DEPARTMENT OF THE PUBLIC ADVOCATE

A CITIZEN'S GUIDE TO THE PROPOSED MERGER BETWEEN

EXELON AND PSEG

April 26, 2006

Public Service Electric and Gas and Public Service Enterprise Group

Public Service Electric and Gas (PSE&G) is a New Jersey-based and operated company that has been providing electric and gas utility service to New Jersey families and businesses for over 100 years. The company serves more than 2 million electric customers and 1.7 million natural gas customers, covering a 2,600-square mile service territory from Bergen to Gloucester counties.

Headquartered in Newark, PSE&G is recognized as one of the best utilities in the nation, providing reliable and high-quality electric and gas utility service to millions of New Jerseyans. PSE&G is owned by its New Jersey-based parent company, Public Service Enterprise Group (PSEG), which also owns energy generation plants and other energy-related businesses.

Exelon Corporation

Exelon is a Chicago-based company that owns and operates utilities serving 5.2 million electric customers in Illinois and Pennsylvania and 460,000 natural gas customers in the Philadelphia area. Exelon is one of the country's largest utilities. Exelon also has a vast holding of energy generation plants, including the largest fleet of nuclear power plants in the country.

The Proposed Merger between Exelon and PSEG

In December 2004, PSEG and Exelon announced their intention to merge their two companies. If this merger is approved, it would create the largest utility in America and one of the largest in the world.

This merger is of great importance to all New Jersey ratepayers. For PSE&G customers, it could impact their utility rates, the reliability of their service, and the quality of customer service provided by the company.

The impact of this merger, however, is not limited to PSE&G customers. This merger could impact every single family, business and government entity in New Jersey because it has the potential to dramatically increase statewide energy costs and have a profoundly negative impact on New Jersey's statewide economy.

The Department of the Public Advocate believes that the citizens of New Jersey should understand what this merger could mean to them and their families, and why our Department opposes it, as proposed. The issues being debated are technical and complex, but their potential impacts are simple and straightforward, and could affect the quality of life of all New Jerseyans.

In an effort to explain these issues plain language, the Department of the Public Advocate, working with its Division of Rate Counsel, offers the following question and answer document about what is at stake with the proposed Exelon-PSEG merger.

Q: What state agency decides whether Exelon can merge with PSEG?

A number of regulatory bodies must approve this merger before it can take effect. In New Jersey, the merger is under review by the New Jersey Board of Public Utilities (BPU). The BPU consists of five commissioners who will vote on whether or not to approve the merger.

The BPU has also asked an Administrative Law Judge (ALJ) to review the case. Once the ALJ makes his decision, the BPU can choose to accept, reject or modify that decision; in other words, the ultimate decision of whether or not to approve this merger still lies with the BPU. Other parties, however, including the Division of Rate Counsel, do have the right to appeal the BPU's decision to the courts.

Q: How will the New Jersey BPU decide whether or not to approve this merger?

The BPU will review the potential impact this merger will have on utility rates, safety and reliability, employees, and competition in New Jersey's energy markets. The BPU has adopted a 'positive benefits' standard of review, meaning that in order to approve the merger the BPU must determine that it will have a positive benefit for the citizens of New Jersey. If the BPU does not find that the companies have demonstrated that this merger will have positive benefits for New Jersey, then they will reject it and PSEG will remain a New Jersey-based and operated company.

Q: What is the role of the Department of the Public Advocate and its Division of Rate Counsel?

The Department of the Public Advocate's Division of Rate Counsel is a party in the merger proceeding before the Administrative Law Judge and BPU, representing the interests of all utility customers throughout New Jersey. In that capacity, we have hired experts to examine the potential impact of the merger, provided testimony, and cross examined Exelon and PSEG's experts before the ALJ.

Q: When will the BPU make its decision?

The BPU is waiting for the ALJ to issue his opinion on the case, which will likely happen at the end of June 2006. The BPU will then consider the recommendation of the ALJ and issue its final ruling, likely in mid-August 2006. Of course, any time between now and then the companies could reach a settlement agreement with the BPU and other interested parties. If a settlement is reached, the BPU could adopt that settlement and approve the merger.

Q: If I am not a PSE&G customer, why should this merger matter to me?

This merger could substantially increase the cost of energy for every single New Jersey family, business and government entity, regardless of whether you are a PSE&G customer or a customer of another utility. If energy prices rise, it would not only burden New Jersey families and businesses who are already paying expensive utility bills, it would also cause a damaging ripple effect throughout New Jersey's economy – everything from running a business to operating a school would become more expensive, and consumers and taxpayers would feel the impact.

Q: How could a merger involving PSE&G increase my energy rates if I get my service from another utility?

To explain how this could happen requires a bit of background on how you pay for utility service in New Jersey. Utility customers' bills are split into two portions – the energy distribution charge and the energy supply charge.

The <u>energy distribution charge</u> is essentially what you pay for someone to deliver electricity or natural gas from the power plant or from the natural gas wellhead to your home. This includes the cost required to build and maintain all of the pipes, wires and other necessary infrastructure, as well as the cost of providing support services, such as reading your meter or processing your bills.

The energy distribution charge is based on the costs incurred by your local utility. This means that if you are not a PSE&G customer, this merger will not directly impact your energy distribution charges.

The <u>energy supply charge</u> is essentially the cost you pay for the actual electricity or natural gas that you use. Electricity is generated from a variety of sources, such as coal power plants, nuclear power plants or renewable sources like solar power. When you pay the energy supply portion of your electric bill, you are buying the electricity generated from these sources.

Your energy supply charges are based on the market price of electricity and natural gas in New Jersey and the surrounding region, which is independent of what utility serves you. The concern about the Exelon-PSEG merger is that the merged company would be so big, and would own so many energy generating plants, that it could drive up the market cost of energy in New Jersey and the region by manipulating the market. This so-called "market power" could mean higher energy costs for everyone in New Jersey, no matter what utility serves you.

Q: What is market power?

Market power is the ability to manipulate a market in order to charge a higher price than would be possible if the market were fully competitive.

A simple illustration might help explain what this means. Let's say a family needs energy to light its home and there are five different power plants from which it could buy power. If those power plants were all owned by different companies, they would compete against each other for the family's business and the family would eventually choose to buy from the company that offered the lowest price. But what if all five of those power plants were owned by the same company? The family would not have different companies competing for its business. Instead, the company that owned all the power plants could greatly increase its price, and the family would have no choice but to buy the power at that inflated price.

In reality, energy markets are much more complex than this example, but the general concept holds true: if one company has too much power in the energy market it can manipulate the market to drive up prices.

Q: Could this merger give Exelon-PSEG market power?

The Division of Rate Counsel has hired experts and done extensive research on this issue, and we have concluded that the merger as currently proposed would give Exelon-PSEG the potential to exercise market power in both the electricity and natural gas markets.

Q: If Exelon-PSEG did exercise market power, what would happen?

The simple answer is that the cost of energy in New Jersey would become even more expensive. Exactly how expensive it could become is hard to determine, but it is very possible that market power could increase costs dramatically. Several experts testified before the ALJ that if Exelon exercised market power even to a small degree it could increase statewide energy costs by hundreds of millions of dollars each year. The potential negative impacts of market power would dwarf any benefits New Jersey citizens would possibly gain in this merger.

Q: How do we prevent Exelon-PSEG from gaining market power?

Exelon and PSEG must commit to selling some of their power plants to ensure that the company cannot exercise market power. In addition, the companies must specify exactly which power plants they intend to sell. Without these specific commitments from Exelon and PSEG, we cannot know whether or not the market power problem has been addressed. Approving the merger without these commitments poses a huge risk that New Jersey could face a dramatic increase in energy prices. This is a risk the Department of the Public Advocate does not believe New Jersey should take.

Q: What promises have Exelon and PSEG made to prevent this problem?

Thus far, Exelon and PSEG have not committed to selling enough power plants, nor have they agreed to specify which plants they will sell.

In fact, rather than selling power plants, the companies have proposed to address the issue of market power almost exclusively through "virtual divestiture." Virtual divestiture means that instead of selling power plants, the companies would simply sell some of the energy generated by those plants for a period of time. Virtual divestiture is an untested idea that has never been used before as a method of addressing market power concerns.

The Department of the Public Advocate opposes virtual divestiture because it believes that if Exelon-PSEG continues to own the power plants in question then there is still too great a risk that the company can exercise market power. The company must sell the plants to eliminate the potential for market manipulation. In addition, the Department does not believe New Jersey should be experimenting with a new way of addressing market power. There is too much at stake for such experimentation when the potential consequence is that New Jersey families and businesses will end up with dramatically higher energy costs.

Q: Will New Jersey citizens and businesses receive any rate relief or direct economic benefit as a result of this merger?

Exelon-PSEG has offered to provide PSE&G customers roughly $30 million per year in rate credits for four years. That would mean a savings of approximately $1 per month to the average PSE&G customer. The Public Advocate believes this offer is unreasonably low by any standard. A number of different reference points will help illustrate why we believe this offer is so low.

For example, several years ago Ohio-based First Energy merged with the New Jersey utility Jersey Central Power and Light (JCP&L). Despite the fact that JCP&L is roughly half the size of PSE&G and there were no concerns about market power, First Energy provided approximately $300 million in savings to New Jersey ratepayers.

Another point of reference is the money Exelon-PSEG will save just by cutting the 950 New Jersey jobs that they have said they will eliminate. The savings the company will gain each year from those job cuts alone will likely be more than double the $30 million per year the companies have offered to New Jersey ratepayers for just four years.

Yet another point of reference is that the companies are asking ratepayers to pay approximately $71 million in severance payments for 35 senior executives, an average of more than $2 million per executive. Under this scenario, PSE&G customers would be paying more than twice as much for lucrative severance packages for 35 executives than all PSE&G customers combined would be getting in rate relief.

Finally, one should consider that over the next several years ratepayers will still be paying almost $2 billion in 'stranded costs' for power plants that PSE&G sold during energy deregulation in the late 1990s. While the procedural and legal background to these transactions is complex, the broader point is that ratepayers are still paying for the cost of building power plants that Exelon-PSEG would be profiting from if this merger were approved. The Department of the Public Advocate believes ratepayers should share in some of the benefits that Exelon-PSEG realizes from running these power plants.

All of these figures help put into context the fact that Exelon-PSEG's offer of rate relief is shockingly low. But it is also important to note that while rate relief is important, this merger is about far more than just temporary rate relief. The negative impacts of market power could instantly wipe out any potential gains from a temporary rate reduction. The main issues at stake here are about statewide energy costs, New Jersey's economy, and the ownership and operation of one of New Jersey's most important businesses for decades to come. These are issues that can only be addressed by firm commitments from Exelon-PSEG, and cannot simply be patched over with offers of short-term rate relief.

Q: What is Exelon's record of reliability and customer service in the states where it does business? How does it compare to PSE&G?

When customers lose utility power, it is more than a minor inconvenience; losing heat, air conditioning or power to run medical equipment can be life threatening. For businesses, from manufacturers to supermarkets, losing power can cause devastating financial losses.

PSE&G has a very strong record of reliability and customer service, and recently received a national award recognizing their superior electric service and reliability. Exelon's utilities have a considerably worse record than PSE&G. For example, Exelon's Illinois utility Commonwealth Edison had power outages that, on average, were more than twice as long as outages experienced by PSE&G customers. Customers of Exelon's Pennsylvania utility PECO experienced power outages about 50 percent more frequently than PSE&G customers, and they lasted an average of twice as long.

The Public Advocate is concerned that after the merger PSE&G will not maintain the high standards and staffing levels that have led to their strong record of customer service and reliability. The Division of Rate Counsel has asked Exelon and PSEG to amend their merger plan with assurances that service and reliability will be maintained after the merger. Exelon and PSEG have so far refused those recommendations.

Q: How will this merger impact low and moderate income customers?

PSE&G serves a great number of low-income customers, many of whom live in New Jersey's largest cities. The Public Advocate is concerned that service to these customers will be diminished if this merger is approved.

For example, PSE&G runs 16 neighborhood walk-in service centers, which are particularly important to customers who want to pay bills in cash, establish creditworthiness, request residential credit assessments and make arrangements for deferring bill payments. Exelon has so far not committed to keeping these walk-in service centers open.

For many years, PSE&G has also supported and funded programs that help low-income customers. This includes New Jersey SHARES, which provides one-time assistance to customers who are facing a sudden financial crisis who are unable to pay their utility bills. Rate Counsel has proposed that as a condition for the merger Exelon-PSEG shareholders should be required to continue to contribute $8 million to New Jersey SHARES over four years so that families facing a serious crisis can get the emergency help they need. Exelon-PSEG have not agreed to this and other proposals to ensure that low and moderate income ratepayers benefit from this merger.

Q: How will this merger impact jobs in New Jersey and our local economy?

Exelon has already said it will eliminate roughly 950 jobs in New Jersey. Because Exelon is headquartered in Chicago and its natural gas operations are centered in Pennsylvania, many additional New Jersey jobs could be moved to another state.

When jobs are lost in New Jersey, it not only hurts the families directly impacted by those job losses, but there is a multiplier effect throughout New Jersey's economy. Rate Counsel has offered the conservative estimate that the elimination of these 950 jobs would cost New Jersey's economy $143 million per year.

Q: What will it mean to New Jersey citizens that PSE&G will no longer be a New Jersey-based company?

This merger would mean that one of the most important businesses in the state would now be controlled and operated by a company in Illinois, potentially for generations to come. Loss of local ownership of a utility can lead to problems such as decreased investment in basic infrastructure, decreased charitable giving and community involvement, deteriorating labor-management relations, and a poorer working relationship between the utility and the BPU, which regulates utility rates.

PSE&G has a long history of quality service, charitable giving, and being involved in partnerships with New Jersey communities. Exelon has not made adequate assurances that this good corporate citizenship would continue long after the merger is approved.

Q: Why does the Department of the Public Advocate oppose this merger?

The Department of the Public Advocate believes the merger, as currently proposed, would do more harm than good to New Jersey citizens.

With PSE&G, New Jersey citizens have a known quantity – a New Jersey-based company that provides safe and reliable energy utility service with strong customer service, and is invested in and involved with New Jersey's communities.

The merger, as proposed, opens New Jersey's families and businesses up to tremendous risk. It would expose families and businesses to the risk of dramatic increases in energy prices. It would expose New Jerseyans to the risk that the new utility would allow reliability and customer service to deteriorate. And it would expose New Jersey to the risk that Exelon will not continue PSE&G's record of good corporate citizenship, environmental stewardship, charitable giving and community involvement.

Given the limited benefits it would offer New Jersey citizens, the Department of the Public Advocate does not believe this merger, as proposed, comes close to justifying such risks.

Q: How can I find out more about this proposed merger? What if I have additional questions?

We encourage people to visit our website at www.state.nj.us/publicadvocate where we've added links to additional information.

If you have additional questions, please email us at info@advocate.state.nj.us.