MEMORANDUM

TO: Ward 3 Democrats Exelon-PEPCO Merger Group

FROM: Bob Jablon

DATE: April 22, 2015

SUBJECT: Statement in Opposition to the Proposed Exelon-PHI Merger

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STATEMENT IN OPPOSITION TO THE PROPOSED EXELON-PHI MERGER

Three principal reasons warrant regulatory denial of the proposed Exelon acquisition of PEPCO. First, approval will likely create an Exelon monopoly power over local generation and distribution use management and conservation services. The cost to consumers will likely be millions of dollars. Environmental protection will be reduced. Second, as merged into Exelon, PEPCO's policies, including its dividends policies, will support Exelon's needs to protect its generation from competition; PEPCO's electric sales revenues can be used to off-set the market risks of Exelon's generation with no benefits accruing to District of Columbia electricity users and ratepayers. Third, control of important PEPCO policy decisions and management will shift to a distant Illinois utility.

Where it does not own or control them, Exelon has a great incentive to prevent or delay local generation and electricity use management services. In this way Exelon can block competition from non-Exelon-owned local generation and services, thereby protecting the economics and markets for its very large, existing generation fleet.

The electricity industry has recently changed markedly and is continuing to change. At one time, utility companies like PEPCO and Chicago's Commonwealth Edison from which Exelon was formed owned generation plants, transmission lines and distribution lines, including connections to electricity customers' homes and businesses. PEPCO, Commonwealth Edison and other electric utilities were tight monopolies, having service obligations with commensurate opportunities to earn relatively assured rates of returns. In exchange for their rights to use public streets, condemnation rights and monopoly status, utilities obligated themselves to provide assured, reliable service at their costs, including fair profits. In contrast, today, most generated power (as opposed to the transmission and distribution of power) is sold at non-price-regulated, market prices. Generation owners, including non-utility owners, have opportunities for great gains, but also risks of great losses.

Generation affiliates of companies like Exelon are now threatened by new competition from independent companies and even businesses and homeowners that sell or use local generation, including wind and solar, and by conservation and time of use shifting mechanisms or load management, which can limit potential utility generator sales. Local generation and load management can be provided through non-utility companies. If electricity use at peak times of use is reduced, fewer new, sometimes very expensive, plants need to be built; use of power when market prices are highest can be avoided.

If the PEPCO (PHI Holdings) merger is approved, Exelon will control generation, transmission and distribution from New Jersey to the District of Columbia as well as elsewhere. Exelon has plans to control distributed generation (*i.e.,* local generation) and other distribution services. It is thus sponsoring legislation in Illinois under which it will receive $250 million in subsidies and ratepayer funding and cost recovery assurances, including a ½ percent rate of return on equity bonus, for local pilot microgrid distribution and related generation. It will receive a potential $100,000,000 authorization for installing up to 5,000 charging stations pilot vehicle charging station projects plus other cost protections. Most importantly, the legislation will allow Exelon to recover major electricity costs applying demand based rates, based on maximum customer use. If implemented, the legislation will make customer installation and use of solar and other forms of local generation, conservation and load management techniques uneconomic or more expensive.

The Illinois legislation is a precursor to Exelon's unstated plans for PEPCO. Allowing these policies to concentrate distribution services in Exelon here will protect Commonwealth Edison generation, but will disadvantage competitors and the public. Approval of the merger will create disincentives towards customer and competitor environmental improvements. Results of allowing a company with Exelon's generation and transmission control to also control PEPCO distribution, distribution services and distributed generation will be anticompetitive and price increasing.

A second reason for opposing the merger comes from Exelon and PEPCO's different business structures. As a utility, PEPCO's operations yield large amounts of cash. PEPCO's 2013 annual revenues totaled $4.666 billion in operating revenues and earnings from power delivery of $289 million. 2013 PEPCO District of Columbia Operating Revenues were $442,681,000. PEPCO has sold its generation, but Exelon and its affiliates own large amounts, including many nuclear and coal plants. In a deregulatory environment, Exelon thus faces generation market risk. The acquisition of

PEPCO will give it cash flow to offset this risk with PEPCO being operated to meet Exelon's financial needs as opposed to meeting local utility needs. The very large premium that Exelon has offered for PEPCO – estimated at over $1.5 billion - can only be sensibly explained by an Exelon recognition of the cash flow advantage and intrinsic market power of its acquiring PEPCO.

There is a third, separate, but related, reason to deny Exelon's purchase of PEPCO. Electricity is a vital product. A takeover of our local utility by a very large, out of state, and geographically distant, company will make it more difficult for customers and regulators to protect against outages, get complaints heard and achieve service reliability responsiveness. Moreover, they will be less able to influence electric policy, such as the preferred mixes of generation and the design of rates. These include questions of what combinations we want of large base load plants that often have high capital costs, but constant availability at low operating unit costs, and of local small, intermittently operating plants that have varying operating costs and sometimes low pollution, delivery and security risks. Do we want to set rates with cost incurrences as the only consideration or do we want to further various kinds of development, conservation, environmental, social and economic needs? If made by Exelon, these kinds of decisions will more likely reflect company financial needs and protection of Exelon's generation fleet and markets as opposed to local priorities and needs.

There are alternatives to approval of the Exelon merger. PEPCO can continue to operate as our local utility. If PEPCO continues to want to cash out, a sale can be approved to a utility that raises fewer concerns. The District of Columbia can consider owning and operating PEPCO's D.C. utility property as a public service, keeping control local and the profits at home. Approximately 2,000 cities in the United States own electric utilities. Some of these are very large like Los Angeles, San Antonio, Seattle and Orlando; some are very small serving 3,000 or fewer customers; most are in between. The risks of an Exelon takeover of PEPCO are such that the sale should be denied.

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