) at the current level. Or, Atlantic could seek to use an outdated cost of service study, as the Board ultimately allowed it to do in the 1997-1998 rate unbundling case.

In the Atlantic Stranded Cost Unbundling proceeding, the Company failed to file a full 1988 cost of service study --the study used in Atlantic Electric's last base rate case as required by the Board's Final Report entitled, "Restructuring the Electric Power Industry in New Jersey: Findings and Recommendations." Stranded Costs and Unbundling Final Order at 13. Instead, Atlantic submitted a 1996 cost of service study, determinants by rate class and pricing by rate class. *Id.* The problem with using updated costs that have not been subject to review by the Board is that there is no assurance that

the cost and revenues are correctly stated and the amount presented are appropriate for purposes of setting revenue requirements and setting of rates. Such verification can only be accomplished in the revenue requirements portion of a base rate case. In either event, none of the merger-related cost savings would be reflected in Atlantic's rates.

Second, even if Atlantic does file a base rate case with a current cost of service study in August 1, 2002, those rates would not become effective until August 1, 2003, more than a year and a half after the merger's anticipated effective date. This is completely inequitable, particularly when Conectiv shareholders would receive an aggregate $493.5 million premium as of the merger's financial closing. *See RAIB*, p.65.

Finally, the fact that Atlantic may file a base rate case in the future does not change the fact that Joint Petitioners' have failed to proffer <u>any credible evidence</u> about the proposed merger's impact on rates (either in the short- or long-term) in this proceeding. Your Honor and the Board is being asked to rule on the merger proposal now -- not in two years. If Your Honor and the Board were to approve the merger now, in the absence of any meaningful evidence as to whether the merger will reduce or increase Atlantic's costs, it will be too late to rectify the situation when the utility does file a base rate case. Since the Board cannot determine whether the merger will result in cost savings or cost increases, it should not approve the merger on the record before it.

Additionally, Joint Petitioners allege that the merger will produce cost savings for Atlantic at some future date. *JPIB*, pp. 17-21. However, as the Ratepayer Advocate established in the record and its initial brief, these alleged "cost savings" are mere conjecture, completely unquantified and unsupported by any valid evidence. *See RAIB*, pp. 57-59. In fact, from the meager evidence produced by the Joint Petitioners, the cost to achieve the merger may be more than the anticipated savings that

may be achieved in the first five years. *RA-6*, pp. 31-32. Board Staff concurs with the Ratepayer Advocate's concerns. *See SIB*, pp. 12-13 and Appendix A, p. 1.[2] Thus, Joint Petitioners' arguments in this section of their brief are nothing more than rote summaries of their unsubstantiated testimony, and should be accorded no weight whatsoever.

As the Ratepayer Advocate and Board Staff argued in their initial briefs, as a condition of merger approval, the Board should require the Joint Petitioners to file a 10 year synergy study and an analysis of the merger related costs and savings. *See RAIB*, Point III, pp. 51-62; *SIB*, pp. 8-13. The Ratepayer Advocate further recommends that the Board approve the merger only if, after the Board and all parties to this case have had the opportunity to review this additional analysis, the Board determines that Joint Petitioners have demonstrated that the merger would result in a net positive benefit in the form of merger savings, 100% of which shall be used to reduce Atlantic's deferred balance contemporaneously with the closing of the merger transaction. [*See RP*-6, at 42].

[2] Board Staff also expressed concern about the Joint Petitioners' failure to designate a location for their books and records, in accordance with *N.J.S.A.* 48:3-7.8. *SIB*, pp. 15-16. Board Staff also expressed the need for a management and operations review on the merged company one year following the merger, and an annual review of the deferred balance. *SIB*, pp. 16-18. The Ratepayer Advocate supports these measures.

POINT II

THE BOARD SHOULD ADOPT THE RATEPAYER ADVOCATE'S RECOMMENDATIONS, AS ECHOED BY BOARD STAFF, TO MITIGATE THE POTENTIAL ADVERSE IMPACTS OF THE MERGER ON ATLANTIC'S EMPLOYEES AND ON NEW JERSEY'S ECONOMY.

The Joint Petitioners Initial Brief did not provide a meaningful rebuttal to the Ratepayer Advocate's and Staff's position with respect to the proposed merger's impact on Atlantic's New Jersey employees. Throughout this case, the Joint Petitioners have repeatedly maintained that they do not anticipate change in staffing levels due to the merger. *JPIB* p. 22. However, the Joint Petitioners have been more than reluctant to provide any meaningful assurances that the employees will not be involuntarly terminated for a given amount of time post-merger. *P-3*, p. 4.

Staff expressed similar concerns in its initial brief stating that:

> On one hand Mr. Shaw assures that there will be no change in the current level of staffing and positions of the New Jersey employees and those employees who volunatrily retire or resign. On the other hand, Mr. Shaw reiterates that he does not have a clue whether the New RC Inc. will offer an enhanced package to ACE's unionized workforce, which will adversely impact the staffing level. Furthermore, Mr. Shaw was not able to assure Staff regarding the length of time the current staffing level will be maintained after the merger is complete. *SIB* p. 19.

The statute governing the acquisition of control of a New Jersey utility clearly states that the Board must evaluate the merger's impact on "the employees of the affected public utility." *N.J.S.A.* 48:2-51.1. Aside from utility service concerns, the loss of New Jersey jobs as a result of the proposed merger will have a great impact on the local economy and will have an immediate adverse impact on those affected New Jersey employees. The Joint Petitioners' meaningless assurances to maintain current

employment level without legally binding commitments does little to assist Your Honor and the Board with its statutory mandated evaluation of the merger. The record is devoid of any evidence supporting their assertion that there will not be a "significant reduction of employees" as a result of the merger. *JPIB*, pp. 22-23. The Joint Petitioners have offered nothing to alleviate the concerns regarding Atlantic's New Jersey employees expressed by the Ratepayer Advocate throughout the course of this proceeding.

To address the concerns set forth herein, Staff recommended that the merger be contingent on several factors.[3] While the Ratepayer Advocate agrees with Staff's recommendations, they do not go far enough to protect the interest of Atlantic's employees. As set forth in the Ratepayer Advocate's initial brief and the testimony of its witnesses, the Joint Petitioners should be held accountable for their representation that the merger will not change the employment level of Atlantic's workforce by conditioning the merger on no significant changes in employees or employment in New Jersey for a minimum of five years.

[3]Staff recommends, among other things, the following: 1) the Joint Petitioners be required to notify the Board of any significant voluntary or involuntary retirement plans 90 days before implementation of such plan for the next five years; 2)Staff further recommends that Petitioner be required to submit quarterly reports, up to the next rate filing, that outline the number of employees, by both function and location, that are based in New Jersey; 3) the Joint Petitioners maintain its regional headquarters for ACE in Southern NJ for at least five years from the date of merger closing and it should be staffed by an adequate number of senior-level regional decision-makers who are familiar with New Jersey regulatory issues; 4) Joint Petitioners should also provide a description of the function and authority of regional vice president to demonstrate the accountability of such positions for ensuring customer satisfaction and reliable service and the regional vice president in charge of service quality and reliability and regional directors should be located in New Jersey; 5) the Joint Petitioners should agree to maintain an adequate number of positions staffed with people familiar with New Jersey and with ACE's rates, regulatory, reliability, engineering and labor relations matters.

POINT III

THE BOARD SHOULD ADOPT THE RATEPAYER ADVOCATE'S RECOMMENDATIONS REGARDING THE PROPOSED MERGER'S EFFECT ON COMPETITION.

A. Mid-merit market power issues

The Joint Petitioners argue that the amount of generation owned by Conectiv and Pepco is too small to raise market power concerns. *JPIB*, pp. 10-13. However, it is clear from the record that Conectiv currently owns a significant portion of a vital segment of the generation supply in PJM: the mid-merit generation that is able to ramp up or down quickly to match expected loads in the PJM market and capture the financial opportunities from the ability to match generation output to loads quickly. Conectiv has repeatedly represented that its mid-merit units set the market prices 40% of the year. *RAIB*, p. 111. Even when it attempted to backpedal from its representations, Conectiv stated that mid-merit plants in general set market prices 40% of the year. This is a large portion of the year when mid-merit units are the price leaders, and Conectiv has a significant piece of the PJM mid-merit market, *i.e.*, 12% of the existing PJM mid-merit capacity. *RP-16*, p. 13, l. 1-2. Even assuming the truth of Conectiv's belated explanations, the merged company will continue to own an important part of this market price setting generation and this alone raises strong market power concerns that the Joint Petitioners have not been able to mitigate.

In addition to these concerns, Conectiv plans to further increase its mid-merit market share by building 4,000 MW of new mid-merit plants. *Id.*, p. 13, l. 4-7. The Joint Petitioners attempt to de-emphasize the importance of these facts by stating that Conectiv and Pepco have sold and/or contracted to sell much of their generation plant. *JPIB*, pp. 10-13. However, the sale of generating plants that the Joint Petitioners may no longer consider financially worthwhile to operate does not mitigate the

importance of the plants the Joint Petitioners will continue to own and will actually increase in market share, *i.e.*, the mid-merit facilities. The sale of the base load plants is irrelevant to the mid-merit market power problems raised by the proposed merger and is more in the nature of a smokescreen for this issue. It is these mid-merit plants that raise genuine market power issues the Joint Petitioners have not been able to refute. Without a sufficient answer to these concerns, the Ratepayer Advocate continues to urge the ALJ and the Board to refuse to approve this proposed merger.

B. Irrelevance of the FERC and DOJ opinions on this merger

The Joint Petitioners also rely on the opinion of the Federal Energy Regulatory Commission ("FERC") about wholesale market power issues and the proposed merger and also that of the Antitrust Division of the U.S. Department of Justice ("DOJ"). *JPIB*, pp. 13-15. However, as demonstrated in our witnesses' testimony and our initial brief, the opinions of those two agencies on this merger are irrelevant to the issues that the ALJ and the Board must review in this proceeding. The FERC opinion was largely related to wholesale market concerns while the ALJ and the Board must review retail market power issues as well as independently evaluate how wholesale market power issues can effect the retail market. *RAIB*, pp. 105-110.

As stated in the Ratepayer Advocate's initial brief, the FERC's opinion noted that no state public utility commission had requested that the FERC review the proposed merger's impact on retail rates in their jurisdictions and that the FERC specifically found that the proposed merger does not adversely affect the state commissions' regulation over the Joint Petitioners. *Section III.B.4 of the FERC Order, 96 FERC ¶ 61,323, Docket No. EC01-101-000, dated September 26, 2001, p. 13* ("*FERC Order*"). The Joint Petitioners' reliance on this opinion is completely irrelevant.

The Board Staff apparently also relied on the FERC opinion. *SIB*, p. 28. For the same reasons mentioned above, the Staff's reliance on the FERC opinion is also irrelevant. However, Staff seems to think the issue of mid-merit generation is significant enough to warrant continued monitoring after the merger with the possibility of revisiting this issue if the merged company's share of the mid-merit market should "increase significantly." *Id.* Currently, Staff believes that the record is "inadequate to meet a final determination" on this issue. *Id.*

There are two problems with Staff's recommendations that need to be addressed. First, the record already contains proof of Conectiv's plan to "increase significantly" its share of the mid-merit market, as outlined above and in the Ratepayer Advocate's initial brief. This proof is sufficient to demonstrate that the market power issue justifies denial of merger approval. Second, revisiting this issue after the merger is complete would leave ACE ratepayers with no remedy to solve the problem. The merged company would have already used its market power to increase market prices and increase the electric bills of not only ACE ratepayers, but also the electric bills of any other New Jersey customers whose electric utility (or third party supplier) purchases power during the hours when the market power was exercised. At that point, it will be too late to do anything to assist those ratepayers. The only meaningful remedy is to deny merger approval before the fact. The merger cannot be undone afterward. While Board Staff's recommendations may be well-intentioned, they are inadequate to address these market power concerns.

CONCLUSION

The Ratepayer Advocate has consistently stated that the proposed merger between ACE, Pepco and New RC should only be approved if positive benefits to New Jersey ratepayers can be demonstrated. As has been argued at length in this brief and in our initial brief, the Joint Petitioners have failed to meet their burden of proof under either the positive benefits or no harm standard. Therefore, the Ratepayer Advocate respectfully requests that the proposed merger only be approved by Your Honor and the Board if all of the recommendations as discussed in our briefs are made explicit conditions of approval.

For all the forgoing reasons, the Ratepayer Advocate respectfully requests that the merger petition be denied as filed.

Respectfully submitted,

BLOSSOM A. PERETZ, ESQ., RATEPAYER ADVOCATE
N.J. DIVISION OF THE RATEPAYER ADVOCATE

By: _____
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