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Joan Claybrook, President

January 14, 2005

Chairwoman Agnes Alexander Yates
Commissioner Richard E. Morgan
Commissioner Anthony M. Rachal, III
Public Service Commission
1333 H Street, NW
Suite 200, West Tower;
Washington, DC 20005

Dear Chairwoman Yates and Commissioners Morgan and Rachal,

Please accept this letter as Public Citizen's formal request that the PSC require PEPCO to re-acquire the power plants it sold as the only means with which to protect DC consumers from rate increases.

In December 2000, PEPCO voluntarily deregulated by finalizing the sale of four of its power plants to Atlanta-based Mirant for $2.75 billion. When the company sold its plants, it ended the ability of DC (and Maryland and Virginia) regulators to protect consumers, as the rates charged by the new owners of the power plants are now federal jurisdiction. The PSC only has de facto jurisdiction over wholesale power rates when PEPCO and other utilities remain vertically-integrated monopolies, as had been the practice in the United States for over 100 years prior to deregulation.

Therefore, the PSC can better protect the District's consumers only if PEPCO re-acquires its power plants, thereby allowing the PSC to mandate that prices charged area residents and businesses are fair by linking them to the cost to produce the energy. Once the power plants were sold, however, unregulated market forces—similar to what Enron did in California—have resulted in price-gouging, with inflation-adjusted PJM wholesale power prices increasing 75% from 1998 to 2004, with average annual wholesale prices rising from $25.92 mw/h in 1998 to $45.21 in 2004.[1]

The four former PEPCO plants—the Morgantown, Chalk Point and Dickerson power plants in Maryland and the Potomac River plant in Virginia—would add over 5,000 MW of capacity that would be under direct regulatory control of the PSC. Such an acquisition would add to the two power plants PEPCO currently owns in DC (Buzzard Point and the Benning Road generation station) and to the already large power plant portfolio PEPCO controls due to its acquisition in August 2002 of Conectiv—an additional 5,000 MW in New Jersey, Delaware, Maryland and Virginia. By ordering the re-acquisition of PEPCO's power plants, the PSC would be able to

[1] Compiled by Public Citizen from PJM www.pjm.com and Bureau of Labor Statistics www.bls.gov data.

restore lower prices for consumers by imposing cost-of-service rates while allowing PEPCO a reasonable rate of return.

On July 14, 2003, Mirant filed for Chapter 11 bankruptcy,[2] partly due to the company's ethical problems, exemplified by the more than $30 million the company has paid to state and federal regulators to settle allegations of market manipulation.[3] One important fallout of the bankruptcy proceeding is that in December 2004 PEPCO sued Mirant for failure to make payments related to the power plants PEPCO used to own.[4]

Public Citizen believes that an order from the PSC to PEPCO to re-purchase its power plants from Mirant might be well-received by Mirant's major creditors under the bankruptcy proceeding. While such a move may be perceived as a longshot, there is no other policy approach that would enable the PSC to effectively protect the District's consumers.

Re-acquiring its power plants would restore transparency not only to the region's electricity markets but to PEPCO's corporate structure as well. Whereas in 2000, 12% of PEPCO's operating revenues came from its unregulated operations, by 2003 45% of its revenues came from its unregulated divisions. This transformation, made possible by deregulation, also means that more of PEPCO's operations are out of the reach of the PSC.

Restoring vertical integration will help put an end to the problems of rising prices and minimal transparency that plagues the PJM market. A regional alliance of large corporations, the PJM Industrial Customer Coalition, was forced to make the following conclusions in a recent white paper[5]: "based on current wholesale and retail pricing trends, as well as the ongoing expiration of retail price caps, PJMICC members have serious concerns that the promise of electric utility restructuring is not being fulfilled…energy-intensive businesses simply do not have the luxury to take a principled, long-term view that markets will <u>eventually</u> produce "just and reasonable results." Relying on declarations that market conditions will improve in the next few years is not a viable answer for businesses subjected to the press of global competition. Business decisions are being made today, based on many factors including energy costs. In deciding where to locate new businesses, close unprofitable businesses, and expand existing businesses, businesses require that every part of the supply chain be efficient and produce the lowest possible cost…Competition for the sake of competition, without close attention to producing benefits for ultimate end users, is not sound public policy. For electric utility restructuring to be considered a success and not merely an ill-conceived experiment with ratepayer dollars, there needs to be closer scrutiny that market participants play by the rules, that resulting prices are free from the influence of market power and, most importantly, that in the near-term and long-term, ultimate end-use customers receive truly "just and reasonable" prices for reliable electric service."

This echoes conclusions reached by the Cato Institute, a leading anti-government, free-market organization: electric "restructuring contributed to the severity of the 2000–2001 California electricity crisis and (some scholars also argue) the August 2003 blackout in the Northeast,

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[2] U.S. Bankruptcy Court, Northern District of Texas, # 03-46590, www.txnb.uscourts.gov
[3] One of those federal settlements is detailed here: www.cftc.gov/opa/enf04/opa5025-04.htm
[4] U.S. Bankruptcy Court, Northern District of Texas, : 04-04371, www.txnb.uscourts.gov
[5] *What Large Commercial & Industrial Customers Need From the PJM Marketplace*

without delivering many efficiency gains. The poor track record of restructuring stems from systemic problems inherent in the reforms themselves. We recommend total abandonment of restructuring and a more thoroughgoing embrace of markets than contemplated in current restructuring initiatives. But we recognize that such reforms are politically difficult to achieve. A second-best alternative would be **for those states that have already embraced restructuring to return to an updated version of the old, vertically integrated, regulated status quo**."[6]

Higher wholesale prices in PJM have made a mockery of the primary benchmark DC uses to measure the relative success of "competition": the share of D.C.'s residential consumers who have chosen an alternative electricity supplier to PEPCO. The highest "choice" rate achieved in D.C. was in December 2002, when 12 percent of the city's residents "chose" an alternative supplier to PEPCO. Nearly two years later, by November 2004, 10,000 fewer D.C. residents were "choosing" an alternative supplier, reducing the share of residential customers "choosing" to 6.8 percent.[7]

Sincerely,

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[6] *Rethinking Electricity Restructuring*, November 2004, www.cato.org/pubs/pas/pa530.pdf
[7] www.dcpsc.org/pdf_files/customerchoice/electric/electric_sumstats_no_cons.pdf