BEFORE THE
PUBLIC SERVICE COMMISSION
OF MARYLAND

In the Matter of the Merger *
Of Constellation Energy * Case No. 9054

Reply Testimony of
AFSCME Council 67, Baltimore ACORN, Cleanup Coalition, Florida Consumer Action Network, MaryPIRG, Progressive Maryland, Public Citizen and SEIU 1199E-DC

1. Our coalition represents tens of thousands of customers directly impacted by the proposed acquisition of Constellation Energy by FPL. The Public Service Commission's primary mission as defined by Maryland law is to "supervise and regulate the public service companies" to "ensure their operation in the interest of the public."[1]

2. Public documents, corporate filings, media reports and our own investigation conclusively show that the proposed acquisition of Constellation Energy by FPL will lead to higher rates for customers, undermine the ability of Maryland to effectively regulate BGE, undermine competition in the regional electric supply market and otherwise harm consumers. As a result, the proposed acquisition is not in the interest of the public unless all of the following conditions laid out in this testimony are met.

3. In order for the proposed acquisition to satisfy the public interest, the Public Service Commission and/or the Maryland General Assembly must:

- Require Constellation Energy to return BGE's power plants at the cost shareholders paid for the power plants—minus the $528 million in stranded costs paid by Maryland consumers and depreciation claimed by Constellation Energy on its corporate taxes filed with the IRS—and subject these facilities to cost-of-service rates with the legal obligation to serve Maryland customers.
- Enact strong "ring-fencing" protections to ensure the assets and value of the distributional utility (BGE) is sufficiently shielded from indirectly or directly subsidizing the operations of the non-utility activities of the parent company.
- Constellation Energy must implement the nation's strongest protections for low-income consumers—including policies governing service shut-offs and bill payment assistance. These policies will be implemented according to the results of a nation-wide survey of utility "best practices" conducted at Constellation Energy's expense.

RETURN POWER PLANTS TO BGE

4. Since Constellation Energy has failed to respond to our May 9, 2006 interrogatories, the best alternative source of similar detailed information of the impact the merger will

[1] § 2-113.

have on rates is included in the May 31, 2006 letter that Constellation Energy sent to Senator Thomas V. Mike Miller, Jr and Delegate Michael E. Busch.[2] This letter details many of the reasons why the proposed acquisition violates the public interest unless certain conditions are met.

5. The May 31 letter reveals that the proposed acquisition of Constellation Energy by FPL will result in dangerous levels of market power, which will lead to uncompetitive markets and substantially higher prices for Maryland consumers. The letter admits that Constellation Energy won 70 percent of the load obligations in the state's most recent power auction, demonstrating that Constellation Energy presides over an uncompetitive market—and that doesn't include FPL's control over substantial power plant capacity in Maryland's regional market. This means that the merger will vastly increase the ability of Constellation's combined unregulated operations to price-gouge Maryland consumers. Constellation Energy likely will control more than 70 percent of the auction, as the letter failed to reveal whether FPL won any of the auction (an important omission, given the fact that FPL owns more than 2,100 megawatts of generation in the regional market) or whether any of the other auction winners will contract with Constellation Energy to supply their power supply obligations. The only effective way to mitigate this market power is to transfer the power plants that used to be under the control of BGE back to BGE and only allow cost-of-service rates to be charged to Maryland customers. In addition, as a result of the various omissions in the letter, we demand information detailing:

- What share of the power auction was won by FPL.
- Whether any of the other auction winners are in negotiations or have otherwise secured power supply agreements from Constellation and/or FPL for their load obligations.

6. The May 31 letter misleads the public into thinking that Constellation Energy is not earning windfall profits off of Maryland consumers as it fails to include the profits Constellation is earning exporting power out-of-state. Constellation's May 31 letter admits that although Constellation Energy won 70 percent of the auction, the company will be "required to acquire energy products associated with…93% of the power needed to serve its BGE residential load obligations in the market at prevailing market rates" because Constellation claims that its fleet of Maryland-based power plants already has its output committed elsewhere. Constellation Energy argues that it is earning a profit margin of 3.1 percent on importing this power. But Constellation Energy fails to say how much it is earning exporting cheap power produced at its Maryland plants, or whether the company is merely "laundering" its energy product sales by selling the output of its Maryland power plants to Constellation Power Source, its power marketer, and then selling that output to its affiliate, BGE. We also don't know whether FPL is supplying any of the power to BGE. Without knowing how much the company is earning exporting power, it is impossible to verify that the company is only earning a 3.1 percent profit margin importing power.

[2] www.sec.gov/Archives/edgar/data/1004440/000110465906038686/a06-12885_1ex99d1.htm

7. Constellation Energy claims in its May 31 letter that its portfolio of BGE's former power plants have gained $2 billion in value since BGE transferred them to Constellation in 1999, including $900 million of improvements the company claims to have invested in the plants. But this claim is inflated, as Constellation Energy has most likely been claiming losses on the value of the power plants when filing its federal income taxes with the U.S. Internal Revenue Service. Any value Constellation Energy has realized from claiming depreciation on its federal and state income taxes must be fully disclosed so that money can be compared with what Constellation Energy claims would be owed when the PSC or the General Assembly orders the power plants to be returned back to BGE.

8. The prices charged by Constellation Energy on the coal, nuclear and hydro power plants formerly controlled by BGE most likely are fetching windfall profits because these relative low-cost power sources are able to charge extremely high profits in a market where natural gas fired generation sets the price of electricity. We asked for financial detail on the profit margins on these power plants, but so far Constellation Energy has failed to respond to our request. This information must be obtained in order to assess whether the merger is in the public interest.

9. In just the last few years, after the deregulation craze in which two dozen states embarked upon an untested theory of electric utility deregulation, market prices for natural gas have skyrocketed. Because natural gas plays a major role in setting the market price of electricity, companies with generation assets fueled by anything but natural gas are able to sell their power at natural gas prices, which far exceeds the cost to produce power from their non-natural gas sources. As a result, owners of non-natural gas facilities are likely reaping windfall profits, even though these nuclear, coal and hydro facilities are decades old and were initially paid for by Maryland ratepayers.

10. Indeed, the Bush Administration concludes that "customers in states with competitive retail markets for electricity see the effects of natural gas prices in their electricity bills more rapidly than those in regulated states, because their prices are determined to a greater extent by the marginal cost of energy—the average operating cost of the last, most expensive unit run each hour—rather than the average of all plant costs. Natural gas plants, with their higher operating costs, often set the hourly marginal price."[3]

11. In addition, PJM concludes in its *2005 State of the Market Report* that "the Energy Market net revenue curve was higher in 2005 for every level of unit marginal costs compared to 2004. The 2005 net revenues for units with marginal costs equal to, or less than, $80 were higher than for any year since PJM introduced markets in 1999."[4]

12. In 2005, an owner of a power plant in PJM with a marginal cost of $30 per installed MW-year earned $241,977 per installed MW-year in net revenue from the Energy Market alone (which doesn't include additional payments for reactive power and other reliability

[3] *Annual Energy Outlook 2006*, U.S. Energy Information Administration, page 82 www.eia.doe.gov/oiaf/aeo/pdf/trend_3.pdf
[4] Page 121, www.pjm.com/markets/market-monitor/som.html

incentives)—a 305% increase from the $59,776 per installed MW-year in net revenue that same facility earned in 2000.[5]

13. Rising natural gas prices vastly increase the marginal costs of power plants fueled by natural gas relative to competing fuels like coal. In 2004, the average cost for a coal power plant was $1.36 per 10^6 Btu, while the average cost for a natural gas power plant was 438% higher, at $5.96 per 10^6 Btu. As recently as 1999—the year Maryland passed deregulation legislation—the average cost of a natural gas power plant was only $2.56 per 10^6 Btu (compared to $1.22 per 10^6 Btu for the average coal plant).[6]

14. The same is true for nuclear power plants that were built 30 years ago.[7] A recent presentation by the Nuclear Energy Institute[8] boasts of a similar cost gap between nuclear power and natural gas: nuclear power busbar cost averages $23 per megawatt hour, compared to $71.40 per megawatt hour for a 7,500 Btu natural gas fired power plant.

15. There is one Constellation facility that does release some financial information: the 415 MW Safe Harbor Water Power Corp. hydro facility, of which Constellation owns 66.7%. According to Public Citizen compilations from FERC filings,[9] Constellation's share of earnings is $66 million (on $109 million of revenue) since the facility was transferred from Baltimore Gas & Electric to Constellation in 2000. Meanwhile, the salary of Safe Harbor's CEO, Marshall J. Kaiser, increased 40% since 2000 (from $145,109 in 2000 to $203,719 in 2004).

16. These massive cost discrepancies are most likely allowing Constellation Energy to earn windfall profits at the same time that the company's affiliate, BGE, is asking Maryland ratepayers for a 72% rate increase.

RING FENCING

17. A review of public statements by Constellation and FPL executives reveals that the merger will have an adverse impact on Baltimore Gas & Electric.

18. FPL CEO Lewis Hay informed the public during a December 19, 2005 conference call to Wall Street analysts that "the primary driver of this transaction is our mutual desire to build the premier competitive energy business. This will be far and away the most effective and efficient competitor in the deregulated markets of this country."[10] The CEO of the new company makes it clear that the priority will be the unregulated portions

[5] Table 3-1, page 119, www.pjm.com/markets/market-monitor/som.html
[6] www.eia.doe.gov/cneaf/electricity/epa/epat4p5.html
[7] It is important to note that the biggest cost of nuclear power is the capital costs, so building new nuclear plants won't guarantee price advantages because the costs to build new plants are so high.
[8] "Nuclear Energy 2006: A Solid Business Platform for Future Growth", February 2006, www.nei.org/documents/Wall_Street_Briefing_2-2-06.pdf
[9] Safe Harbor Water Power Corporation *Form 1 Annual Report for Major Electric Utilities, Licensees & Others*, http://elibrary.ferc.gov/
[10] George Lobsenz, "FPL-Constellation Deal Powered by Merchant Ambitions," *The Energy Daily*, December 20, 2005, Vol. 33 No. 241.

of the company, and not strengthening the regulated entities like Baltimore Gas & Electric.

19. This prioritization of the unregulated divisions will come at the direct expense of regulated entities like Baltimore Gas & Electric. Statements made by both Hay and Constellation CEO Mayo Shattuck during the December 19 Wall Street conference call imply that ratepayers of the regulated utilities will be subsidizing the riskier, unregulated portions of the companies' operations.

20. According to the *Wall Street Journal*, "the fact that Constellation derives so little profit from the Baltimore utility has resulted in a credit rating that is several notches lower than FPL."[11]

21. Another article describes the threat to ratepayers in more detail: "FPL Group Inc. and Constellation energy Group Monday announced an $11 billion combination creating the industry's highest-octane merchant power business *on top of a solid financial foundation provided by steady, cash-generating regulated utilities in Florida and Maryland*…For Constellation, Chairman, President and Chief Executive Officer Mayo Shattuck said the transaction solved his company's looming problem of lacking the financial and generation heft to fully pursue growth in competitive energy markets. He noted that Constellation was financially 'constrained' by concerns expressed by credit rating agencies about the risks of Constellation's reliance on its competitive business, which provides about two-thirds of the Baltimore-based company's revenues. Constellation's unregulated business has been highly profitable, but rating analysts still tend to view such activities with suspicion because they got burned by the Enron Corp. and other energy trading scandals of the recent past. As a result, Constellation has not enjoyed the strong credit ratings awarded to more predictable energy companies that are heavy on regulated operations. 'We've had some concern that the requirements to growth might be constrained by the moving targets of rating agencies.'"[12] [emphasis added]

22. Thus, it is no exaggeration to say that the merger is intended to enlist Florida and Maryland regulated utility ratepayers together in funding the expansion of the merged company's non-utility businesses nationwide. It is for precisely this reason that we respectfully request the PSC to reject Constellation's claim that "there will be no harm to BGE or its customers as a result of the transaction" and the PSC must survey other states' "best practices" on ring-fencing protections, including Wisconsin, Oregon and California.

BGE'S CUSTOMERS ARE "CAPTIVE"

23. Constellation Energy argues that "Baltimore Gas and Electric has no captive energy commodity customers, as the State of Maryland has adopted retail choice."[13] FERC made an original determination back in 2000, just months after Maryland passed its

[11] Rebecca Smith, "FPL, Constellation Reach Agreement on $11 Billion Deal," December 19, 2005.
[12] George Lobsenz, "FPL-Constellation Deal Powered by Merchant Ambitions," *The Energy Daily*, December 20, 2005, Vol. 33 No. 241
[13] FPL and Constellation filing under EC06-77 on February 9, 2006, page 9, http://elibrary.ferc.gov/

deregulation law certifying that BGE had no captive ratepayers under the assumption that retail "choice" would flourish, and cancelled strict code of conduct rules that would have governed affiliate transactions between Constellation's unregulated power plants and Baltimore Gas & Electric.[14]

24. But six years later the facts show that FERC's assumptions were wrong because household consumers in BGE's service area *are* captive. As of April 2006, only 32 households, out of a total of 1,087,416 eligible, were served by alternative suppliers to BGE (for a "choice", or "switching", rate of 0.003%).[15] We can think of no legal or common sense methodology that could conclude that 99.997% of households in BGE's service territory that remain under contract to BGE are anything other than "captive" ratepayers.

25. This issue must be addressed as part of the merger proceeding because the union of the two companies involves the addition of over 2,100 MW of generation capacity controlled by FPL—a huge new addition of power plants that must adhere to code of conduct rules to ensure no affiliate transaction abuses that threaten the nearly 1.2 million captive BGE ratepayers in Maryland.

26. We therefore request that the PSC determine that BGE has *de facto* captive ratepayers.

"BEST PRACTICES" FOR LOW-INCOME CUSTOMER PROTECTIONS

27. With the failure of deregulation to provide affordable power to Maryland consumers, the PSC must mandate stronger protections for low-income consumers, particularly on shut-off and bill payment assistance policies. The PSC must undertake, with the financial assistance of Constellation Energy, a nationwide survey of "best practices" in order to guarantee that Maryland's low-income consumers will enjoy protections equal to the strongest policies enacted by a state or a utility in the country.

[14] *Order Denying Late Motion to Intervene and Denying Rehearing*, issued June 15, 2000, docket ER00-1598-001, http://elibrary.ferc.gov/

[15] www.psc.state.md.us/psc/electric/enrollmentrpt.htm

28. In conclusion, the acquisition as currently proposed by the companies is not in the public interest. Only on the adoption of the above conditions, particularly the re-regulation of BGE's former power plants, will the proposed acquisition be in the public interest.

Respectfully submitted,

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