



NUCLEAR INFORMATION AND RESOURCE SERVICE

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Submitted electronically and by USPS Priority Mail Express on February 17, 2015

Comments of the Nuclear Information & Resource Service (NIRS) on the Application for Approval of the Proposed Acquisition of Pepco Holdings, Inc. by Exelon Corporation Before the Maryland Public Service Commission Case No. 9361

Please accept the comments of Nuclear Information & Resource Service (NIRS) on the above-referenced case, the proposed acquisition of Pepco Holdings, Inc. (Pepco, or PHI) by Exelon Corp. (Exelon). NIRS is a nonprofit environmental organization, headquartered in Takoma Park, Maryland. The preparer of these comments, Executive Timothy Judson, has sixteen years experience monitoring the energy and utility sectors, with a particular focus on merchant nuclear power generation and utility restructuring. Exelon emerged as the largest player in both sectors more than a decade ago, and NIRS has monitored the corporation's activities very closely with respect to the Pepco acquisition and a number of other current issues.

NIRS opposes Exelon's proposed acquisition of PHI, for several reasons:

- It provides no material benefit to Maryland residents and ratepayers and does not meet the public interest standard for approval.
- It exposes Pepco ratepayers to the risk of steep commodity price and/or utility rate escalation in Maryland, and throughout Exelon's and PHI's current service territories.
- It has the potential to undermine other environmental and public policy priorities, including greenhouse gas reductions and sustainable energy goals.
- For the first time, it would tie Pepco ratepayers into a company that relies primarily on the generation of electricity from nuclear power plants and the production of radioactive waste, and increases the risk that Maryland residents could bear the cost of subsidizing their operation and/or decommissioning.

In short, Maryland deserves a better utility than Pepco, but Exelon would be substantially worse. This is for several material reasons: Exelon's business model and policy objectives run counter to those that are in Maryland residents' interests; and Exelon is pursuing the Pepco takeover for the primary purpose of offloading risks from its struggling nuclear power business; and by acquiring Pepco, Exelon would achieve an unprecedented level of monopoly control of the distribution, transmission, and generation markets. As a result, the takeover is inimical to the public interest and poses multiple risks to Pepco ratepayers.

While Exelon has operated in Maryland for going on three years, the proposed acquisition of Pepco presents unique and unprecedented risks of monopoly control and market domination that cannot be mitigated sufficiently by merely placing conditions on the ownership transfer. Exelon's and, previously, Constellation's ability to exercise monopoly control has been limited by a diversity of utility businesses in Maryland, from small coops and municipal utilities to a comparably sized investor owned utility (IOU) in Pepco. Baltimore Gas & Electric's (BG&E)

and Pepco's market power has been limited by their independent ownership. Should the proposed acquisition be approved, that balance would be lost, and more than 80% of Maryland's transmission and distribution infrastructure, as well as a plurality of the state's generation capacity, would be controlled by the same parent corporation.

Exelon's Record of Leveraging Market Power to Influence Policy and Markets

To know what life is going to be like with Exelon going forward, Maryland need only look to what it is doing in Illinois and New York. In Illinois, Exelon has long dominated the state's power sector, as both the dominant utility (Commonwealth Edison) and by far the largest generator of electricity, with its six nuclear power plants accounting for 46% of electricity produced in the state. Last year, Exelon used its influence to defeat a bill to fix the state's renewable portfolio standard by threatening to close three uncompetitive nuclear plants if the state did not commit to subsidizing their continued operation.¹ It has continued pressuring legislators for major subsidies and incentives to support its power plants, and pushed through a resolution promoting a national policy agenda that would result in steep electricity price increases and block competition from new energy technologies.²

In total, Exelon seems to be seeking over \$1 billion per year in subsidies, incentives, and market reforms in Illinois, which would raise the price of electricity by 38% statewide. In September, Exelon proposed \$580 million per year in state-based subsidies, based on a misinterpretation of the Environmental Protection Agency's Clean Power Plan.³ In addition, Exelon stands to benefit from capacity market reforms proposed by PJM, which would increase revenues for its Illinois reactors by an estimated \$568 million per year, resulting in a 19% increase in electricity prices statewide and an 11% increase in the total delivered cost of electricity.⁴ When questioned at a state agency hearing in December, Exelon stated it would not forego its request for state-level subsidies in light of its anticipated capacity market windfall,⁵ and it has continued advocating for the state to subsidize nuclear. In total, the result would increase the cost of electricity by \$1.15 billion per year, averaging over \$100 million for each of the eleven nuclear reactors Exelon operates in Illinois.

Leveraging Poor System Planning for Merchant Generation Subsidies

At the same time, Exelon is trying to obtain a similar subsidy for one of its nuclear reactors in New York, which suggests another way Exelon could harm Maryland ratepayers. The Ginna Nuclear Power Plant near Rochester is one of the oldest, smallest, and most economically challenged in the country. Exelon is seeking New York PSC (NYPSC) approval of a contract

¹ Daniels, Steve. "Clean-energy law revamp is dead." Crain's Chicago Business. May 15, 2014. Chicago, IL. http://www.chicagobusiness.com/article/20140515/NEW_S11/140519854/clean-energy-law-revamp-is-dead
Tomich, Jeffrey. "Ill. still in search of solution for 'broken' renewable standard." Environment & Energy Publishing. Washington, D.C. April 23, 2014. <http://www.eenews.net/stories/1059998295>

² Illinois General Assembly. HR 1146. Adopted May 29, 2014.
<http://www.ilga.gov/legislation/BillStatus.asp?DocTypeID=HR&DocNum=1146&GAID=12&SessionID=85&LegID=82396>

³ Daniels, Steve. "Exelon puts an opening price tag on nuclear rescue: \$580 million." Crain's Chicago Business. September 24, 2014. <http://www.chicagobusiness.com/article/20140924/NEWS11/140929909/exelon-puts-an-opening-price-tag-on-nuclear-rescue-580-million>

⁴ Daniels, Steve. "New math to help Exelon's nukes." Crain's Chicago Business. December 6, 2014. <http://www.chicagobusiness.com/article/20141206/ISSUE01/312069983/new-math-to-help-exelons-nukes>

⁵ Ibid.

with Rochester Gas & Electric (RG&E) to subsidize Ginna's continued operation, on the basis of a reliability study indicating possible system reliability problems if Ginna were to close.⁶ The proposed contract was submitted to NYPSC on February 13, 2015, and would appear to result in a ratepayer subsidy of approximately \$47 million per year.⁷ However, the contract involves a complicated pricing scheme, which has yet to be analyzed in detail and raises further questions about the veracity of Exelon's filings with the NYPSC, RG&E and the New York Independent System Operator (NYISO).⁸

Exelon's original petition indicated that the reactor's basic operating costs were substantially higher than the level reflected in the contract, and maintained that Exelon would recommend closure of Ginna unless it were awarded a contract that met its operating costs.⁹ Exelon later issued statements affirming the operating cost estimates derived from its NYPSC petition, citing an operating cost of \$56-\$64 per megawatt-hour (MWh),¹⁰ substantially higher than the estimate of \$50/MWh in the proposed contract.¹¹ If its statements were accurate, Exelon is now committing to operate Ginna for nearly four years at a price that would entail losses totaling nearly \$100 million. It is not clear why Exelon is willing to continue operating the reactors under such conditions, and raises concerns about whether the company has manipulated reliability concerns to extract a subsidy.

Exelon's proposed "ring-fencing" provisions would not protect Maryland ratepayers from such a scenario, but its likelihood is increased if Exelon were to own not only a power plant, but the local transmission and distribution utility into which it is connected. That precise situation would result from the takeover of Pepco, with Exelon's Calvert Cliffs Nuclear Power Plant located within Pepco's transmission system. Exelon's Ginna proposal has benefited from RG&E's record of poor system planning and investment, as documented in a 2012 audit commissioned by NYPSC.¹² RG&E was found to suffer from systemic problems in those areas, and has struggled

⁶ Exelon Corporation, Constellation Energy Nuclear Group, LLC, and R.E. Ginna Nuclear Power Plant, LLC. "Petition for Initiation of Proceeding to Examine Proposal for Continued Operation of R.E. Ginna Nuclear Power Plant." Filed with New York State Public Service Commission. Albany, NY. July 11, 2014. <http://documents.dps.ny.gov/public/Common/ViewDoc.aspx?DocRefId=%7b3046BCE2-7856-404B-B73A-29E731C6A44C%7d>

⁷ AGREE release

⁸ "Reliability Support Services Agreement Between R.E. Ginna Nuclear Power Plant, LLC and Rochester Gas and Electric Corporation." February 13, 2015. <http://documents.dps.ny.gov/public/Common/ViewDoc.aspx?DocRefId={D5FC0B9F-4B22-460F-B722-65D433599015}>

⁹ Azulay, Jessica, and Tim Judson. "Economic Impact of the Proposed Ginna Nuclear Power Plant Contract." Alliance for a Green Economy and Nuclear Information & Resource Service. January 2015. http://allianceforagreenconomy.org/sites/default/files/Ginna_Economic_Impacts_January_2015.pdf

¹⁰ Malik, Naureen, and James Polson. "http://www.bloomberg.com/news/articles/2015-01-05/new-york-reactor-s-survival-tests-pricey-nuclear" <http://www.bloomberg.com/news/articles/2015-01-05/new-york-reactor-s-survival-tests-pricey-nuclear>

¹¹ Calculated based on the pricing formula in the above-referenced Reliability Support Services Agreement, and the market price and generation projections used in the above-referenced Azulay-Judson report.

¹² Liberty Consulting Group. "Final Report. Management Audit of Iberdrola S.A., Iberdrola USA, New York State Electric and Gas, and Rochester Gas and Electric. Volume I: Audit Report." Prepared for Public Service Commission, State of New York. June 4, 2012. <http://documents.dps.ny.gov/public/Common/ViewDoc.aspx?DocRefId=%7BA8AA4111-01B0-4513-8D80-4C7B41AA095F%7D>

to undertake a set of transmission upgrades to address system vulnerabilities related, in part, to unplanned outages at Ginna. The “Rochester Area Reliability Project” was initially scheduled to be completed by 2014,¹³ but has since been delayed until at least October 2018.¹⁴

In December, RG&E announced it had identified an alternative substation upgrade that would eliminate the need for Ginna and substantially shorten the length of time for which the reactor would be needed. However, RG&E has not indicated how soon it could implement the substation expansion, and the three-and-a-half year term of the proposed Ginna contract suggests little hope that it would be implemented soon. For a net subsidy of \$165 million, NY regulators and RG&E customers are essentially being held hostage to steep electricity price increases by a combination of Exelon’s uneconomical nuclear power plant and incompetence or negligence by the utility. The potential for such an arrangement could more easily be replicated by the kind of integrated but partially unregulated monopoly that would be created by Exelon’s proposed acquisition of Pepco.

Rate Increases Will Be Necessitated by Debt Financing of the Proposed Acquisition

Exelon is pursuing the acquisition of Pepco precisely in order to offload risks facing its merchant nuclear business onto an expanded utility customer base, and to leverage the resulting increased monopoly power to inflate revenues for nuclear generation. This basic intent to raise electricity prices is evident from the basic structure of the deal, which will itself necessitate substantial rate increases for Pepco customers:

- Exelon would purchase Pepco for \$1.3 billion more than its stock market value.¹⁵
- Exelon is funding only about \$1 billion of the transaction (less than 15%) through unencumbered cash from sales of assets.
- The purchase would be financed almost entirely with debt that Pepco customers, ultimately, would be the ones to repay.

The debt financing package includes \$3.5 billion in loans and over \$2 billion in future equity issuances, risky financial instruments that are more commonly used in private equity transactions.¹⁶ Thus, Exelon will need to derive enough revenue from Pepco customers to pay off over \$5.5 billion in debt, equivalent to nearly \$3,000 for each of Pepco’s approximately two million ratepayers. As a result, Exelon is entering into this acquisition with a structural obligation to derive nearly sixty times more in earnings from the average Pepco ratepayer than the offered

¹³ Rochester Gas and Electric Corporation. “Application of Rochester Gas and Electric Corporation for a Certificate of Environmental Compatibility and Public Need for the Construction of the “Rochester Area Reliability Project, etc.” Filing with the New York Public Service Commission. September 27, 2011. http://www.rge.com/MediaLibrary/2/5/Content%20Management/RGE/RARP/PDFs%20and%20Docs/RARP_Application_signed_092711.pdf

¹⁴ New York Independent System Operator. “Additional Reliability Study for Exelon Corporation: Evaluation of the Impact of the Retirement of the Ginna Nuclear Generation Station On the New York State Transmission System.” May 12, 2014. <http://documents.dps.ny.gov/public/Common/ViewDoc.aspx?DocRefId={8ED49682-3B26-436C-B4AA-B142F8C0E9F9}>

¹⁵ Holan, Mark. “Year in Review 2014: Exelon Corp. makes \$6.8 billion bid for Pepco Holdings Inc.” *Washington Business Journal*. December 17, 2014. <http://www.bizjournals.com/washington/news/2014/12/17/year-in-review-2014-exelon-corp-makes-6-8-billion.html?page=all>

¹⁶ Daniels, Steve. “With Pepco deal, Exelon takes page out of private-equity playbook.” *Crain’s Chicago Business*. April 30, 2014. <http://www.chicagobusiness.com/article/20140430/NEWS11/140439971/with-pepco-deal-exelon-takes-page-out-of-private-equity-playbook>

\$50 credits toward their bills. Exelon says that proposed rebate program would ostensibly be financed through projected “efficiencies” achieved by joining Pepco to Exelon’s larger utility operations. Even if Exelon is to be believed that it can achieve such efficiencies without compromising service quality, it begs the question how it plans to pay off nearly \$6 billion in new debt without substantial rate increases.

Exelon’s Corporate Strategy and Policy Agenda

In addition, Exelon has stated that, by acquiring Pepco, it will be able to guarantee that all of its annual shareholder dividends will be paid out of revenues from its utility business.¹⁷ That means Exelon’s regulated utility customers would be responsible for 100% of shareholder dividends, even though they would only represent 60-65% of the corporation’s business¹⁸ – that is, Pepco customers would be responsible for paying a 50% greater share of dividends than Exelon’s utility business represents. This speaks to both the heavy financial risks Exelon faces in its merchant generation business, and the company’s strategy to transfer that risk to its utility customers.¹⁹ In light of these factors, Exelon’s proposed three-year rate freeze provides little reassurance against steep rate hikes in years four, five, and beyond.

Unfortunately, though, Pepco customers likely would not need to wait that long to see their bills rise. Exelon cannot guarantee shareholders any profits from operating nuclear power plants, so it must do so on the backs of captive customers. While that business strategy might be enough to shore up investor confidence for the moment, it will not last long if Exelon does not restore its generation business to profitability by substantially increasing the price of electricity, in particular for its fleet of twenty-three aging nuclear reactors. About one-quarter of them are unprofitable, as a result of rising operational costs in excess of market electricity prices. Exelon is not able to divest its nuclear plants because of this fundamental problem:

- No other company would buy them for the same reason Exelon would sell them, that their operating costs are too high for them to operate profitably in the merchant energy markets.
- A previous effort to spin off merchant nuclear plants failed to receive approval, as a transparent effort to offload environmental liabilities into an over-leveraged business doomed to fail.²⁰
- And retiring reactors early could entail over \$1 billion in unfunded liabilities for decommissioning.²¹

¹⁷ Exelon Corp. “Exelon Announces Acquisition of Pepco Holdings, Inc.” Slide presentation. April 30, 2014. <http://assets.fiercemarkets.com/public/sites/energy/reports/exelonpepcoreport.pdf>

¹⁸ Lubow, Howard E., and Dr. J. Robert Malko. “Prepared Reply Panel Testimony of Howard E. Lubow And Dr. J. Robert Malko On Behalf of the Staff of the Maryland Public Service Commission.” Maryland Public Service Commission Case No. 9361. December 8, 2014. http://webapp.psc.state.md.us/Intranet/casenum/NewIndex3_VOpenFile.cfm?filepath=C:\Casenum\9300-9399\9361\Item_88\9361Lubow-Malkow_Reply_Testimony_Final_PublicRedacted.pdf

¹⁹ Judson, Timothy. “Killing the Competition: The Nuclear Power Agenda to Block Renewables, Stop Climate Action, and Subsidize Aging Reactors.” Nuclear Information & Resource Service. September 2014. <http://www.nirs.org/neconomics/killingthecompetition914.pdf>

²⁰ New York Public Service Commission. “PSC Rejects Entergy Spin-Off Plan: Proposed Sale of 3 Nuclear Power Plants in NY Not in the Public Interest.” Press Release. March 25, 2010. [https://www3.dps.ny.gov/pscweb/WebFileRoom.nsf/Web/EBF6CB0D8B8E5CEF852576F10059B6F6/\\$File/pr10025.pdf?OpenElement](https://www3.dps.ny.gov/pscweb/WebFileRoom.nsf/Web/EBF6CB0D8B8E5CEF852576F10059B6F6/$File/pr10025.pdf?OpenElement)

The best option for Exelon is to raise the prices it is paid for electricity from its nuclear power plants. However, that is the worst option for Pepco ratepayers. It is also the basis for Exelon's opposition to renewable energy, efficiency, and distributed generation. The electricity system cannot rely solely on inflexible, unresponsive nuclear and coal plants, and Exelon depends on the volatile market prices created by natural gas generation to ensure the profitability of its generation portfolio. But the growth of wind, solar, and energy efficiency – which are rapidly becoming the lowest cost energy resources, with efficiency and wind now less expensive than natural gas – will likely result in much more stable electricity prices in the long term, at lower rates than most nuclear power plants can operate at profitably.²²

Exelon's Opposition to Sustainable Energy Resources and Distributed Generation

In this proceeding, Exelon has stated that it is a supporter of renewable energy and that it operates a substantial amount of wind and solar generation, but such claims are unsupported by the record. In 2014, the clean energy organization CERES ranked the nation's thirty-two largest utilities on energy efficiency and renewable energy.²³ Exelon rated in the bottom of both categories:

- It is 21st out of 32 utilities in efficiency, at just 2.69% of electricity sales.
- And it is 22nd in renewables, at just 2.97% of sales.

Pepco already rates higher in renewable energy, by comparison, at 3.40%. What renewable generation Exelon provides is merely a boutique portion of its portfolio, mostly required by state renewable portfolio standards.

In point of fact, Exelon is one of the leading opponents of renewable energy in the United States. It gained notoriety for its position in 2012, when the American Wind Energy Association terminated the company's membership and removed Exelon from its board of directors, because of its vociferous opposition to the Renewable Energy Production Tax Credit.²⁴ Due in part to Exelon's advocacy, the PTC has repeatedly failed to be renewed over the last four years, leading to an unpredictable environment for one of our most promising and cost-effective energy

²¹ U.S. Nuclear Regulatory Commission. "SECY-13-0105: Summary Findings Resulting from the Staff Review of the 2013 Decommissioning Funding Status Reports for Operating Power Reactor Licensees." October 2, 2013. <http://www.nrc.gov/reading-rm/doc-collections/commission/secys/2013/2013-0105scy.pdf>

Sum of decommissioning trust fund shortfalls for Exelon reactors known to be at risk of closure (Byron 1 and 2, Clinton, and Ginna) equaled \$1,112,545,716 in 2013.

²² Cooper, Mark. "Comments of Dr. Mark Cooper, Before the Environmental Protection Agency, In the Matter of Carbon Pollution Emission Guidelines for Existing Stationary Sources: Electric Utility Generating Units." Docket No. EPA-HQ-OAR-2013-0602. November 24, 2014.

<http://www.nirs.org/climate/background/cooperepacppcommentexhibitb12114.pdf>

<http://www.nirs.org/climate/background/cooperepacppcommentexhibitb12114.pdf>

²³ Kwasnik, Joseph M., et al. "Benchmarking Utility Clean Energy Deployment 2014: Ranking 32 of the Largest U.S. Investor-Owned Electric Utilities on Renewable Energy and Energy Efficiency." Ceres. July 2014.

<http://www.ceres.org/resources/reports/benchmarking-utility-clean-energy-deployment-2014/view>

²⁴ Wernau, Julie. "Wind energy group gives Exelon the boot: Cites power company's opposition to continued wind subsidies." *Chicago Tribune*. September 10, 2012. http://articles.chicagotribune.com/2012-09-10/business/chi-wind-energy-group-gives-exelon-the-boot-20120910_1_exelon-corp-wind-energy-wind-investment

sources. In addition, Exelon announced in 2014 that it intends to oppose the Investment Tax Credit that benefits residential distributed energy, most popularly for rooftop solar.²⁵

It is not clear that Exelon even knows what clean energy is. The company's comments on the EPA's Clean Power Plan list five different versions of failed or unproven nuclear, coal, and natural gas as emissions-reducing technologies, all ahead of proven sustainable energy solutions, such as solar and demand management²⁶; inexplicably, its comments leave out wind entirely. Exelon's effort to promote its preferred energy source, nuclear, as a "clean" energy source is possible only by ignoring the vast quantities of long-lived radioactive and hazardous wastes and environmental justice impacts it produces, from the mining and processing of uranium all the way to the production of irradiated nuclear fuel and decommissioning of contaminated reactor facilities, never mind the risk of catastrophic accidents like Fukushima and Chernobyl.

Conclusion

The company's advocacy serves only one purpose: to convince policymakers to provide subsidies and incentives to restore uncompetitive nuclear plants to economic viability, ultimately by trying to position nuclear as the only viable energy option, no matter how much ratepayers and taxpayers must pay for it. Exelon is simply attempting to slow or stop the deployment of renewable energy sources, and the responsive and resilient infrastructure that will integrate them, in order to avoid the consequences of its previous business decisions.

The Pepco takeover would be instrumental in empowering Exelon to advance that agenda, by accumulating an unprecedented level of monopoly control and political influence. It would become the largest utility in the country, with 10 million ratepayers, all within a single electricity market, the PJM Interconnection. Pepco's independent voice within PJM would be lost, and Exelon would have the single largest share of both the distribution utility and wholesale markets. This would significantly increase Exelon's ability to manipulate market prices to its advantage, well beyond the jurisdiction of the Maryland PSC to regulate. In addition, by becoming the local power company for the nation's capital Exelon could leverage the symbolic value of its presence here to advance a national policy agenda that is also contrary to the expressed will and interests of Maryland ratepayers.

For the above reasons, the proposed acquisition of Pepco by Exelon would be counter to the public interest standards governing approval of utility merger requests. Therefore, the Public Service Commission must deny the Pepco and Exelon's application. Thank you for the opportunity to share our views.

²⁵ Trabish, Herman K. "Utility Exelon Wants to Kill Wind and Solar Subsidies While Keeping Nukes." Greentechmedia.com. April 1, 2014. <http://www.greentechmedia.com/articles/read/Utility-Exelon-Trying-to-Kill-Wind-and-Solar-Subsidies-While-Keeping-Nukes>

²⁶ Exelon Corporation. "Comments of Exelon Corporation on U.S. Environmental Protection Agency's Proposed Carbon Pollution Emission Guidelines for Existing Stationary Sources: Electric Utility Generating Units, 79 Fed. Reg. 34,830 (June 18, 2014)." Docket ID No. EPA-HQ-OAR-2013-0602. December 1, 2014. http://insideepaclimate.com/sites/insideepaclimate.com/files/documents/jan2015/epa2015_0167.pdf