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Exelon's Proposed Acquisition of Pepco: Corporate Strategy at Ratepayer Expense

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John A. Wilson Building
1350 Pennsylvania Avenue, NW
Washington, DC 20004
Committee on Transportation and The Environment

Testimony of Cathy Kunkel on behalf of the Institute for Energy Economics and Financial Analysis

Thank you for the opportunity to testify.

My name is Cathy Kunkel. I am a fellow with the Institute for Energy Economics and Financial Analysis, a non-profit organization that conducts research on economic and financial issues related to energy and utilities. This week we released a report analyzing the proposed merger of Exelon and Pepco Holdings. I would like to enter this report into the record, and share some of our key findings with you now.

Our conclusion is that the short-term benefits promised by Exelon to DC do not outweigh the long-term risks to Pepco's customers.

A fundamental difference between Exelon and Pepco Holdings is that Exelon owns power plants and Pepco Holdings does not. Exelon is the largest owner of nuclear power plants in the country. This means that Exelon has a financial interest – even a fiduciary duty – to pursue policies and to operate its company in a way to maximize power prices to benefit its nuclear plants. This is not in the interest of DC electric customers.

It is not in the interest of DC electric customers for two reasons. One reason is that Exelon pursues policies that support nuclear generation and weaken competitors like renewable energy. D.C. has made great strides in renewable energy over the past several years and has set long-term goals for renewable energy, particularly solar. D.C. needs an electric utility that is a willing partner in this effort. But nowhere in the hundreds of pages of testimony it has provided in support of this merger has Exelon expressed any approval of or support for D.C.'s renewable energy goals. Instead, after taking over Constellation in Maryland, Exelon has lobbied against community renewable energy, against expanding the renewable energy standard, and against other renewable energy policies. This does not bode well for D.C. if the merger is approved.

Exelon's ownership interest in nuclear power also creates the risk of rate increases for Pepco's customers. Let me explain.

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The electric utility industry today is in a period of rapid change. Low natural gas prices, stagnant demand for electricity, and the growth of renewable energy and energy efficiency all have eroded profit margins for coal and nuclear power plants in deregulated markets. Major utilities that own deregulated coal and nuclear plants – like FirstEnergy, American Electric Power, Duke, and Exelon – have been caught flat-footed by the changes in the market and their aging plants are now facing an uncertain future. These utilities have responded by shifting their focus towards growing their regulated operations, where they are assured more stable revenues through the electric rates that we pay.

That is exactly what Exelon's objective is with this merger. Through this merger, Exelon would acquire Pepco's regulated distribution utilities – a new and stable revenue source, to counterbalance the volatile and uncertain earnings of its nuclear plants. Exelon has also stated that it plans to invest more money into its regulated operations, which translates into higher rates so that Exelon can recover and profit on those investments. Since Exelon acquired Baltimore Gas & Electric in 2012, BG&E customers have experienced 4 rate increases.

Exelon is willing to pay a lot to gain access to Pepco's regulated operations - $2.5 billion more than what Pepco's assets are actually worth. The high price puts pressure on Exelon to extract as much value as possible from the purchase, which adds to the risk of rate increases for Pepco customers.

Because such a significant part of its business is nuclear power generation, Exelon has financial incentives that Pepco currently does not have, and the DC PSC would necessarily have to work harder to police Exelon and make sure it is not taking advantage of Pepco by trying to pass on to Pepco customers costs that they should not have to bear.

If this merger happens, it will be impossible to go back. No public service commission has ever split up a utility holding company.

D.C. has an advantage now in that Pepco is not tied to any generation and it is not tied to these aging and expensive nuclear plants. That makes Pepco more flexible and better able to take advantage of the changes that are going on in the electric utility industry and help accelerate the transition towards renewable energy.

But this merger would weaken D.C.'s control over its electric utility. It would place that control instead into the hands of a Chicago corporation that has a strong financial interest – even a fiduciary duty - to maintain the profitability of its nuclear power plants.

This merger may be good for Exelon, but it will not be good for DC. Thank you.