BEFORE THE

MARYLAND PUBLIC SERVICE COMMISSION

IN THE MATTER OF THE MERGER OF EXELON CORPORATION AND PEPCO HOLDINGS, INC.	**CASE NO. 9361**

DIRECT TESTIMONY

OF

RICHARD D. TABORS

ON BEHALF OF THE STATE OF MARYLAND

AND THE

MARYLAND ENERGY ADMINISTRATION

PUBLIC VERSION

December 8, 2014

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I. INTRODUCTION, PURPOSE AND SUMMARY

Q. PLEASE STATE YOUR NAME, BUSINESS ADDRESS, AND POSITION.

A. My name is Richard D. Tabors. I am president of Tabors Caramanis Rudkevich ("TCR") and a Research Affiliate of the Massachusetts Institute of Technology ("MIT") Energy Initiative, where I co-direct the "Utility of the Future" Project. My business address is 75 Park Plaza Boston, MA 02142.

Q. PLEASE DESCRIBE YOUR PROFESSIONAL QUALIFICATIONS AND EDUCATIONAL BACKGROUND.

A. From July 2012 until March of 2014, I was president of Across the Charles, a consulting firm based in Cambridge, MA. From November 2004 until June 2012, I was a Vice President of Charles River Associates ("CRA") and for a period within that time, co-head of their Energy & Environment Practice. From 1989 until 2004, I was the founder and President of Tabors Caramanis & Associates, which was sold to CRA in 2004.

From 1976 until 2005, I was a member of the research staff and teaching faculty of MIT, where I was Assistant Director of the Laboratory for Electromagnetic and Electronic Systems (MIT's power systems engineering group) and Deputy Director of the

Technology & Policy Program, both of which are housed within the School of Engineering. From 1970 to 1976, I was a joint researcher and Assistant Professor in the College, the Graduate School of Design, and the Center for Population Studies in the School of Public Health at Harvard University.

I have spent much of my professional career at the intersection between economics and engineering, primarily in the design and implementation of markets and market investment decisions in the electric power sector. With Fred C. Schweppe, Michael C. Caramanis and Roger E. Bohn, I co-authored *Spot Pricing of Electricity*, which is generally considered the basic theoretical text for the design of electric energy and transmission markets worldwide. My resume is attached as Exhibit RDT-1 to this Testimony.

During my professional career, I have provided expert testimony in more than 50 legal matters throughout the United States and internationally, including arbitrations, proceedings before the Federal Energy Regulatory Commission ("FERC"), state regulatory commissions and before the United States Congress concerning matters related to energy, the development of power projects, and the decisions to invest in the electric energy market.

I received a BA from Dartmouth College in Biology and pre-medical science and an MSc and PhD from the Maxwell School of Syracuse University in Geography and Economics.

Q. PLEASE SUMMARIZE THE MIT ENERGY INITIATIVE UTILITY OF THE FUTURE PROJECT.

A. The MIT Energy Initiative Utility of the Future Project is focused on analyzing changes underway within the distribution sector of the power industry. The Project recognizes that the technology underlying these changes has been alternatively described as "disruptive" or "opportune." The New York Public Service Commission has opened a proceeding called "Reforming the Energy Vision" that is focused on both defining and encouraging the market for new technologies in the distribution sector. To date, statements both pro and con regarding the developments that are occurring in the distribution sector have been long on opinion and short on analytics. The objective of the Project is to develop and apply analytic methods to understanding the potential impact of distributed energy technologies on the power sector both in Europe and in North America. The Project is a consortium-funded by both North American and European energy companies and utilities as well as technology development corporations. It has been underway for 18 months and will continue for another 24 months.

Q. ON WHOSE BEHALF ARE YOU TESTIFYING?

A. I am testifying on behalf of the State of Maryland and the Maryland Energy Administration ("MEA").

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. My testimony presents my expert opinion concerning whether the proposed merger of Exelon Corporation ("Exelon") and Pepco Holdings, Inc. ("PHI") (collectively, "Applicants") poses any risk of harm to Maryland ratepayers and, if so, whether the Applicants' proposed commitments mitigate those potential harms.

Q. WHAT DATA SOURCES DID YOU RELY UPON TO PREPARE YOUR TESTIMONY AND EXHIBITS?

A. My testimony is based primarily on my review of Applicants' application and supporting testimony, the responses of the Applicants to various data requests, the depositions of Mr. Crane and Mr. Rigby, and information concerning the positions taken by Maryland distribution utilities on common policy issues. More broadly, my testimony is informed by my experience with the restructuring of wholesale electric markets and by my current research on the transformative impact that distributed energy resources ("DER") are having on retail electric utilities. Exelon, PHI and others have referred to the anticipated outcome of this transformation as the "utility of the future."

Q. PLEASE SUMMARIZE YOUR CONCLUSIONS.

A. My first conclusion is that the proposed merger poses potential and increased risks of harm to ratepayers and, more generally, to the economy of the State of Maryland. This conclusion is based primarily on three facts:

- Approval of the merger will result in two PHI electric distribution utilities, Potomac Electric Power Company ("Pepco") and Delmarva Power & Light Company ("Delmarva") becoming part of the Exelon family of companies, which will place Exelon in a dominant position in the Maryland retail market and would affiliate the PHI companies with substantial generating assets, which is not the case today;
- Exelon already owns Baltimore Gas & Electric Company ("BGE"), another Maryland distribution utility. Together, the merged entity would have a dominant share of Maryland's retail electricity market. The merger would reduce the ability of the

Commission and customers to rely upon "across the fence" comparisons as a tool to ensure reliable service at reasonable rates; and

- The merged entity would have both the ability, and the motivation, to act in ways to limit the development of DER in Maryland and thereby to blunt receipt of the benefits associated with the transition to the utility of the future.

My second conclusion is that the Commission should reject the merger because these facts, as developed below, show a substantial risk of harm to Maryland ratepayers and the State as a whole, and I do not perceive an adequate means of mitigating these harms.

The remainder of my testimony presents the evidence supporting the three facts summarized above.

II. MARYLAND RETAIL ELECTRIC MARKET

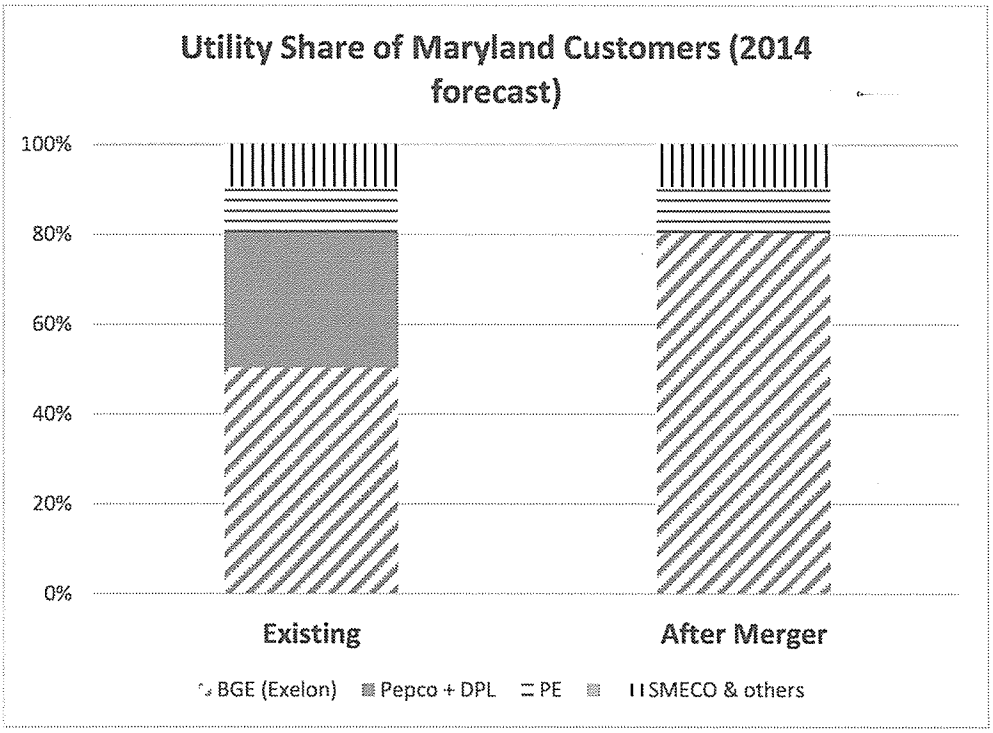
Q. IN WHAT MAJOR WAYS WOULD APPROVAL OF THE PROPOSED MERGER CHANGE THE STRUCTURE OF THE MARYLAND RETAIL ELECTRIC MARKET?

A. Approval of the proposed merger would mean that Pepco and Delmarva would no longer be owned by PHI but, instead, will become part of the Exelon family of companies. The transfer of the control of these two utilities to Exelon would change the structure of the Maryland retail electric market in two important ways. First, the distribution segment of the retail market would become significantly more concentrated. Second, the distribution segment of the retail market would be dominated by distribution utilities that are owned by Exelon, a company with what appears to be a significant motivation to maximize its return on unregulated generating assets, rather than on distribution system assets. Following approval of the merger, Exelon will control retail service to roughly 80 percent

of Maryland's retail customers. Another roughly 10 percent of customers will be served by Potomac Edison, which is owned by FirstEnergy, another company with significant interests in unregulated generating assets.

Q. PLEASE SUMMARIZE THE INCREASE IN MARKET CONCENTRATION THAT WOULD RESULT FROM APPROVAL OF THE PROPOSED MERGER.

A. Maryland is currently served by thirteen distribution utilities – four investor-owned utilities, four rural electric co-operatives and five municipally-owned utilities. The relative market shares of those utilities, expressed in terms of 2013 number of retail customers, are presented in the following bar chart based on the data in Exhibit RDT-2.



As shown, Baltimore Gas and Electric has the dominant market share, at 50% of total sales, followed by Pepco and Delmarva at 30% and Potomac Edison at 10%.

Thus, if the merger is approved, the resulting merged entity would have about an 80% share of all customers in the retail market. (The same percentage limited to residential customers is also roughly 80%.)

Q. DO MARYLAND'S DISTRIBUTION UTILITIES CURRENTLY "COMPETE" WITH ONE ANOTHER?

A. While the distribution utilities have different franchise territories, there is little doubt that they are "across the fence" competitors. Customers--and regulators--will compare one utility company against another neighboring company in terms of their rates, terms, and conditions of service.

Q. WHY IS "ACROSS THE FENCE" COMPETITION CRITICAL TO THE COMMISSION AND TO MARYLAND RATEPAYERS?

A. This type of competition is critical because each of the distribution utilities are always cognizant of there being a point of comparison. This comparison is not against national norms or standards set in a jurisdiction with different rules, different geography and different ratepayer profiles, but is against similarly-situated utilities. From the perspective of the Commission, "across the fence" competition is critical as a means of seeing and comparing the technical, economic and regulatory alternatives within the context of a specific regulatory issue or a single or parallel set of Commission proceedings.

Q. IN WHAT WAYS IS THE COMMISSION ABLE TO MAKE COMPARISONS AMONG THE DISTRIBUTION UTILITIES?

A. The Commission can compare and contrast policies and procedures of BGE with those of Pepco, Delmarva, and other of the Maryland utilities. This ability to compare and

contrast is critical because of the asymmetry of information between the Commission and the utilities. No one understands the utility better than it does. While the Commissioners can do ex-post reviews of decisions that utilities have actually made, and the results of those decisions, the Commission, like most regulatory bodies, almost never has the same amount of information about the options available to a given utility as is available to the utility itself. As a result, when a utility presents a proposed action, or has taken an action, the Commission's review is often constrained by the evidence the utility presents describing the options that are, or were, available to it as part of its justification for its decision. In such cases, it can be extremely difficult for the Commission to determine whether the utility has, or had, better options available to it that its management team either did not consider, or considered and rejected. However, with across the fence competition, the Commission often has the ability to determine if the utility has, or had, better options available to it. Comparing one utility against another helps the Commission to identify the full range of viable options and judge whether the option the utility selected or proposed was reasonable. Indeed, differences in position can help the Commission identify and understand the different approaches that are available.

Q. IS THERE EVIDENCE THAT "ACROSS THE FENCE" COMPETITION EXISTS AMONG MARYLAND'S REGULATED DISTRIBUTION UTILITIES?

A. Yes—PHI CEO Joseph Rigby said so in his deposition. Mr. Rigby testified that the PHI distribution companies and BGE are compared on a variety of indicators, including "typical reliability measures around duration and frequency of outages," "rates," and "customer satisfaction indices." Rigby Deposition Transcript at 73:10-74:7 (attached as Ex. RDT-3; *see* Ex. RDT-4 for confidential excerpts). Mr. Rigby said that the

companies are compared with respect to storm restoration—"whether we like it or not." Ex. RDT-3 at Rigby Tr. 73:19-20.

Mr. Rigby also noted that Pepco and Delmarva monitor proposals BGE makes at the Commission, and the types of services being offered. Ex. RDT-3 at Tr. 74:8-15. Mr. Rigby stated that as the utilities are in the same state, monitoring BGE is "in the category of common sense or just being prudent." Ex. RDT-3 at Tr. 74:16-22.

While there is no door-to-door competition for distribution customers, there is also no question that the ability of customers to move to what are perceived to be places with better quality utility services is of concern to PHI. Mr. Rigby acknowledged that if utility service is inadequate, customers can leave Pepco's franchise territory and move elsewhere. Ex. RDT-3 at Tr. 91-92. He noted that a few years ago Montgomery County threatened to have Pepco's franchise revoked, and that PHI took the threat "very seriously." Ex. RDT-3 at Tr. 87-88.

Q. HOW WOULD APPROVAL OF THE MERGER REDUCE THE ABILITY OF THE COMMISSION TO REGULATE THE MERGED ENTITY AND POTOMAC EDISON?

A. The merger would reduce the ability of the Commission to regulate the Exelon distribution utilities and Potomac Edison because the Commission would no longer be able to draw upon insights from the "across the fence" competition among BGE, Potomac Edison, Pepco and Delmarva. Across the fence competition is one of the tools available to the Commission to ensure reasonable rates and services.

Q. WILL ACROSS THE FENCE COMPETITION STILL EXIST IN MARYLAND IF THE MERGER IS APPROVED?

A. Yes, but it will be significantly reduced. First, BGE and Potomac Edison will no longer be competing with Pepco and Delmarva as distribution utilities, or pure "wires companies," whose parent has no financial interest in generating assets. Second, Exelon will own three geographically contiguous distribution companies serving roughly 80% of the market, two of whom serve the large metropolitan and suburban areas of the State.

Q. BUT HAVEN'T THE APPLICANTS STATED THAT, POST-MERGER, THE DISTRIBUTION UTILITIES WILL BE "LOCALLY MANAGED"?

A. Yes, though I am uncertain what that means in this context. The Joint Application states that the PHI Board of Directors, which will be selected by Exelon, will consist of seven members, a majority (four) of whom will be "some combination of officers or directors of Exelon and officers of one or more of Delmarva Power, Pepco, and [Atlantic City Electric]."[1] Joint Application at 16-17. The PHI Board will select the Boards of Directors of Pepco and Delmarva, and those Boards will select the officers of each of the distribution companies. Joint Application at 17. This arrangement makes plain that Exelon will be in charge of naming the persons who will direct each of the distribution utilities currently owned by PHI. In addition, and as I address later in my testimony, it seems clear the distribution utilities will be expected, if not required, to follow whatever overall strategic direction is adopted by Exelon.

[1] Application of Exelon Corporation, Pepco Holdings, Inc., Potomac Electric Power Company, and Delmarva Power & Light Company with Appendices, 16-17, *In re the Merger of Exelon Corp. & Pepco Holdings, Inc.,* Case No. 9361 (Aug. 19, 2014) ("Joint Application").

Q. BUT HAVEN'T THE POSITIONS OF THE MARYLAND DISTRIBUTION UTILITIES ALWAYS BEEN IN COMPLETE ALIGNMENT ON MAJOR ISSUES?

A. No. The positions of BGE and Pepco have not always been in complete alignment on major issues. BGE, either individually or as part of a larger group, has often taken a different, and arguably less consumer-friendly, position than Pepco on common issues of concern.

Q. CAN YOU PROVIDE SPECIFIC EXAMPLES OF ISSUES ON WHICH BGE AND PEPCO HAVE TAKEN SIGNIFICANTLY DIFFERENT POSITIONS?

A. Yes. The first example concerns the recovery of the cost of investments in advanced metering infrastructure ("AMI").

Q. PLEASE SUMMARIZE THE DIVERGENT POSITIONS BGE AND PEPCO TOOK WITH REGARD TO RECOVERY OF THEIR PROPOSED INVESTMENTS IN AMI.

A. In 2009 (prior to Exelon acquiring BGE), both BGE and Pepco had the opportunity to obtain funding for a portion of their AMI costs under the American Recovery and Reinvestment Act. Pepco and BGE each filed applications with the Commission, in Case Nos. 9207 and 9208, respectively, seeking Commission approval to establish rate mechanisms through which they could recover the remainder of their AMI costs from their ratepayers. Pepco requested approval of a traditional rate mechanism, i.e., the establishment of regulatory assets so it could defer recognition of its incremental AMI deployment costs until it could file for their recovery in its next base rate case, and the

Commission approved Pepco's cost recovery mechanism.[2] In contrast, BGE requested approval of a special surcharge that would enable it to recover its AMI costs as it incurred them and to do so dollar for dollar through an annual true-up. The Commission did not approve BGE's proposal, nor did it approve BGE's revised proposal to limit the amount it would collect through the proposed surcharge.[3] In rejecting BGE's revised proposal, the Commission cited Pepco's willingness to proceed with a regulatory asset and recovery through future base rates.[4]

Q. WHAT IS YOUR NEXT EXAMPLE?

A. My next example concerns a divergence in the approaches taken concerning the financing of energy efficiency in the residential and commercial sectors.

Q. PLEASE DESCRIBE THE DIVERGENT POSITIONS BGE AND PEPCO TOOK WITH REGARD TO FINANCING ENERGY EFFICIENCY.

A. In 2011, MEA filed proposals in Case No. 9154 and other related cases for utility involvement in financing energy efficiency investments in the residential and commercial sectors. The MEA proposals included a recommendation that the Commission require at least one utility to develop a Small Business On-Bill Financing program. Pepco did not oppose this recommendation. By contrast, BGE submitted initial comments opposing the MEA proposals,[5] though BGE subsequently changed its position.

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[2] *In re Potomac Elec. Power Co. & Delmarva Power & Light Co. Request for the Deployment of Advanced Meter Infrastructure*, Case No. 9207, Order No. 83532 (Md. Pub. Serv. Comm'n Aug. 13, 2010).

[3] *In re the Application of Baltimore Gas & Elec. Co. to Deploy a Smart Grid Initiative & to Establish a Surcharge for the Recovery of Cost*, Case No. 9208, Order No. 83531 (Aug. 13, 2010).

[4] *Id.* at 36.

[5] *In re Baltimore Gas & Elec. Co.'s Energy Efficiency Conservation & Demand Response Programs Pursuant to the EmPower Md. Energy Efficiency Act of 2008*, Case No. 9154 (Md. Pub. Serv. Comm'n Oct. 11, 2011).

Q. DO YOU HAVE ANOTHER EXAMPLE?

A. Yes, my example concerns the development of agricultural waste (poultry) energy generation cooperatives.

Q. PLEASE SUMMARIZE THE DIVERGENT POSITIONS BGE AND PEPCO TOOK WITH REGARD TO THE DEVELOPMENT OF POULTRY ENERGY GENERATION COOPERATIVES.

A. The purpose of Maryland Senate Bill 521, which was introduced in 2014, was to establish a "Poultry Litter Energy–Generating Cooperative Program." The program would enable energy generation using poultry litter as a feedstock, through cooperative investment. Both Exelon and BGE[6] came out strongly against the bill, each independently arguing that they were already actively committed to renewables though a significant Tier 1 solar initiative and other actions, including agricultural waste generation projects. Exelon's most focused criticism of Senate Bill 521 was that it would subsidize a particular type of technology and provide the technology a competitive advantage. The objections of both Exelon and BGE indicate opposition to non-utility generation and other innovations which would enable customers to displace energy that would otherwise be delivered by their utility.

By contrast, PHI did not comment on Senate Bill 521; its actions demonstrated, at a minimum, neutrality (if not tacit support) for Senate Bill 521.

[6] *See* Exelon and BGE Comments attached as Ex. RDT-5 and Ex. RDT-6 respectively.

Q. HAVE EXELON/BGE AND PHI APPROACHED THE ISSUE OF DISTRIBUTED ENERGY RESOURCE DEVELOPMENT FROM THE SAME VANTAGE POINT?

A. No. The two utilities have approached the issue of Distributed Energy Resources within their service territories from different perspectives.

Q. WHY IS THAT THE CASE?

A. The reason is that PHI is a wires company, while Exelon/BGE is a "hybrid" utility.

Q. WHAT DOES IT MEAN TO BE A WIRES COMPANY?

A. A wires company is one that owns no electric generating plant but has focused attention on the consumer end of the business and in competing for and providing reliable and affordable delivery services.

Q. HAS PHI ALWAYS BEEN A WIRES COMPANY?

A. No. Until 2010, PHI owned and controlled the market-based generating company Conectiv Power Delivery. [redacted]

Q. WHAT DOES IT MEAN TO BE A HYBRID COMPANY AS EXELON REFERS TO ITSELF?

A. [redacted]

[redacted]

Q. WHAT ARE THE IMPLICATIONS OF THESE DIFFERENCES FROM THE PERSPECTIVE OF THE COMMISSION?

A. The critical difference between the structure of the current PHI and that of Exelon/BGE is that while PHI has a single business focus on wires—both transmission and distribution [redacted]

[redacted] This is juxtaposed against PHI—which currently has no need to act to preserve generation asset value, and can focus almost entirely on its transmission and distribution customer base and maintaining the quality of service to those customers.

Q. ARE THERE ANY RECENT EXAMPLES WHERE THIS DIFFERENCE IN FOCUS HAS BEEN PARTICULARLY VISIBLE?

A. Yes. In the current and ongoing PJM Capacity Performance ("CP") process, there is a difference in the comments of PHI and Exelon that underscores the distinction between the motivations of a wires company and a hybrid company.

Q. CAN YOU BRIEFLY DESCRIBE THE PJM CAPACITY PERFORMANCE PROPOSAL?

A. Yes. PJM is investigating whether changes to the design of the PJM capacity market is needed given the performance of the fleet during the January 2014 "polar vortex." The CP proposal includes numerous changes to the current structure of the capacity market, including enhanced requirements for fuel supply, stricter operational flexibility requirements such as startup times and minimum operational duration, and the elimination of certain types of demand response ("DR") as a capacity product.

Q. WHO WILL BE IMPACTED FINANCIALLY SHOULD THESE CHANGES BE ADOPTED?

A. The financial impact will be in the form of increased costs for load (i.e. electricity customers) and increased revenue for capacity resources (i.e. electricity generators). If the proposal is approved, much of Exelon's nuclear generation fleet would likely qualify as CP resources and be able to earn substantially higher capacity revenues.

Q. DID EXELON AND PHI COMMENT ON THE CP PROPOSAL?

A. Yes. Exelon was generally supportive of the proposal, and highlighted that there is an "urgent" need for the proposal to move forward.[7] By contrast, PHI's "repeatedly expressed concern" that the stakeholder process itself was "too abbreviated," and that PJM has not allowed "proper vetting and review" of the proposal.[8] PHI also raises concerns about "expected large cost increases to customers." PHI highlights the significant investments it has made in DR, and raises concerns that the proposal "will affect the ability of the PHI utilities and others to deliver on state commitments and product offerings to customers."

Q. WHAT IS YOUR CONCLUSION BASED ON THE ABOVE EXAMPLES?

A. My conclusion is that the Commission and, by extension, Maryland ratepayers, have gained information and knowledge through the presence of retail utilities owned by different corporate parents, as they appear to take different approaches to innovation and to being responsive to consumer needs. As a result, Maryland ratepayers have benefited, and continue to benefit from, the presence of these retail utilities. The merger of Exelon

[7] Comments of Exelon Corporation, *available at* http://www.pjm.com/~/media/committees-groups/committees/elc/comments/comments-of-exelon-corporation-performance-proposal.ashx.

[8] Comments of Pepco Holdings, Inc. (Sept. 12, 2014), *available at* http://www.pjm.com/~/media/committees-groups/committees/elc/comments/pepco-holdings-inc-comments-on-pjm-capacity-performance-proposal.ashx.

and PHI will remove the existing competition among the utilities to "look better." Instead, Exelon—a generation-oriented hybrid utility—will (1) set the corporate agenda before the Commission for a much broader share of the Maryland customer base; (2) have little competitive challenge within the State; and (3) have an incentive, as discussed in greater detail later in this testimony, to discourage innovation in technological advances such as distributed energy resources where that innovation will reduce sales of energy from Exelon's central grid generation.

Q. ISN'T IT POSSIBLE THAT EACH OF THE EXELON UTILITIES, BGE AND PEPCO/DELMARVA, WILL BE ABLE TO PRESENT CONFLICTING VIEWS ON ISSUES TO THE COMMISSION?

A. That seems very unlikely. [redacted] More broadly, Exelon requires its business operations to act in accordance with the company's strategic plans. Mr. Crane could not recall an instance in which any Exelon business unit took actions outside the overall Exelon strategic plan. Ex. RDT-9 at Tr. 67-68.

III. IMPACT OF PROPOSED MERGER ON DEVELOPMENT OF DISTRIBUTED ENERGY RESOURCES ("DER") IN MARYLAND

Q. PLEASE BRIEFLY DESCRIBE THE CHANGES THAT THE ELECTRIC DISTRIBUTION INDUSTRY IS CURRENTLY UNDERGOING.

A. There are three major technological changes taking place in the industry – often now referred to as "disruptive technologies." They have been given this name because the changes are "disruptive" to the incumbent energy supplier—but seen as market opportunities by their developers.

Q. PLEASE DESCRIBE THE FIRST CHANGE THAT IS UNDERWAY.

A. Distributed generation is the first of the disruptive classes of technology within the distribution sector, in that it allows retail customers to produce a portion of their electrical needs and, under specified circumstances, to sell back their excess energy to the distribution utility. This trend has been led by rooftop solar (photovoltaics), the economics of which have benefitted significantly from federal and state subsidies, from a dramatic reduction in the cost based on increased international demand and international production and, from a number of highly creative financing structures. Small scale generating technologies using natural gas plus advances in stationary fuel cells have added to the challenge of distribution utilities to maintain market dominance in their own service territories. Distributed generation threatens the basic premise underlying distribution utility cost recovery throughout much of the country, i.e., that the primary rate designed to recover the majority of a distribution utility's capital infrastructure of substations, poles and wires is billed to customers on the basis of the quantity of electricity the utility delivers to them each month. This rate design is referred to as an

energy charge, and is expressed in cents per kWh. Under this rate design, the less energy a distribution utility delivers to a customer each month, the less revenue it collects.

Q. DOESN'T MARYLAND EMPLOY A POLICY OF "RATE DECOUPLING," WHICH ELIMINATES THIS LOSS OF DISTRIBUTION REVENUE WHEN SALES DECREASE?

A. Yes. Currently BGE, Pepco, and Delmarva all have rate decoupling mechanisms that adjust distribution rates up or down based on past sales. If sales (and therefore revenue) were higher than anticipated in a month, the distribution rate would be adjusted slightly down in a following month. If sales were lower than anticipated in a month, the rate would be adjusted up slightly. This true-up mechanism allows a distribution utility to earn their approved revenue independent of the actual quantity of energy delivered. However, while rate decoupling can eliminate some of the potential financial downside of lower-than-expected distribution sales, it does nothing to actively encourage distribution utilities to develop DER-friendly policies. And, if a customer were to exit the system altogether, it creates a risk of shifting or stranded costs. Rate decoupling cannot change this dynamic.

Q. PLEASE DESCRIBE THE SECOND CHANGE THAT IS UNDERWAY.

A. The second technological innovation that is becoming a threat to electric distribution utilities is the significant push for distributed storage. Development of storage technology is a major element of the R&D activities of the U.S. Department of Energy, state funded research and development programs, and a large number of private corporations. Distributed storage combined with distributed generation could make it possible for retail customers to require only limited energy from the distribution utility

while counting on the distribution infrastructure for reliability, i.e., back-up should the generator and the battery fail.

Q. PLEASE DESCRIBE THE THIRD CHANGE THAT IS UNDERWAY.

A. The third change underway affecting the delivery and use of retail energy is the revolution in Information & Communications Technology ("ICT"). ICT is the enabler of change. It centers on providing the retail consumer the ability to intelligently schedule consumption for non-critical loads, to respond to price signals and move load from one time block to another; to participate in electric markets for energy and capacity; and under specific circumstances to provide ancillary services to the wholesale utility such as regulation or spinning reserves. ICT has become a highly competitive platform-based business. Corporate entities such as Google or Apple (among many similar or smaller companies) are purveyors of information, are within nearly every retail customer's vision and understanding and have the development capability and experience to be able to move quickly into new market niches. Electricity has seen initial forays by these companies in development of communication platforms and corporate purchases such as Google and NEST. The electric distribution sector represents new and untouched territory for experienced ICT players.

Q. WHAT IS THE GENERAL IMPLICATION OF THE ENTRY OF THESE DISRUPTIVE TECHNOLOGIES INTO THE DISTRIBUTON SYSTEM?

A. These disruptive technologies are transformative in the industry and as a result are already applying downward economic pressures on distribution companies. These pressures can only increase as the technologies become more visible to retail customers and as their relative economics continue to improve.

Q. HOW ARE THESE PRESSURES BEING VIEWED BY DISTRIBUTION UTILITIES?

A. Distribution utilities view the pressures from these potentially disruptive technologies as a potential "death spiral." Under this view, the lower demand for energy means that the distribution utility must increase its energy rate if it is to recover all of its fixed costs. The increase in the energy rate then provides the incentive for more retail consumers to decide it is better to install distributed generation than to purchase all of their energy from the utility. This requires the utility to increase energy rates yet again. The process continues to spiral downward with lesser demand for the distribution utilities product that has to be charged for at a higher rate to cover cost. Decoupling can serve to protect against this and as I note later both Pepco and Delmarva have decoupled rates in Maryland.

While this description is admittedly oversimplified, the terminology of the "death spiral" has found its way into the literature and the vocabulary of the industry through multiple channels in the past months. The Edison Electric Institute ("EEI"), in their report "Disruptive Challenges: Financial Implication and Strategic Responses to a Changing Retail Electric Business" discusses and even diagrams the characteristics of the "death Spiral."[9] The conclusion to the EEI report (at 19) captures the flavor:

> While the threat of disruptive forces on the utility industry has been limited to date, economic fundamentals and public policies in place are likely to encourage significant future disruption to the utility business model. Technology innovation and rate structures that encourage cross subsidization of DER and/or behavioral

[9] Peter Kind, *Disruptive Challenges: Financial Implications and Strategic Responses to a Changing Retail Electric Business,* Edison Electric Institute (January 2013), http://www.eei.org/ourissues/finance/documents/disruptivechallenges.pdf.

modification by customers must be addressed quickly to mitigate further damage to the industry franchise and to better align interests of all stakeholders.

Q. WHAT DOES THIS MEAN IN TERMS OF ACTIONS THAT A DISTRIBUTION UTILITY MIGHT TAKE TO RESIST THESE PRESSURES?

A. There are a significant number of actions that a distribution utility can take. One is to seek relief in the regulatory arena such as decoupling. Another is probably inaction. Relative to their customers and often relative even to their regulators, distribution utilities can significantly control the speed at which processes move forward. The list of opportunities for the distribution utility to drag its feet, including by defining the rules for reliability and safety, and to resist through regulatory proceedings the incorporation of distribution technologies into their systems, is nearly endless. As an example, if permits are required for a distributed generator to be connected to the grid to allow the meter to run backwards for the owner, the staffing of the permitting operation within the utility can be so constrained with multiple assignments as to make permitting of new generation just one more paper in a tall pile. Staying with the same distributed generator example, another class of opportunity for distribution utilities to hamper the development of distributed resources is presented by the opportunity to define the hardware needed – and therefore the hardware cost –for protection of the distribution system during potential outages.

By way of additional example, Mr. Rigby acknowledged during his deposition that distribution system design and operation can influence behind the meter generation deployment, as can the distribution utility's own deployment of such generation, and its rates, terms, and conditions of service. Ex. RDT-3 at Tr. 121:19-122:14. Mr. Crane

likewise confirmed that all kinds of system considerations can come into play in determining how much DER can be added to a distribution system. Ex. RDT-9 at Tr. 180-184. Mr. Crane also made clear that the entity with most access to information about what can be deployed on the system is the distribution utility itself. Ex. RDT-9 at Tr. 185.

Another way in which distribution utilities can react is to propose entirely new services and compensation structures in an effort to promote and profit from the deployment of these new technologies.

Q. ARE THE APPLICANTS AWARE OF THE TRANSFORMATIONAL TRENDS AND CHANGES THAT YOU HAVE IDENTIFIED?

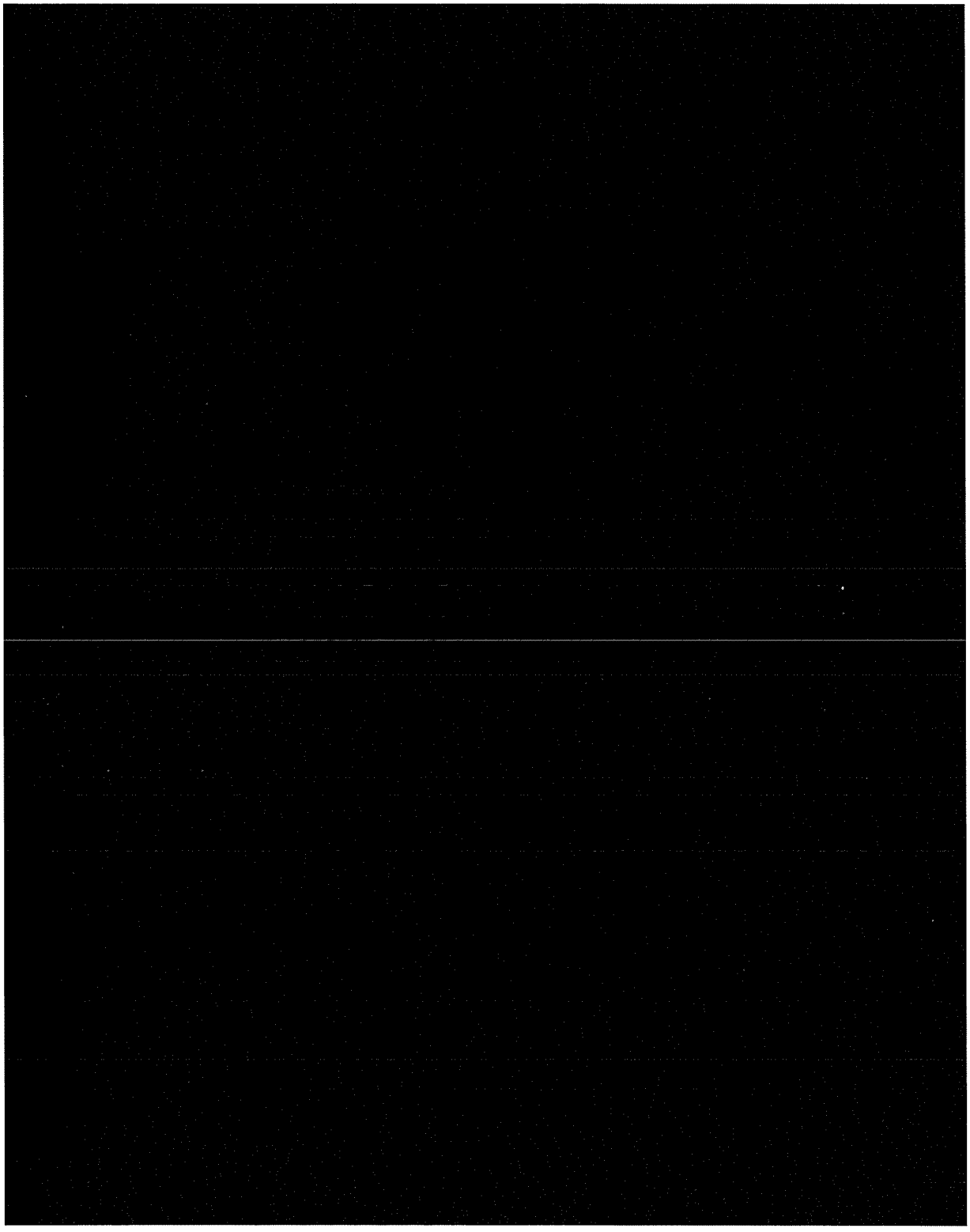
A. [redacted]

[redacted]

As I have noted, these changes involve advances in information and communications technology, distributed generation, electric storage, electric vehicles, and the interplay of these technological advances, and are anticipated to occur at the distribution utility level and/or on the customer's side of the meter.

Q. HAVE THESE CONCERNS BEEN ADDRESSED IN EXELON'S STRATEGIC DOCUMENTS?

A. [redacted]



[redacted]

Q. WHAT ISSUES DOES THE PROPOSED MERGER RAISE IN THE CONTEXT OF THESE DEVELOPMENTS?

A. If the merger is consummated, the regulatory landscape in which these technological developments play out is one in which Exelon will be the dominant utility voice and utility actor in Maryland. Absent the merger, Pepco, as a large urban/suburban distribution utility, stands as an across-the-fence competitor to BGE. Pepco and Delmarva will be able to propose to the Commission and their customers (both existing and potential) their vision of how these utility of the future issues should be implemented. Pepco and Delmarva will serve as an independent voice to advocate what is technically and economically feasible and desirable. To the extent that the implementation is customer driven, at least in substantial part, [redacted] then customers will be able to play Pepco off of BGE: BGE will be hard pressed to explain why it is not willing to provide utility of the future services that Pepco is willing to provide, and vice-versa. It is not desirable for Pepco and Delmarva Maryland customers, and, indeed, for affected economic interests in Maryland generally (including BGE's customers), to have essentially one voice and one actor dominating the implementation of what is anticipated to be the largest change in the electric industry in decades.

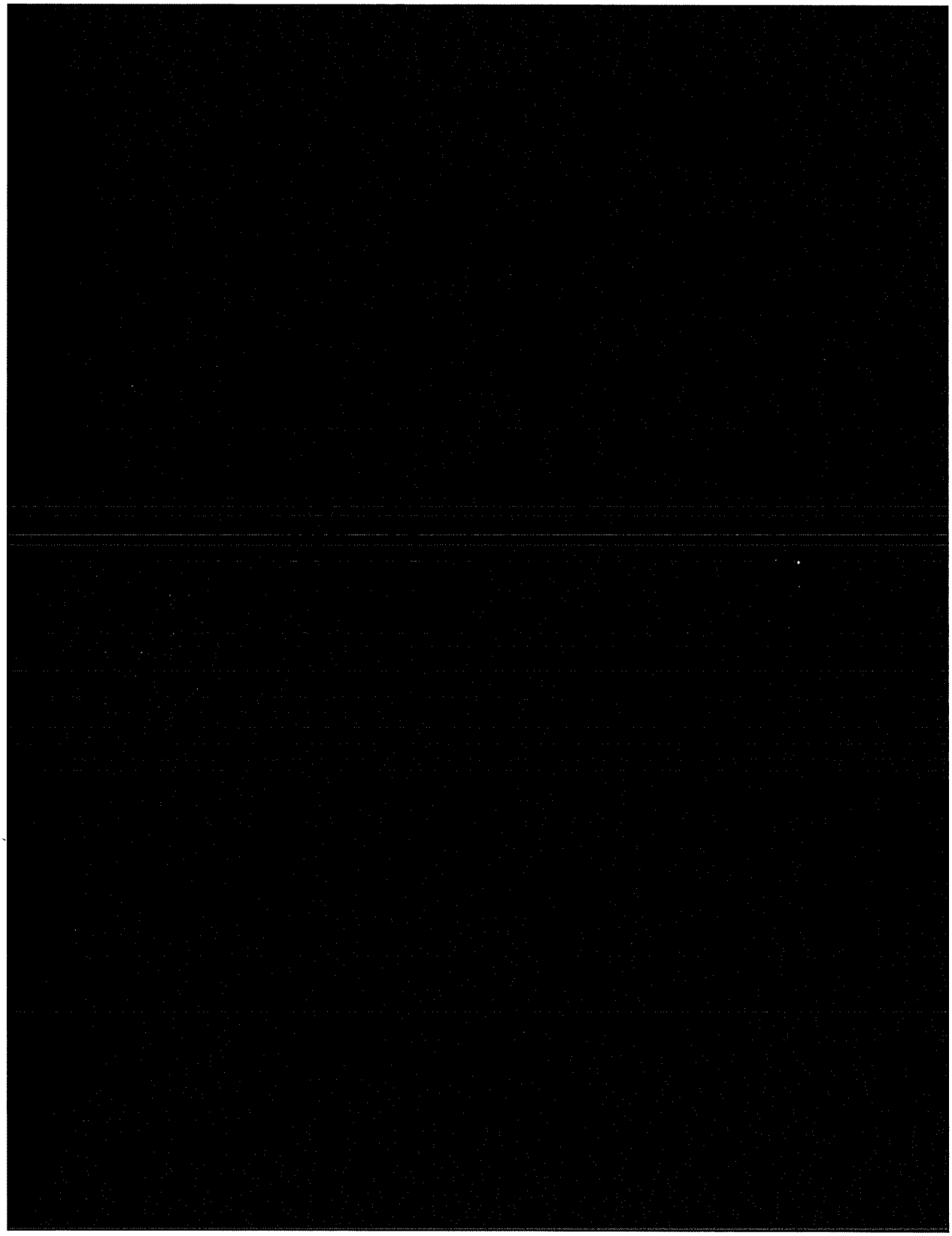
Q. WHO BENEFITS AND WHO LOSES WHEN THE UTILITY WORKS TO SLOW OR OTHERWISE HAMPER THE INTRODUCTION OF NEW TECHNOLOGIES?

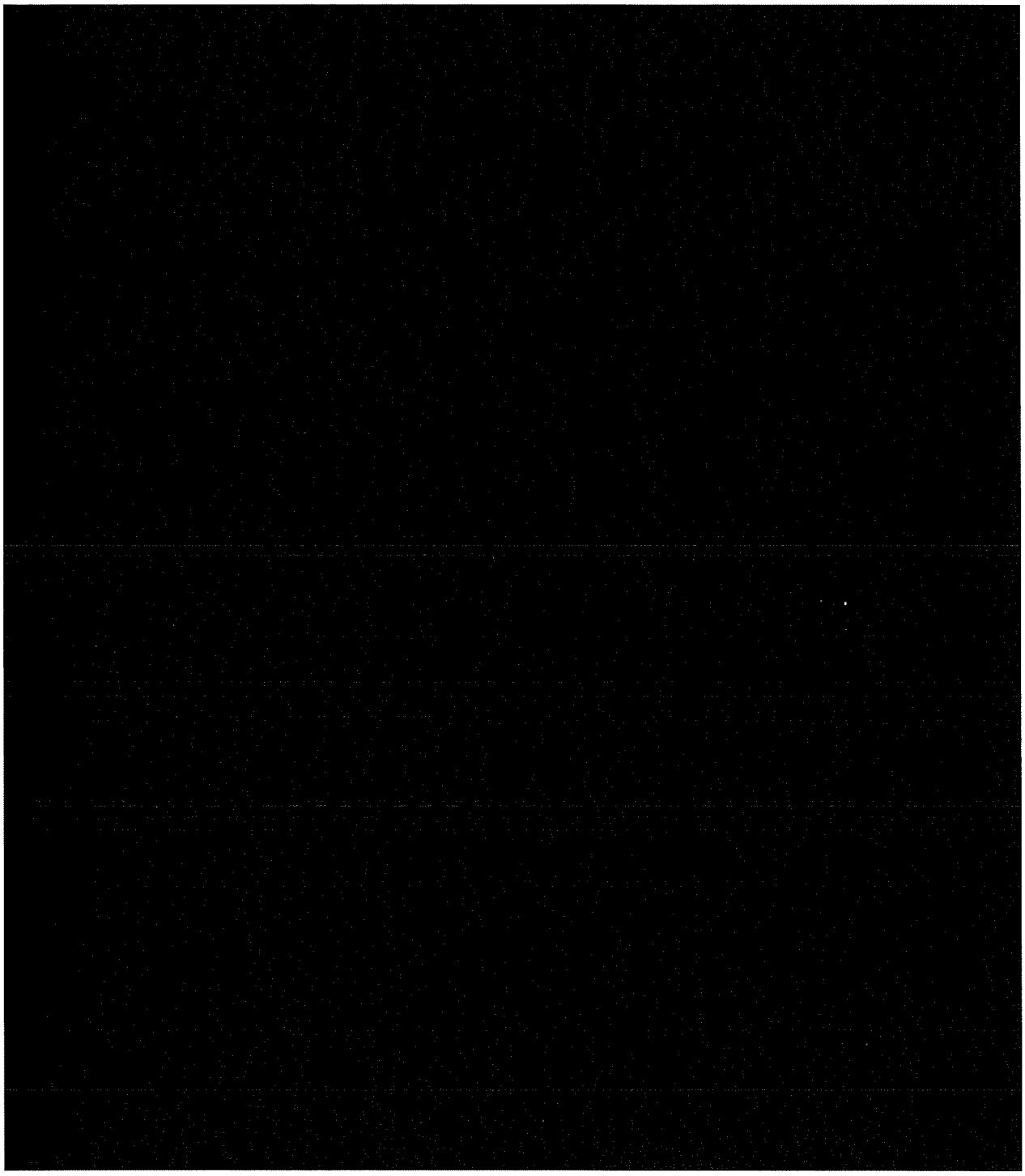
A. Electricity consumers are the losers because the technologies that might be attractive to them have become more expensive in two ways. The first is that delay costs time and, as is always the case, "time is money." The second is that delay slows the overall growth of innovative technologies; if technologies are prevented from developing rapidly their production and distribution and installation capabilities, then they cannot advance down the learning curve as quickly. The result is that the technologies cost more.

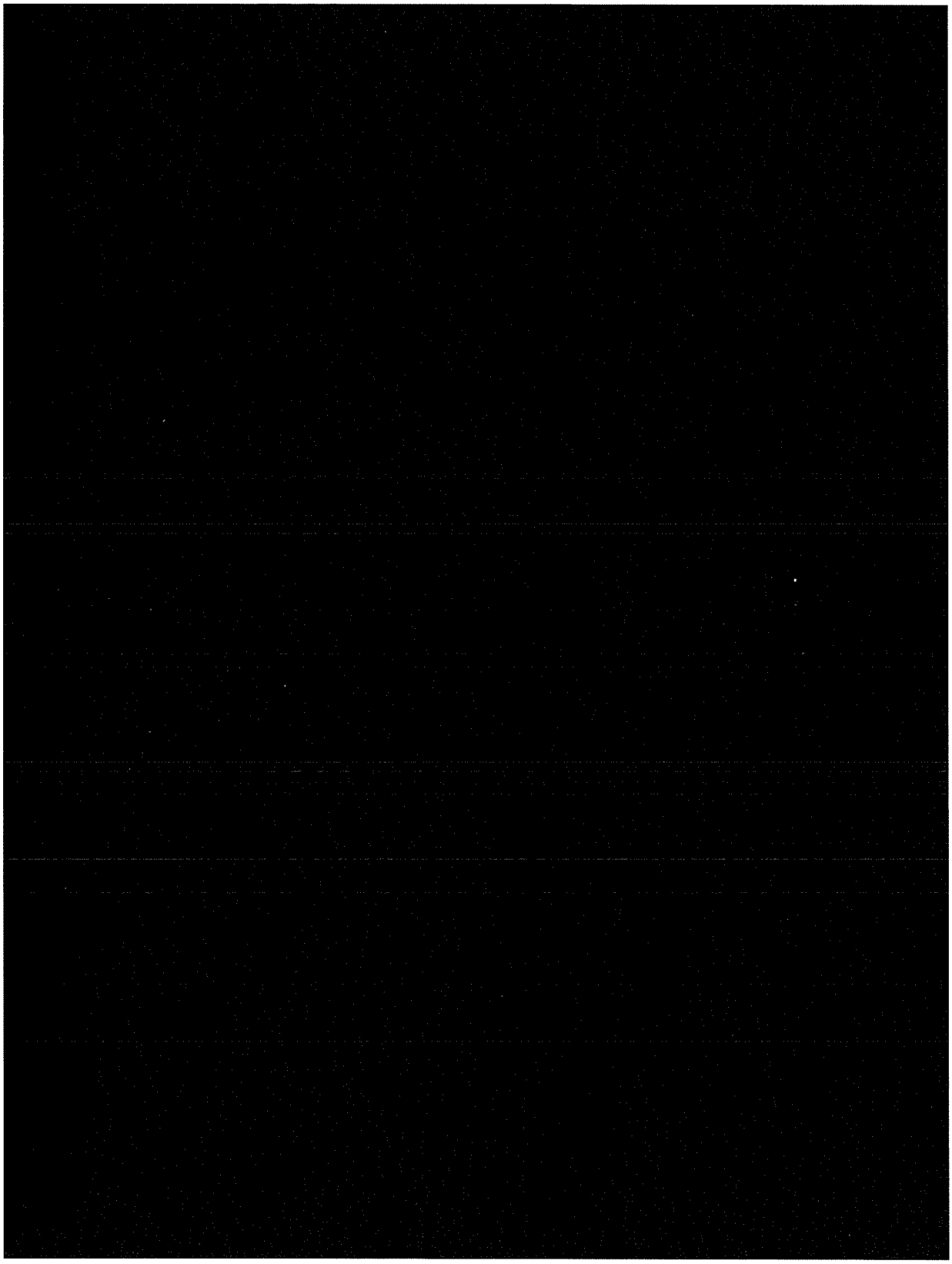
In the case of Exelon, the winner under these circumstances could well be its central grid generation, in that slowing down the process means Exelon will be able to sell more electricity for longer before it sees its market erode.

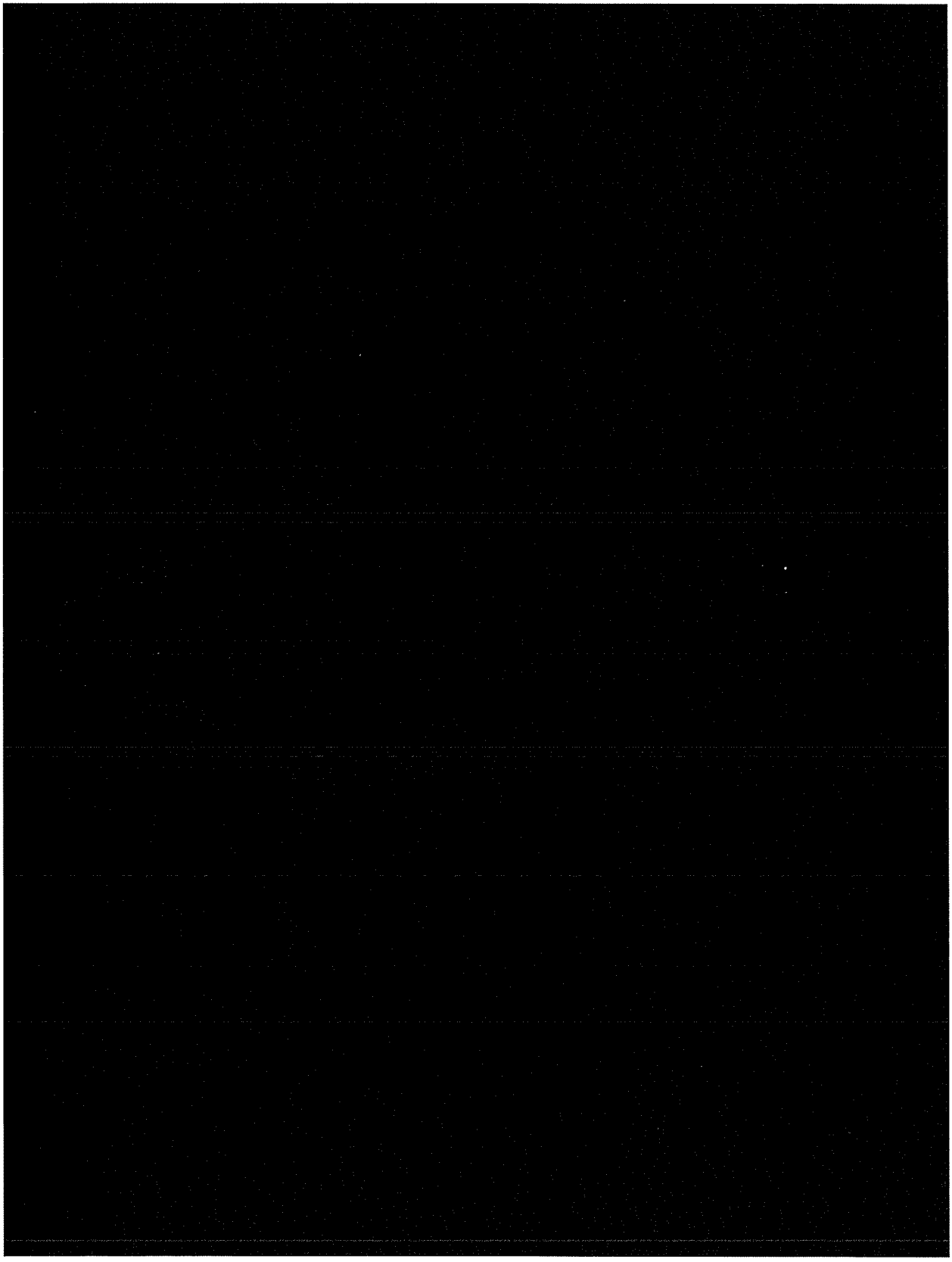
Q. PRIOR TO THEIR PURSUIT OF THE PROPOSED MERGER, DID EXELON/BGE AND PHI APPROACH THE ISSUE OF THE IMPACT OF DISTRIBUTION SECTOR INNOVATIONS IN THE SAME WAY?

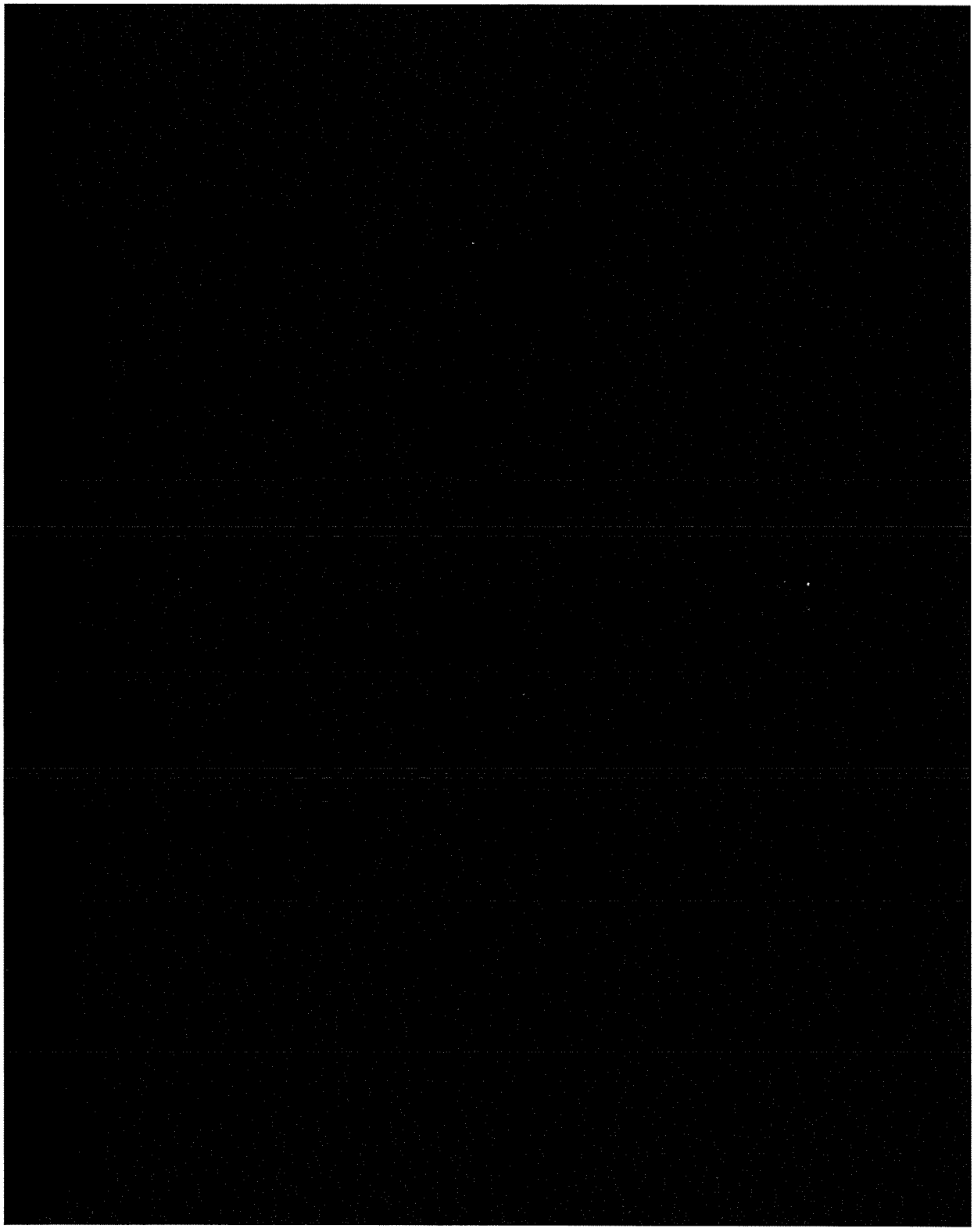
[redacted]











[redacted]

Q. CAN A UTILITY PLAY A POSITIVE ROLE IN THE DEVELOPMENT AND ACCEPTANCE OF NEW TECHNOLOGIES?

A. There are circumstances in which the utility can play a positive role. These circumstances are when the utility becomes the facilitator or the financer of the spread of innovation. As I noted above, the utility can advocate for regulatory changes that will foster the development of these technologies provided it receives an appropriate level of compensation for doing so. [redacted]

[redacted]

Q. ARE THERE FORCES THAT WORK AGAINST THIS ROLE?

A. Yes, it is important to note that the very fact of a merger of two distribution utilities such as Exelon and PHI work against these forces. Competition among the state's utilities, i.e. the "across the fence" aspect, mitigates the incentive of a utility to support innovation when it has the potential or the probability of reducing that utility's sale of energy. After the merger, this tempering force will no longer exist.

Q. IF THE TRENDS THAT YOU HAVE IDENTIFIED IN TECHNOLOGY DEVELOPMENT AND IN THE POSSIBLE RESISTANCE TO CHANGE THAT YOU SEE IN THE DISTRIBUTION UTILITIES ARE OMNIPRESENT, WHY IS THIS AN ISSUE IN THE EXELON PHI MERGER?

A. The issues that I have identified are omnipresent. The impact of the issues is more critical in the case of the Exelon-PHI merger for at least two reasons.

Q. WHAT ARE THOSE REASONS?

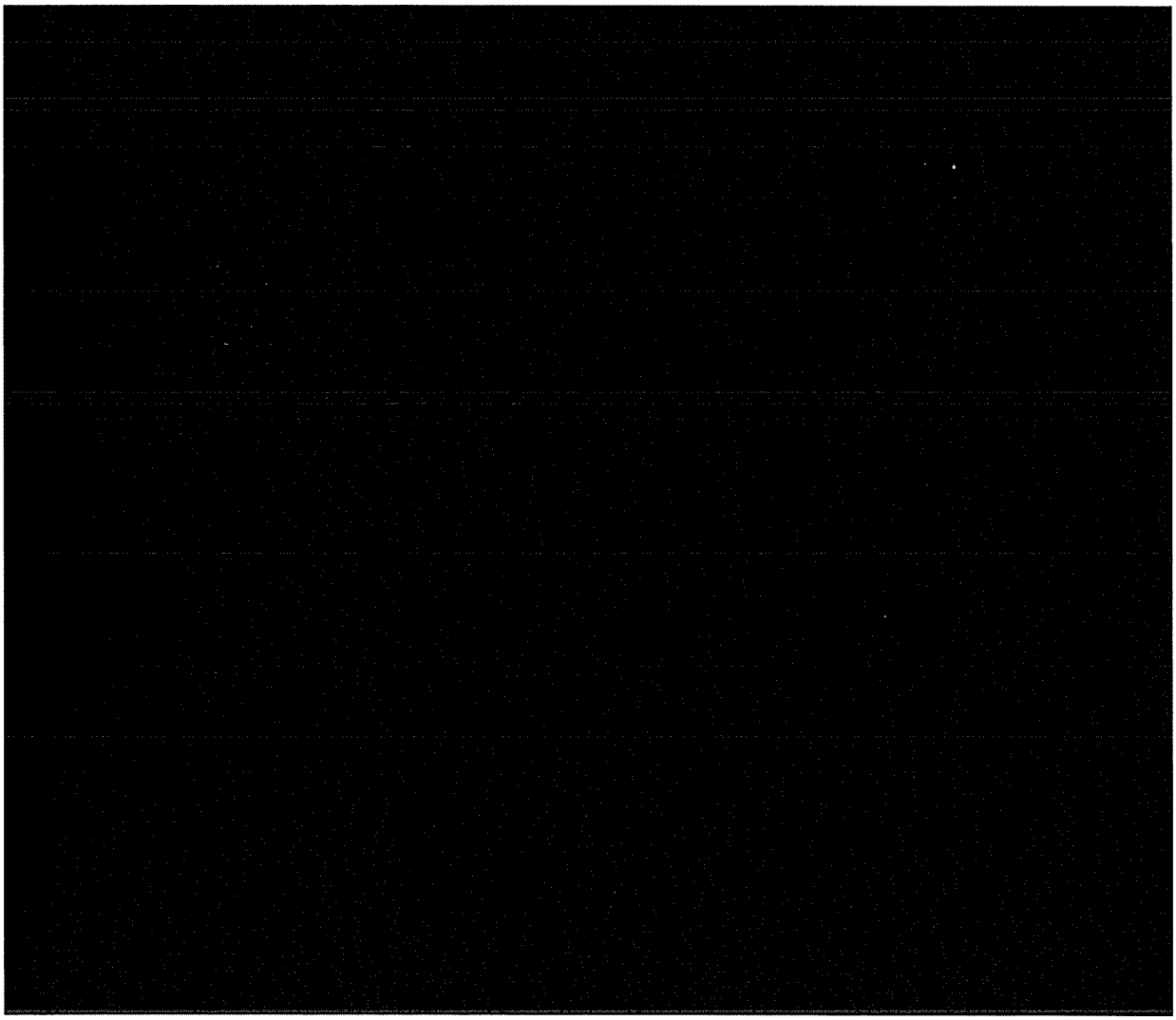
A. The first reason is the significant reduction in pressure on the merged Exelon utilities to be innovative and forward looking. The merged entity will have only minimal competition to "do good" for the ratepayers of the state. Currently, BGE is under pressure to always look "across the fence" to see what Pepco and Delmarva are doing. But for the merger, the Commission would have the benefit of PHI's independent proposal(s) and input for addressing utility of the future issues.

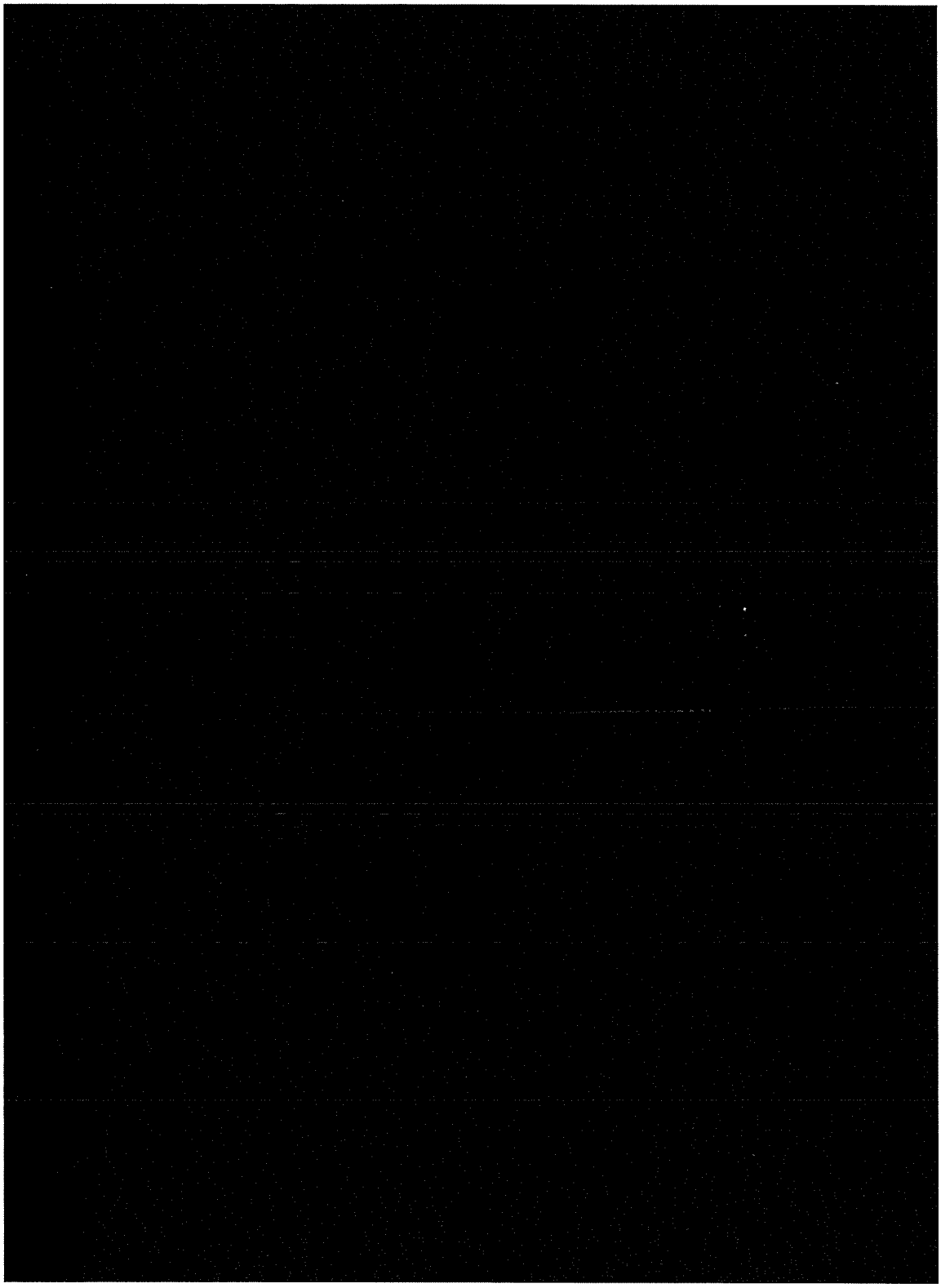
As I have noted, the merger of Exelon and PHI will create commonly owned distribution utilities that will serve roughly 80% of the retail customers in Maryland. If

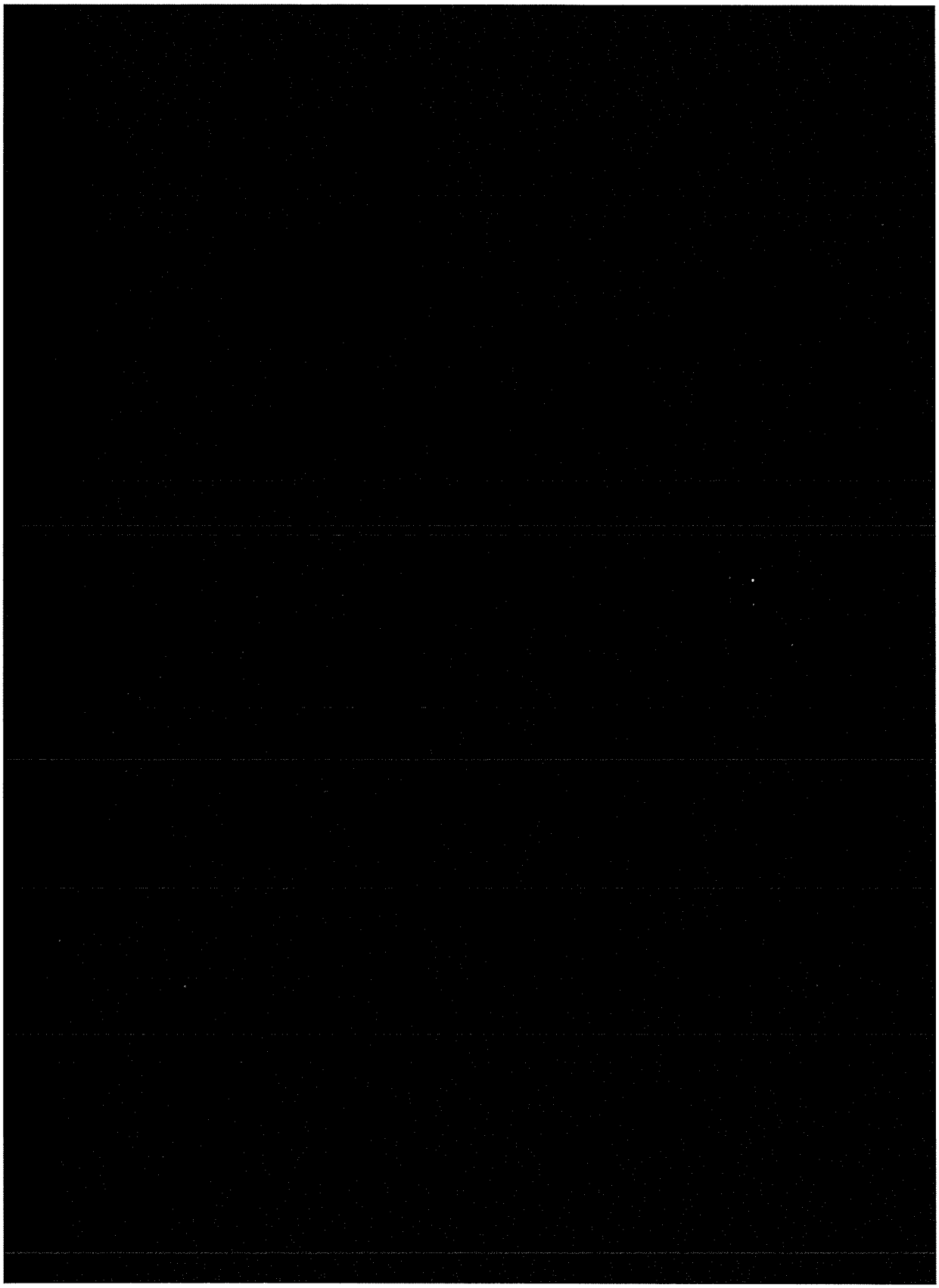
the case for inaction is strong in a utility with "across the fence" competition, it is far stronger in an environment in which there is likely to be no competition.

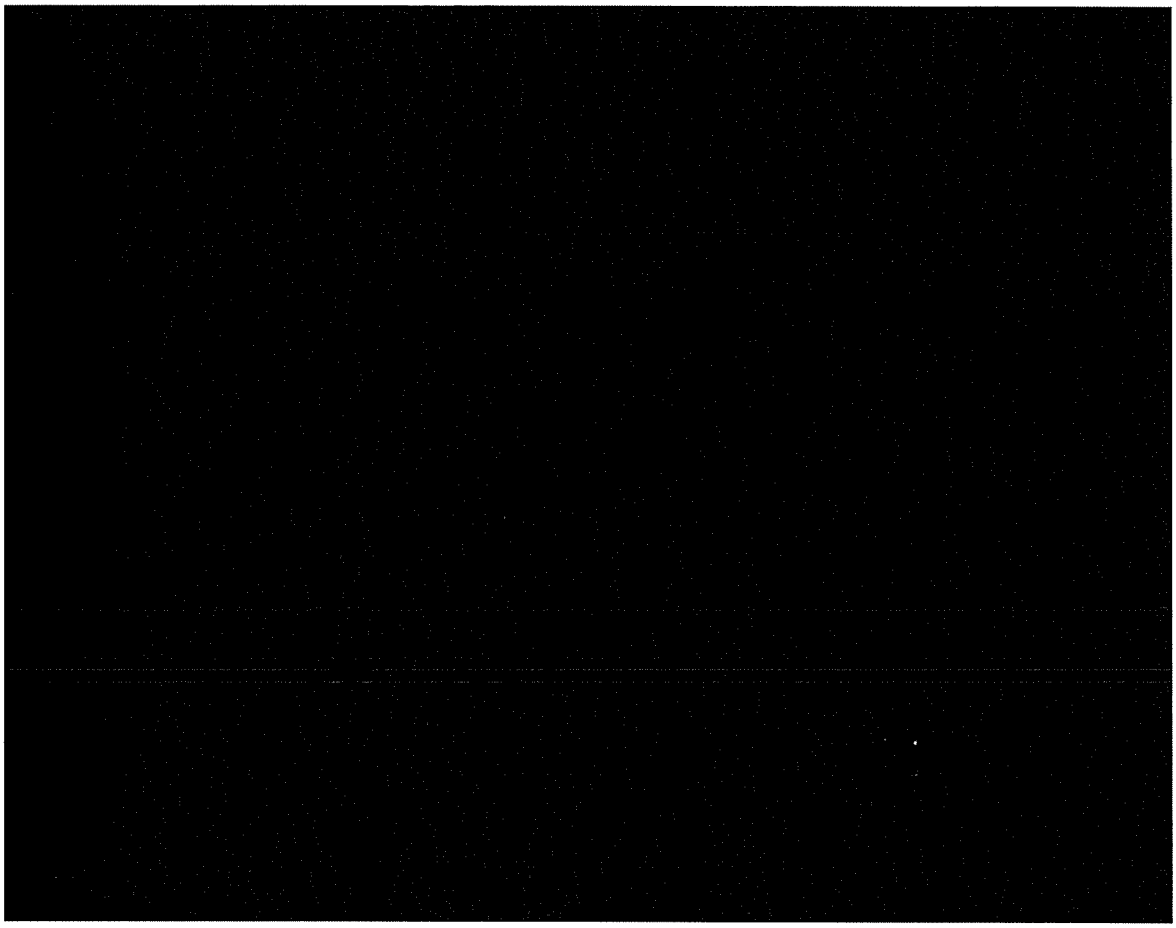
Q. WHAT IS THE SECOND REASON?

A. The second reason is that Exelon will own multiple distribution utilities in PJM, where much of its nuclear fleet is located. Exelon has an inherent interest to leverage its control over its distribution utilities to favor its grid generation. That generation is significantly challenged. Exelon believes that in the current energy economic environment, several of its nuclear units are or soon may be uneconomic to operate.









Q. IS IT YOUR POSITION THAT, WHEN MERGED, EXELON AND PHI WILL HAVE THE INCENTIVE TO HAMPER THE INTRODUCTION OF DISTRIBUTED ENERGY RESOURCES AND SYSTEMS?

A. Yes and, as indicated, it may well be in Exelon's best interest to maintain the *status quo*. This is the case because the strategy of the *status quo* works to hold current retail consumers captive. Holding those customers captive tends toward increasing the demand for energy across PJM and, in so doing, works, even if indirectly, toward keeping the Exelon fleet on line.

Q. IS IT YOUR POSITION THAT, POST-MERGER, EXELON WILL HAVE THE MEANS TO HAMPER THE DEVELOPMENT OF DISTRIBUTED ENERGY RESOURCES AND SYSTEMS?

A. Yes. The merged entity would have the means to hamper the development of DER and Maryland regulators would have limited ability to detect it.

Q. IN WHAT WAYS COULD THE MERGED ENTERPRISE HAMPER THE DEVELOPMENT OF DER?

A. The merged entity will have the ability to hamper the development of distributed energy resources in multiple ways, including passively (by omission), as well as actively (through visible action).

CEO Crane and CEO Rigby both acknowledged in their deposition testimony that these were many ways in which a distribution utility can influence and control the development and deployment of distributed generation and storage resources. As CEO Crane stated, no distribution utility system in operation today was built to accommodate the kinds of two-way power flows that arise from behind the meter generation. Ex. RDT-9 at Tr. 176-77. Control over utility infrastructure and what does, or does not, get built will substantially affect the rate of distributed generation penetration and dictate where it can, and cannot, be built.

Q. PLEASE CONTINUE.

A. The utility's control over its planning process will be another, similar instrument of control. Utilities will be able to set thermal line ratings and other technical operation standards that will afford them the ability to influence and control what distributed generation is built when and where. The utility's ability to file proposed tariff changes is

another means of potential control, including, for example, whether or not the utility will seek to adopt time of use rates. Distribution utilities may well find themselves providing a dispatch or balancing function, balancing customer resources with central grid resources in order to match overall resource needs with customer load. Dispatch protocols and the like will afford the distribution utility yet another means of favoring incumbent generation.

The distribution utility can propose rules for interconnecting new resources, which will likewise enable it to hamper DER development.

They will have the ability to hamper by restraining or defining in anticompetitive ways the acceptance of—and thereby the revenues potentially attributable to—DER in return for the provision of system level services such as reserves, regulation, and VAR support.

In addition, CEO Crane identified "big data" as the technological advance that he believed would ultimately have the most impact on DER customers and the utility. Ex. RDT-9 at Tr. 133-34. Here, again, the distribution utility will control customer and system information, and have a very large say in the implementation of software and sensor and communication technology. All of these are potential means of control.

Q. IN WHAT ADDITIONAL WAYS COULD THE MERGED COMPANIES EXERCISE ANTICOMPETITIVE PRACTICES TO THE DETRIMENT OF THE DEVELOPMENT OF DISTRIBUTED ENERGY RESOURCES?

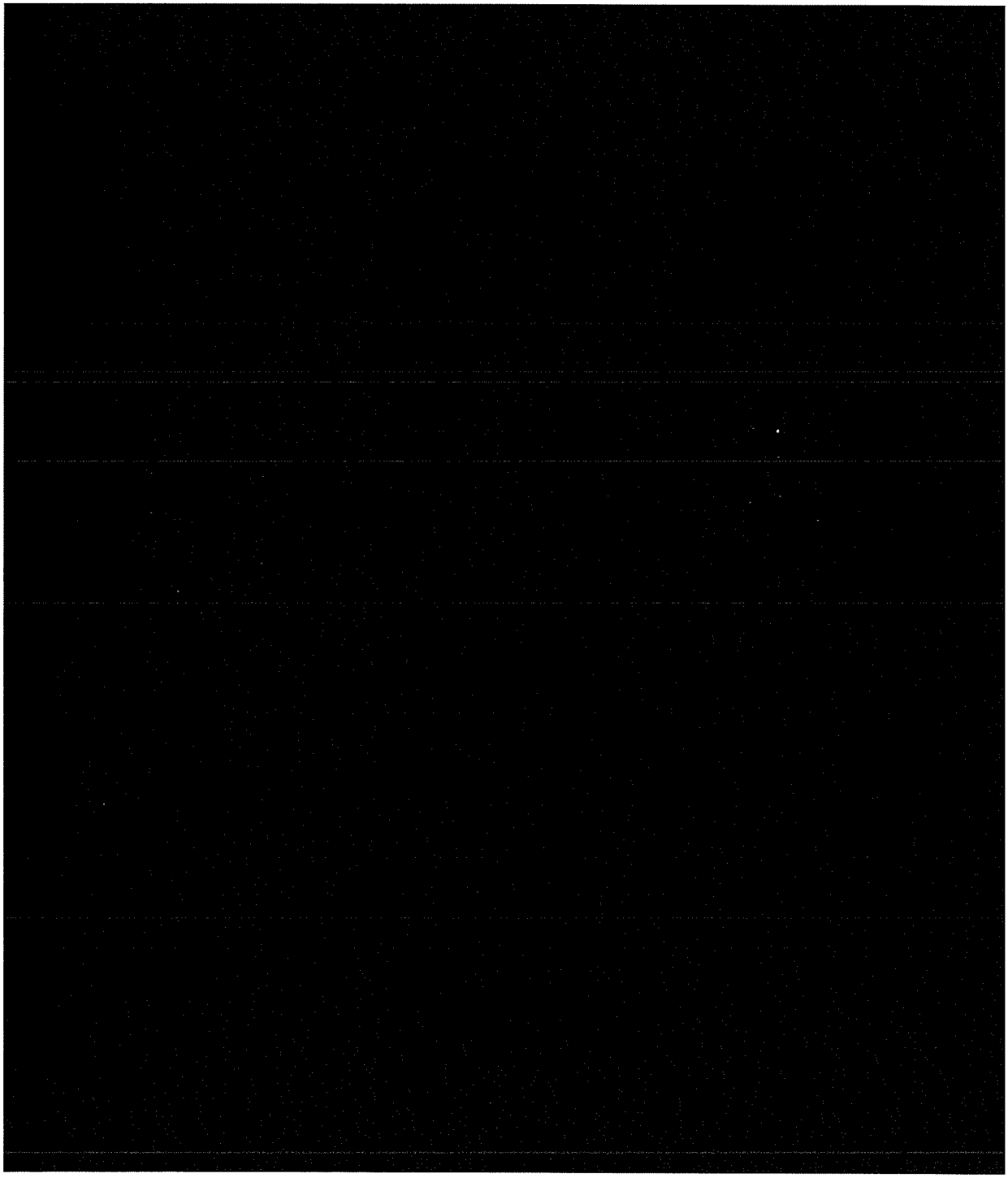
A. Exelon could choose to favor its own distributed resources to the detriment of customers and competitors. [redacted]

[redacted] In addition, they have perfect knowledge of the topology of their distribution system, which will allow them to cherry pick locations for distributed generation, for instance, where there is little or no need for incremental strengthening of the system. Exelon's utilities could propose plans and projects that would thwart competitors by eliminating sites for distributed resources. These informational and operational advantages lend themselves to anticompetitive conduct that has the potential to harm Maryland ratepayers as a whole and ratepayers of the merged utility specifically.

Q. IS THE FUTURE WELL ENOUGH UNDERSTOOD TO ASSURE THAT THE MERGED COMPANY WILL HAVE A SIGNIFICANT ADVANTAGE?

A. The precise structure of the future distributed energy systems is uncertain. The certainty is that the technologies under development will compete with central grid generation and with the current, utility-controlled system for delivery of energy to the end consumer. The merged utility, through its size and geographic expanse, will be the dominant player—the gorilla in the room—given its ability to communicate with most every retail consumer, knowledge of the behavior of those consumers, control of utility operations, and comparatively deep pockets for financing of development and implementation.

Q. DOES EXELON UNDERSTAND ITSELF AS HAVING THE ABILITY TO FAVOR ITS CENTRAL GRID GENERATION AS REGARDS THESE TECHNOLOGICAL ADVANCES?



[redacted]

Q. HOW DOES THE POTENTIAL FOR ANTICOMPETITIVE BEHAVOR AFFECT THE COMMISSION?

A. Because the merged entity will be the central and dominant player in the Maryland distribution utility market, it may well seek to close doors for competitors to enter the distributed resources or energy efficiency markets in order to advantage Exelon's substantial grid generation or its own distributed resources. Keeping those doors open is in the best interest of Maryland ratepayers.

Q. WHAT EVIDENCE IS THERE THAT OWNING THE WIRES AND THE OTHER DISTRIBUTION INFRASTRUCTURE CAN RESULT IN ANTICOMPETITIVE BEHAVIOR ON THE PART OF THE OWNER?

A. One source of such evidence comes from the electric power industry prior to restructuring, when the decision was made to make wholesale generation a fully competitive market. FERC recognized that if the entity that owned generation also owned the transmission assets, it had an inherent economic interest to favor its own generation over any that might be competitive, either by hampering or outright preventing access to the controlled transmission wires.

Q. HOW DID FERC ADDRESS THIS CONCERN?

A. Under the leadership of the Chairman Betsy Moeller, FERC issued Order Nos. 888 and 889 on April 24, 1996, establishing rules and the procedures for open access to the transmission system throughout the interconnections over which FERC had authority.

Q. WHAT HAS BEEN THE IMPACT OF FERC ORDER NOS. 888 AND 889?

A. While these orders have been challenged repeatedly (including before the US Supreme Court), the concept and the basic structure adopted by FERC have remained. Transmission—the wires—are separated from the generation to assure the necessary foundation for open competition for wholesale energy. Even more important, that functional unbundling operates in the context of a wide range of measures such as open access transmission tariffs to protect against anticompetitive conduct and the ability of transmission owners to leverage control over transmission to favor their generation affiliates.

Q. WHY IS THIS ACTION RELEVANT TO ISSUES IN THE DISTRIBUTION SYSTEM, OVER WHICH FERC HAS NO JURISDICTION?

A. It is relevant because the conditions that existed in the period before 1996 in the wholesale energy sector are now coming to exist in the distribution or retail sector. There is the same concern that the single entity that controls the utility will act to leverage that control to favor its affiliated generation. It is in the financial interest of that owner to restrain and if possible to prevent a competitive supplier – even a seller of small scale generation systems – from having access to its infrastructure.

Q. WHY SHOULD THIS ISSUE BE OF SPECIFIC CONCERN TO THE COMMISSION?

A. This issue should be of importance to the Commission because the merged entity will have the same incentive—and now an enhanced ability—to block competition in the supply of energy and other services across large swaths of Maryland.

Q. WHY ISN'T EFFECTIVE REGULATION THE ANSWER TO THE LEVERAGING CONCERN?

A. Effective regulation is going to be hampered post-merger by the loss of Pepco and Delmarva as across-the-fence competitors to BGE.

Q. WON'T PEPCO AND DELMARVA DISFAVOR DISTRIBUTED GENERATION BECAUSE IT WILL REDUCE AND ADVERSELY IMPACT THEIR VOLUMETRIC DISTRIBUTION OF ELECTRICITY?

A. That is unclear. [redacted] There are few, if any, regulatory safeguards in place to address the market and competition concerns associated with these utility of the future issues. [redacted]

[redacted] It is reasonable to believe that, for significant periods of time, Maryland's distribution utilities will be operating in gray areas where the rules of the road are not clear. As FERC noted incident to its open access transformation rulemaking, one of the ways in which an incumbent utility can favor its own generation is simply by litigating issues and slowing down necessary action. It is also important to note that the problem of leveraging may well involve conduct that is, at the time, perfectly lawful. FERC has been regulating transmission markets and addressing generation market power issues for some twenty years. In addition to open access transmission tariffs, and regional transmission organizations, FERC has implemented anti-market manipulation rules, required market monitors, sought to exercise oversight over transmission planning processes and, in doing so, continued to identify ways in which incumbents can favor their affiliated generation. Few such protections exist at the distribution utility level: much of this will have to be worked out.

A further consideration is simply the influential aspect of Exelon's voice as Exelon, and as the incumbent distribution utility. [redacted]

[redacted] In this regard, it is worth noting that, according to CEO Crane, the Chairman of the New York Public Service and another New York Commissioner solicited Exelon's thinking concerning utility of the future issues in conjunction with the New York proceeding that is addressing these issues. Ex. RDT-9 at Tr. 99-102. He stated with respect to that off-the-record meeting that, "There was high level conversation about who would be the distribution system operator. I don't think we ever got to a point that we knew what their feelings were. But there was a discussion to have." *Id.* at Tr. 102.

In addition, the distribution utility enjoys a superior position of information about its own system and operations. I reasonably believe that the distribution utility will have a highly influential voice in the stakeholder process as utility of the future regulation is developed in Maryland in the future.

Q. CAN YOU EXPAND UPON YOUR OBSERVATION THAT INCUMBENT WIRES UTILITIES CAN FAVOR THEIR AFFILIATED GENERATION IN NUMEROUS WAYS?

A. Exelon will have ownership and control over the vast majority of distribution wires and other distribution assets in Maryland. The implication of this control is that it can use both the fact of ownership and of operations to actively discourage or prevent other competitors attempting to enter the electricity supply business from fair access to these assets. This may include developers of small residential and commercial scale generation or, most specifically, the activities of independent micro-grid developers seeking to

[10] Ex. RDT-12 at 21.

market a higher level of reliability to end users. In both examples, the new entrant will need to have access to the existing wires in order to be able to avail themselves of wholesale energy for backup and/or transfer capability on distribution lines between small scale generation sites or micro-grids.

Q. WHY ARE SMALL SCALE GENERATION DEVELOPERS AND MICRO-GRID DEVELOPERS DIRECT COMPETITORS TO A HYBRID UTILITY LIKE EXELON?

A. Small scale generation developers and micro-grid developers have products to sell that are in direct competition with the product of the distribution utility. At the most basic level these products are electric energy, capacity and reliability. These are the same three core products, or attributes of delivered energy, that Exelon is providing.

IV. CONCLUSION

Q. WHAT ARE THE IMPLICATIONS OF THE DIFFERENCES IN THE UTILITY LANDSCAPE IN MARYLAND THAT YOU BELIEVE WILL RESULT FROM APPROVAL OF THE PROPOSED MERGER?

A. The critical difference between the structure of the current PHI and that of Exelon is that while PHI is almost entirely a wires business – both transmission and distribution – Exelon has an integrated or hybrid focus [redacted] it is the fiduciary responsibility of the board of directors and management of Exelon to pay specific attention to protection of the value of its significant generation assets along with their transmission and distribution assets.

[redacted]

Q. HAS EXELON PROPOSED ANY COMMITMENTS TO ADDRESS THESE ISSUES?

A. No. [redacted] Mr. Crane confirmed at his deposition that none of the Applicants' proposed commitments addresses how Exelon and PHI plan to adapt to the evolving role of distribution utilities. Ex. RDT-9 at Tr. 20:3-8.

Q. DO YOU SEE A WAY TO MITIGATE THE HARMS YOU HAVE IDENTIFIED?

A. No, I do not. I do not see any way to compensate for the loss of Pepco and Delmarva as across the fence competitors post-merger. I would note that the California Public Service Commission denied the proposed merger of Southern California Edison Company and San Diego Gas and Electric Company based, in substantial part, upon this very consideration. This essential competition will be lost at what is anticipated to be a transformative period in the distribution utility industry. I also do not see a good means to insulate Pepco and Delmarva ratepayers and other affected competitors post-merger from the potential of Exelon leveraging its control over the distribution utilities to favor its central grid generation. Moreover, absent the merger, Pepco and Delmarva as across-

the-fence competitors will help serve as a check on Exelon exercising control over BGE to favor its central grid generation.

I am aware that some individuals, such as former FERC Chairman Wellinghoff, have advocated for the implementation of a distribution level independent system operator ("DISO") to safeguard against competition and market power issues that could result from the implementation of these utility of the future technologies. I am not persuaded that such a DISO would in fact mitigate the harms I have identified independent of my opinion with regard to the DISO concept. Even with a DISO, it is reasonable to assume the local distribution utilities would have substantial means to thwart the deployment of distributed generation. In any event, no such DISO exists in Maryland, or has even been proposed to my knowledge, and CEO Crane indicated at his deposition that Exelon disfavored mimicking the transmission system operator concept at the distribution level, noting that it would be a "very complex and costly thing to do." Ex. RDT-9 at 104-105.

Q. IS IT YOUR POSITION THAT THE MERGER OF EXELON AND PHI IS IN THE BEST INTEREST OF THE CONSUMERS/RATEPAYERS OF MARYLAND?

A. No. My position is that a merger such as the one proposed between Exelon and PHI, through which one company will effectively control roughly 80% of the retail load in the state, is contrary to the best interests of and will harm the Maryland ratepayers. This is the case, as discussed, because it will remove any level of "across the fence" competition between the two utilities and, in large part, will remove that competition for all customers in Maryland simply because of the dominance of the resulting merger. In addition, as

shown, the technology change that is forecast in the industry is likely not in the best interest of the merged entity. As an owner of substantial central grid generation, it will have both the incentive to slow the introduction of the consumer-side distributed technologies and the ability to do so.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes.