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December 23, 2015

District of Columbia Public Service Commission
1325 G Street, NW Suite 800
Washington, DC 20005

RE: Pepco-Exelon Merger FC 1119

Dear Madam Chair and Members of the Commission,

Public Citizen is a national consumer advocacy organization with over 400,000 members and supporters across the country, 2,000 of which reside in the District of Columbia. As an organization dedicated to serving the needs of America's households, we promote policies and regulations that provide families with affordable, reliable and clean energy. Public Citizen has a long record of challenging large utility consolidation that results in massive utilities that span multiple states and undermine the ability of local officials to protect consumers. The acquisition of Pepco Holding Inc. by Exelon Corporation would result in such an entity and put its ratepayers in the District of Columbia at risk.

We support the commission's initial finding that the takeover does not satisfy the public interest standard in accordance with D.C. Code §§ 34-504 and 34-1001. In fact, we believe that the takeover of Pepco by Exelon would present significant harm to District electricity consumers. And we contend that the non-unanimous settlement negotiated by Exelon and the Bowser administration does not remediate the fundamental issues associated with the deal, but rather represent short-term benefits that do not mitigate the long-term risks inherent in, what the commission has noted, "the permanent change in the ownership and control of the District's local electric distribution company." The change of control would create the largest utility in the country and give Exelon a near monopoly in the mid-Atlantic region. For these reasons, we believe the PSC should again reject the proposed merger.

Inherent conflict of interest puts consumers and District goals at risk

By design, this acquisition cannot be in the public's interest because Exelon's business model – which seeks to increase profits and offset the heavy losses being incurred by its unregulated nuclear plants – is in conflict with the best interest of Pepco customers and is misaligned with the District's clean energy goals.

As a regulated distribution utility, Pepco's main obligation is to buy electricity at the lowest possible price. Exelon's primary business, electricity generation, prioritizes the sale of power at the highest possible price. Harm to the District can occur by actions that increase the cost of Exelon's generation and by Exelon's failure to identify ways to reduce the District's dependence on conventional

generation. If Pepco remains an independent company, unaffiliated with any generation, it will have the political and economic wherewithal to encourage cost-effective, sustainable and locally controlled power.

Exelon's 63% dependence on conventional generation revenue gives it an incentive to discourage sustainable energy innovations and competition. Exelon CEO Chis Crane frequently refers to energy efficiency and renewable energy as counterproductive to Exelon's bottom line and considers these technologies as incongruous and disruptive to Exelon's business. As a result, Exelon is notoriously hostile to clean energy at the federal and state level often at the expense of ratepayers. The PSC was right to illuminate this conflict and the threat to D.C.'s clean energy goals under an Exelon regime in its decision to reject the takeover.

Nothing in the settlement agreement resolves this issue. In fact, there is no way to resolve the issue because it stems from an inherent conflict between Exelon's business model and the District's priorities.

Shareholders gain at the expense of consumers

One criterion for evaluating whether the merger is in the public interest is whether the proposal balances "the interests of a utility's shareholders and investors with the interests of ratepayers and the community." The Commission has noted that benefits to shareholders and the merging companies "must not come at the expense of ratepayers."

Exelon's offer to purchase Pepco for \$6.8 billion represents a hefty premium over the latter's market value of \$1.6 billion. This premium will result in a windfall for Pepco shareholders. To pay this premium, Exelon will incur more debt. As a result, Pepco will be more highly leveraged. In the August 25 order to reject the proposed merger, the Commission notes its "concerns that the pressure to meet the earnings accretion expectations and the synergies necessary to justify the purchase could lead to pressures for cost cutting and investment curtailments that may be detrimental to customers." The settlement agreement does not resolve this issue.

Further, the premium offers a benefit to shareholders extremely disproportionate to that for ratepayers. Exelon is offering Pepco customers only a tiny fraction of the \$1.6 billion windfall for Pepco shareholders under the proposed acquisition, even with the increased Customer Investment Fund (CIF) offered in the settlement. PHI has 1,860,336 total utility customers. If the customer benefits equaled the Pepco stockholder windfall, the CIF would be \$860 per customer (i.e., \$1.6 billion divided by 1.86 million customers). For D.C. that would equal \$290 million (i.e., \$860 times 337,117 customer base) rather than the \$73 million in the settlement. Even though no one is advocating for that amount, considering Pepco ratepayers paid for Pepco's transmission and distribution assets, Pepco's customers are clearly ill-served by Exelon's proposed paltry CIF offering.

Not only does the proposed CIF fail to mitigate the disparity between the benefit the acquisition would bestow on shareholders and the claimed ratepayer benefit; it is unclear whether it represents a significant benefit at all. Only \$40 million of the \$73 million would reach customers by way of temporary assistance, and this short-term gain only masks the inevitable rate shock that will arrive on April 1, 2019. The remaining investments are actually payments to the District Government.

Dominance of one perspective and one way of doing things: Exelon's way.

The proposed takeover would, if approved, create the largest electric utility holding company in the country and give Exelon a monopoly in the mid-Atlantic region. This would allow Exelon to use its influence over its utilities to protect its generation interests at the expense of ratepayers and eliminate the independent voice of Pepco, which has taken positions that differ from – and in some cases served as a counterbalance to – Exelon in numerous forums including regulatory matters, energy legislation and energy market proposals.

In interpreting the public interest standard, the commission reviewed the impact the merger would have on competition in the retail and wholesale markets that affect the District and District ratepayers. If Exelon acquires Pepco, benchmark competition and across-the-fence rivalry between Pepco and BGE will be lost – meaning customers and regulators will have limited ability to compare several area utilities' reliability targets. "Benchmark competition and across-the-fence rivalry enable commissions and customers to compare adjacent companies based on price and quality, then use that comparison to take action: regulatory action to improve performance or consumer action to change suppliers." Exelon's monopoly in the region, if the merger is approved would wipe out meaningful competition at the local level. It is this competition for customers that drives improvements and performance in the electricity sector. In addition, Exelon's monopoly – with its express promises of consolidation and streamlining – will bring one-size-fits-all policymaking for customers across its territories. That means a loss of innovation, diversity and competition in every aspect of providing reliable, sound service to customers. If Exelon makes a major error, the number of customers who suffer as a result will be vastly greater, and there will be fewer companies with alternative practices from which to borrow.

At the wholesale level, the merger will consolidate Exelon's political control of the regional market, PJM, enhancing its already outsized ability to influence the operations of the wholesale market, directly impacting ratepayers. This control is one way Exelon can undermine local control. If PJM, controlled by Exelon, is at odds with local government mandates and initiatives, this private corporation has the legal authority, with backing from the Federal Energy Regulatory Commission ("FERC"), to overrule and ignore local statutes that PJM believes to be at odds with its mission and FERC-approved tariff.

This control is also one way customers' rates could increase. Monitoring Analytics, the Independent Market Monitor for PJM, in its initial response to the proposed merger cautioned against the concentration of Exelon's market power if it acquired Pepco. "A consolidation of transmission companies reduces the pool of companies that have the expertise to compete to build competitive transmission projects. Consolidation will reduce the competition to build competitive transmission projects. A reduction in competition will likely result in higher costs for customers."

The settlement does not resolve these critical competition issues. In fact, it appears to create additional risks. First, the settlement weakens competition further by granting the merged company new market opportunities it has not earned through competition. Commitments 118 through 128 lay out the various ways Exelon will assist in the development and distribution of renewable energy projects in the District of Columbia. These arrangements either give Exelon a preferred position over local competitors or sole access to contracts. Rather than aligning with the District's clean energy goals,

these arrangements would likely lead to higher prices and less innovation. They could lead to stagnation in the entire sector as the utility can shut out competitors or delay and ultimately decide not to develop the projects.

Second, commitment 116 of the non-unanimous settlement describes a broad set of conditions that would allow Exelon to leave PJM – a move that would cripple PJM and lead to rate hikes for DC ratepayers. The Independent Market Monitor in its brief on the settlement warns that “if Exelon were allowed to create its own RTO, which is possible in concept under the current federal rules, the Market Monitor and the Commission would not have the same ability to influence the creation of rules that protect the public interest of customers in the District of Columbia.”

Undermine the Commission’s ability to protect consumers

The commission concluded in its order to reject the merger that the change of control to Exelon "would make regulatory tasks more complex; more time-consuming and more costly." It was the conclusion of the District Government that this merger could affect the Commission’s ability to regulate Pepco effectively under Exelon because of the size and complexity of Exelon’s corporate structure, the geographic scope of Exelon’s operations, and the multiplicity of state regulatory authorities involved in regulating the merged company’s operating affiliates. Nothing in the settlement changes the complexities of regulating Exelon. If anything, monitoring the commitments made by Exelon in the settlement would create an even greater regulatory burden for the Commission.

The District Government also expressed concern that Exelon would use “its core competencies in regulatory and legislative affairs” to shape how Pepco is regulated in the District. Add to this Exelon’s clear acumen at shock-and-awe public persuasion campaigns. The Commission should reflect on the tools Exelon has employed since the merger was rejected in August - threatening of charitable donations, hiring those close the Mayor’s administration to hawk the deal, a media blitz, an atroturf campaign, behind the scenes machinations to suppress public scrutiny and debate - as it considers whether it can effectively protect the interests of the public when they conflict with what Exelon wants. In addition to the problems the Commission has identified with regulating Exelon, the company of course can lobby the D.C. Council and the Mayor to modify or restrict the Commission’s resources and authorities.

Finally, it should be noted that this transaction was never intended to serve District electricity consumers; nor was it initiated because Pepco was for sale. It was not. The purpose of this transaction has always been to offset the risk accrued from Exelon’s failing nuclear generation business. Exelon will gain a reliable source of revenue to offset its risky portfolio – profit from the District alone would be over \$100 million annually. In return, Pepco shareholders will get a windfall, while Pepco ratepayers will assume the risk of higher rates, decreased competition and loss of local control. This is a fundamentally flawed proposal. In order to serve the public interest, it must be rejected.

Endnotes

¹ *Formal Case No. 1119, In the Matter of the Joint Application of Exelon Corp., Pepco Holdings, Inc., Potomac Electric Power Company, Exelon Energy Delivery Company, LLC and New Special Purpose Entity, LLC for Authorization and Approval of the Proposed Merger Transaction*, Order No. 17947 (“Order No. 17947”), rel. Aug. 27, 2015, p.1

- ¹ Initial Post –Hearing Brief of The State of Maryland and the Maryland Energy Administration, Formal Case No. 9361, p.23
- ¹ Public Citizen, Factsheet, Exelon: A Snapshot of the Corporation Trying to Takeover Pepco, Oct 2015.
<http://www.citizen.org/documents/exelon-a-snapshot-of-the-corporation-trying-to-takeover-pepco-october-2015.pdf>
- ¹ Formal Case No. 1703, Order No. 17424, p.4
- ¹ Formal Case No. 1703, Order No. 17424, p.13
- ¹ Formal Case No. 1703, Order No. 17424, p.13
- ¹ Formal Case No. 1703, Order No. 17424, p.57
- ¹ Formal Case No. 9361, Order No. 86990 p. D-13 - 14
- ¹ Formal Case No. 1703, Order No. 17424, p.2
- ¹ Supplemental Testimony of Scott Hempling Concerning Applicants' Revised Commitments On Behalf of Grid 2.0 Working Group November 17, 2015 Exhibit GRID2.0, p.24
- ¹ Comments of the Independent Market Monitor for PJM, FERC Docket No. EC14-96, filed July 21, 2014, Pages 6-8.
- ¹ Motion of Joint Applicants to Reopen the Record in Formal Case No. 1119 to Allow for Consideration of Nonunanimous Full Settlement Agreement and Stipulation, or for Other Alternative Relief, Exhibit A, p. 27-31
- ¹ Initial Post-hearing brief of DC Solar United Neighborhoods and MDV-SEIA Regarding a proposed non-unanimous settlement agreement p 43-47
- ¹ Brief on Non-Unanimous Settlement of the Independent Market Monitor for PJM, p. 3
- ¹ Formal Case No. 1703, Order No. 17424, p. 128
- ¹ District Government's Br. at 37- 38, citing Tr. at 3041:6-3047:6, 3060:11-3065:2 (Smith); District Government Confidential Cross-Examination Exhibit No. 14 at 80; District Government Cross-Examination Exhibit No. 37 (DC SUN Cross-Examination Exhibit No. 1).
- ¹ District Government's Br. at 37
- ¹ Formal Case No. 1703, Order No. 17424, p.224