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In The Matter of the Merger of Exelon Corporation and Pepco Holdings, Inc.
BPU Dkt. No.: EM14060581

HEARING
Newark Hilton
Newark, N.J. 07102

January 14, 2015

Good morning Commissioner Fiordaliso. My name is Stefanie Brand and I am the Director of the New Jersey Division of the Rate Counsel. I would like to make a brief statement today about the proposed merger of Pepco Holdings, Inc. ("Pepco"), parent company of Atlantic City Electric Company ("Atlantic"), and Exelon Corporation ("Exelon") on behalf of the ratepayers of the State. As you know, if the joint petition is granted, Pepco, and its regulated utilities including Atlantic City Electric, will become a wholly-owned subsidiary of Exelon Corporation.

Since the filing of the joint petition to merge Pepco into Exelon on June 18, 2014, extensive discovery was propounded, testimony was filed by various parties and multiple settlement discussions have taken place. Rate Counsel, as well as the other parties in this proceeding met with the Joint Petitioners in good faith in order to come to an agreement.

Unfortunately, Rate Counsel did not execute the partial stipulation before you today. We believe that Rate Counsel's signature would signify our endorsement that the terms of the partial stipulation satisfy the statutory requirements and that Atlantic's customers will be better off with the consummation of the merger with the terms as outlined in the stipulation. Unfortunately we are unable to make that endorsement for the reasons I will outline today. I ask that the Board consider our concerns while reviewing the partial stipulation.

The Joint Petitioners filed their petition for approval of the proposed merger pursuant to N.J.S.A. 48:2-51.1. Under that statute the Board is required to look at four criteria in reviewing the merger: impact on competition, impact on employees, impact on rates, and impact on gas and electric service.

The specific statutory language is:

> In considering a request for approval of an acquisition of control, the board shall evaluate the impact of the acquisition on competition, on the rates of ratepayers affected by the acquisition of control, on the employees of the affected public utility or utilities, and on the provision of safe and adequate utility service at just and reasonable rates.

N.J.S.A. 48:2-51.1.

In addition to its review under to the statute, the Board has adopted a "positive benefits standard" as the standard of review under N.J.A.C. 14:1-5.14. As codified in the Board regulation:

> The board shall not approve a merger, consolidation, acquisition and/or change in control unless it is satisfied that **positive benefits** will flow to customers and the state of New Jersey and, at a minimum, that there are no adverse impacts on any of the criteria delineated in N.J.S.A. 48:2-51.1. (emphasis added).

The burden of proof to show “no adverse impact” on competition, employees, rates, and electric service and an overall “positive benefit” to Atlantic’s 545,000 customers and to the State of New Jersey lies squarely with the Joint Petitioners.

Financial Benefits

At first glance, the Partial Stipulation appears to offer both Atlantic’s ratepayers and the State monetary and other benefits. However a closer examination of the terms and conditions offered by the Joint Petitioners in the Partial Stipulation reveals that what the Companies’ offer is illusory and insufficient to meet the statutory requirement. For example one of the most direct benefits offered by the Joint Petitioners in this Partial Stipulation is the “Customer Investment Fund” representing synergy savings to be shared with Atlantic’s customers. The synergy savings the Joint Petitioners are willing to share if this merger is consummated is $62 million.[1] However, that $62 million is fleeting at best. This is because the Partial Stipulation places no limitation on the post-merger transition costs Atlantic may seek later and does not provide in any way for a “stay out,” i.e., a period of time when the Company will refrain from seeking a rate increase.

Without express limitation on the level of post merger transition costs recoverable by Atlantic in a future proceeding, costs associated with the merger, such as installing new computer systems or severance payments that would not have been incurred by Atlantic but for the merger, may be sought by the Company in Atlantic’s next base rate case without limitation. In other words, the $62 million of benefits to Atlantic’s customers may be offset or totally wiped out without some sort of commitment from Joint Petitioners in the Partial Stipulation that the transition costs will not be recovered

[1] See, Paragraph 7 of the Partial Stipulation.

or at least will be capped in a subsequent rate case to keep the integrity of the synergy savings benefit. Without this limitation on transition costs, the benefit to Atlantic customers cannot be quantified and may well be illusory.

Moreover, the lack of a stay out provision means that the synergy savings benefit may be handed out today only to be taken back tomorrow. Atlantic City Electric's territory has been especially hard hit due to the economic downturn of the casinos in Atlantic City. It is little comfort to a business or residential customer to receive a check for $115 and then a rate increase soon thereafter that could dwarf the $115 benefit.

Similarly, the Joint Petitioners have offered to pay for and implement over a five year period an energy efficiency program, the details of which will be worked out after the consummation of the merger. Although the Joint Petitioners state the energy efficiency program will be worth $15 million dollars in energy efficiency savings, the actual out of pocket cost to Joint Petitioners to implement the energy efficiency program is a fraction of the $15 million. While Rate Counsel supports including funding of energy efficiency programs as a merger benefit, the reality is that the overall tangible benefit to Atlantic's customers from this provision will be minimal.

Thus, Rate Counsel is concerned that without a limitation on transition costs and a stay out, the purported financial benefits of this Stipulation are illusory or fleeting at best. There can be no doubt that there will be synergy savings and benefits to shareholders from this merger and those savings and benefits should be more concretely and tangibly shared with ratepayers.

Reliability Benefits

In addition to the financial commitments offered by the Joint Petitioners, the Partial Stipulation purports to provide several reliability benefits. In the Partial Stipulation, Joint Petitioners commit that by 2020 Atlantic will achieve reliability performance levels as follows:[2]

a. SAIFI[3] not to exceed 1.05 interruptions; and

b. CAIDI[4] not to exceed 100 minutes.

Joint Petitioners agree that if the above level of reliability improvements are not achieved across either SAIFI or CAIDI, Atlantic's return on equity in its next electric distribution base rate case filed after January 1, 2021, will be reduced by fifty (50) basis points until the subsequent base rate case. [5]

There are several observations to be made with this reliability commitment. First as can be seen from the charts below, Atlantic has already reached the CAIDI merger reliability commitment.

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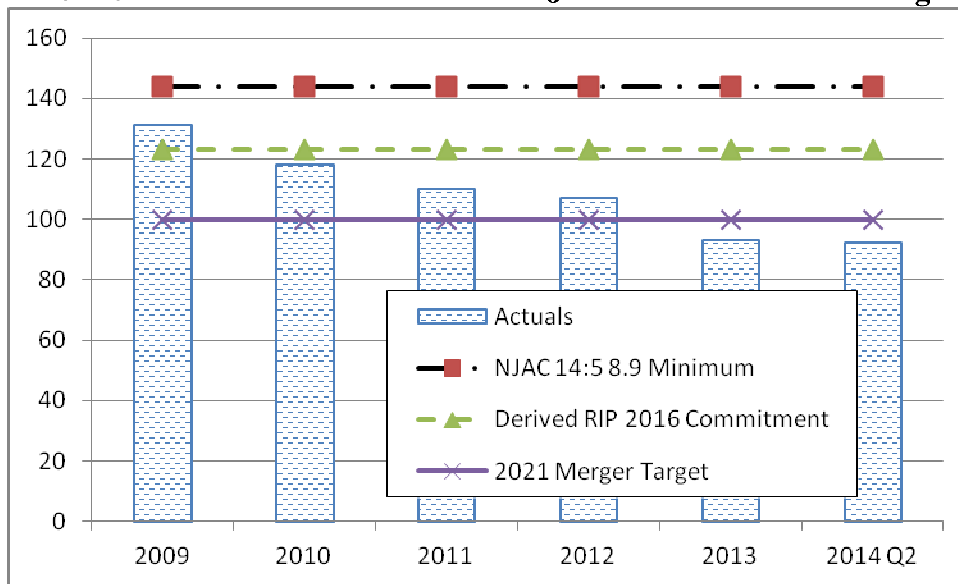
[2] See, Paragraph 14 of the Partial Stipulation. This value is based on a three-year historical average calculated over the 2018-2020 period excluding major events as calculated consistent with the methodology currently utilized by the Board of Public Utilities.
[3] SAIFI means System Average Interruption Frequency Index.
[4] CAIDI means the Customer Average Interruption Duration Index.
[5] Id.

ACE CAIDI Performance Relative to Joint Petitioners' 2021 Target[6]



As you may know, concerns regarding Atlantic's reliability performance were raised in the Company's 2009 base rate case (BPU Docket: ER09080664). From that proceeding the parties agreed in 2011 to enter into a Phase II stipulation to address reliability concerns that resulted in the Reliability Investment Program ("RIP"). The RIP was designed to substantially improve the reliability of the distribution system across Atlantic's operating area by reducing the frequency and duration of customer outages. The RIP has fulfilled its intended CAIDI goal and has exceeded it, not only meeting the RIP commitment but reaching the level that the Company is now proposing to meet in the merger.

Since the inception of the RIP in 2011, SAIFI has also seen marked improvements as seen below.

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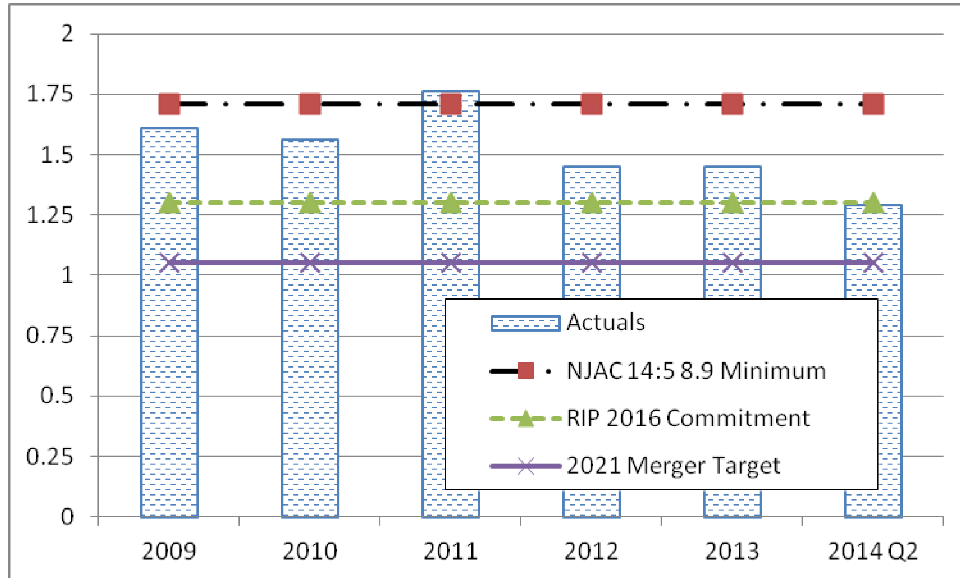
[6] RC-4 Maximilian Chang Direct Testimony page 9.

ACE SAIFI Performance Relative to Joint Petitioners' 2021 Target[7]



Although with SAIFI, the Company has not yet met the merger goals, we anticipate that improvements in SAIFI would have reached the merger commitments under the existing RIP by the time it was scheduled to end in 2016. Therefore, it is unclear whether this Partial Stipulation is offering reliability improvements beyond those improvements that Atlantic would have reached absent the merger.

In any event the penalty of 50 basis points is based on a three-year historical average calculated over the 2018-2020 period and not enforceable until "the next electric distribution base rate case filed after January 1, 2021."[8] This is not a significant enough sanction for non-compliance. It is unlikely to be significant enough to deter non-compliance, and Atlantic's customers would not see the benefits of the 50 basis point

[7] RC-4 Maximilian Chang Direct Testimony page 10.
[8] See, Paragraph 14 of the Partial Stipulation.

reduction in rates until 2021, six or more years after the merger's consummation. Because the Company has failed to show that the merger will result in reliability benefits beyond what Atlantic would have reached under the existing RIP, the reliability commitment should not be considered a merger benefit.

In order to achieve the reliability goals of SAIFI not to exceed 1.05 interruptions; and CAIDI not to exceed 100 minutes, the Joint Petitioners commit to continuing the RIP through 2021 and "during the period 2016 through 2021, ACE commits to spend at least 90% of the aggregate budget amount over those six years …"[9]

The value of the 90% capital spend commitment is also hard to quantify. Exhibit One below is an attachment to the Partial Stipulation which shows the amount of RIP spending anticipated over six years from 2014 through 2019 and the amount of overall capital spending estimated during that period.[10]

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[9] See, Paragraph 16 of the Partial Stipulation.

[10] Exhibit One shows the RIP Capital and Vegetation Spending as well as the currently anticipated base distribution spending. It merits noting that Exhibit One shows Atlantic's spending anticipated over 2014-2019 only and does not estimate spending for years 2020 and 2021 even though the Partial Stipulation commits to the extension of the RIP until 2021. At this time there is no hard number that the Joint Petitioners are committing to spend for the last two years of the extended RIP program.

Exhibit One

Categories	Forecast					Note: All dollars are in millions
	2014	2015	2016	2017	2018	2019
Base Distribution Capital Spending						
Customer driven	17.2	15.2	19.2	18.8	18.3	19.1
Load	25.7	12.3	44.0	34.0	30.0	42.6
Planned reliability	31.7	17.3	39.2	41.7	41.9	34.9
Emergency	33.5	33.5	33.5	33.5	33.5	34.2
Base Spending Totals	108.1	78.3	135.9	128.0	123.7	130.8
Reliability Improvement Program						
Priority Feeders	7.8	5.0	10.0	10.0	10.0	5.0
Load Growth	20.1	7.4	23.2	19.4	23.5	30.8
Distribution Automation	3.3	3.3	10.6	8.6	8.6	6.1
Feeder Improvement	6.7	4.7	7.5	8.0	8.5	5.5
Substation Improvement	3.6	1.5	3.8	4.6	2.3	0.7
RIP Totals	41.5	21.9	55.1	50.6	52.9	48.0
Total ACE Distribution Capital Forecast	**108.1**	**78.3**	**135.9**	**128.0**	**123.7**	**130.8**
Vegetation Management						
(Operations and Maintenance Expense)						
Total	14.4	14.6	14.6	14.6	14.6	14.6

The Joint Petitioners' commitment to spend 90% applies only to the RIP and Vegetation Management spending as shown on Exhibit One. For example, in 2019 Total RIP Capital spending is $48 million. Therefore, the Joint Petitioners' commitment is to spend 90% of $48 million or approximately $43.2 million in 2019. However, as Exhibit One also shows, RIP budget is only one part of the company's overall capital spending in 2019 of $130.8 million. There is no commitment in the Partial Stipulation for the Joint

Petitioners to maintain any level of overall reliability spending. Thus, even if we were to remove the Customer Driven ($19.1 million) and Emergency ($34.2 million) categories because those categories are not purely reliability driven, the company would be free under this agreement to reduce its base spend budget of $77.5. Atlantic could also easily re-categorize base spending as RIP spending thereby fulfilling the merger commitment but in actuality decreasing overall reliability spending.

In other words, as written, the Partial Stipulation allows Atlantic to decrease the Base Distribution Capital Spend so that the overall reliability spending for a particular year can go down while still meeting its merger commitment. This is a situation that could undermine the important steps we have made to improve Atlantic's reliability.

Rate Counsel notes further that the Partial Stipulation does not require regular rate cases that would permit the Board to monitor reliability spending. The Partial Stipulation only states that Atlantic will file "a distribution base rate proceeding in the first three years following the closing of the Merger."[11] If Atlantic files a base rate case in 2016, but not thereafter, it will be difficult for the Board to monitor the capital spending in between base rate cases. It is possible that the level of capital spending can go down substantially leaving ratepayers of Atlantic only the pre-merger RIP reliability standards and no demonstrable reliability benefit as a result of the merger..

We have already experienced a situation in this state where reliability spending was neglected post-merger in favor of paying dividends. It is important that we not permit this to happen again. A provision requiring periodic base rate cases for the first 10 years and a more meaningful spending floor and cap is needed to satisfy the statutory requirement for positive benefit.

[11] See, Paragraph 9 of the Partial Stipulation.

The second reliability commitment of the Partial Stipulation is equally without true substance. The Partial Stipulation states:

> The Joint Petitioners aspire to achieve first-quartile SAIFI and CAIDI performance. For the purposes of this settlement, the Parties define first-quartile performance across SAIFI and CAIDI using 2013 IEEE 2.5 beta definitions and exclusions across the Exelon peer panel of 26 utilities, which is a subset of the full IEEE annual survey panel. [12] (emphasis added).

As paragraph 13 clearly states, this is an "aspirational" goal for the Joint Petitioners. This is by no means a firm commitment to reach first quartile performance. There are no penalties or any consequences associated with failing to reach the first quartile performance. It is merely a promise to discuss in the future about detailed projects, activities, capital and O&M budgets estimates. [13] Although we applaud the Joint Petitioners openness to discuss first quartile performance, willingness to discuss, by itself is not a substantial merger benefit.

Most Favored Nation

In a multi-jurisdictional approval process as in the instant Pepco Exelon merger where public utility commissions from several states are statutorily mandated to approve mergers, it is customary to have a "most favored nation clause" in the stipulation of settlement. The most favored nation clause is used primarily to mitigate the risk of jurisdictions that approve the merger transaction early in the process to insure that the

[12] See, Paragraph 13 of the Partial Stipulation. "The 2013 reported numbers (SAIFI 0.85 interruptions, CAIDI 91 minutes) will be used for benchmarking."

[13] Paragraph 13 of the Partial Stipulation "The Within six months after the closing of the Merger, Joint Petitioners agree to provide a comprehensive Reliability Analysis explaining how ACE could achieve first-quartile performance. The Reliability Analysis will include detailed projects, activities, capital and O&M budgets estimates."

benefits awarded in one state are comparable to that awarded in another. In this instance, New Jersey is ahead of Maryland, Delaware and District of Columbia in the approval process making the most favored nation clause critical. It is the safety net to insure that Atlantic's customers and the State are allocated a fair share of the benefits. Much like the other "benefits" provided in the Partial Stipulation, however, the most favored nation clause in the agreement lacks substance.[14]

First, the customer investment fund allocation of $114 per customer is based on actual customer count of 543,989 customers ($62 million/543,989 = $114 per customer). While the Partial Stipulation is clear that New Jersey will receive a full $62 million it is not clear how the comparison to other states and the definition of "material' will be judged. If Atlantic's customer count decreases from 543,989 at the time of the consummation of the merger it should be clear that the full $62 million must be credited to ratepayers regardless of how many customers remain in Atlantic's system.

Moreover, the Partial Stipulation contains troubling language that limits the parties' rights to claim additional benefits under this section:

> In recognition of the risks to New Jersey of approving the transaction before the other jurisdictions, the Parties agree that New Jersey should be protected in the event that the Joint Petitioners agree or accept orders under which another jurisdiction obtains a higher amount of direct customer financial benefits than provided through the CIF (calculated on a per-distribution customer basis) or other materially better benefits in the aggregate than those contained in this Stipulation:
>
> (1) If, on a per-distribution customer basis, the benefits provided to other jurisdictions are **materially** more beneficial in the aggregate than the terms of this Stipulation with respect to financial benefits, credits or payments to customers including the amount of the CIF specified in Paragraph 7, then Exelon will increase the financial

[14] See Paragraph 91 of the Partial Stipulation.

benefits, credits or payments to ACE customers including the CIF to an equivalent amount calculated on a per-distribution customer basis. In no event will the operation of this methodology cause New Jersey's $62 million CIF or the $15 million in energy-efficiency savings to be reduced. (emphasis added).[15]

This provision is very narrow. There are many "benefits" that may be agreed to in other States that will not be subject to this provision. Moreover, according to the Partial Stipulation, the benefit received by utility customers in another jurisdiction must be "materially" more on a per distribution customer basis. A two dollar difference per customer may not be material in terms of that one customer but would be worth $1.08 million in the aggregate. Thus the lack of definition of materiality could undermine the goal of this provision. Rate Counsel does not believe that the language in this most favored nation clause is sufficiently iron clad to ensure that New Jersey's ratepayers receive the same benefits as those in other states.

Conclusion

Rate Counsel has carefully reviewed the pending joint petition considering each of the above-mentioned criteria to ensure Atlantic's ratepayers are fully protected and New Jersey gains a positive benefit if the proposed merger is approved. The Stipulation includes terms such as Ring Fencing to protect Atlantic from more risky businesses within the Exelon family and limitation on the Money Pool to insure that Atlantic's customers are protected. However the Partial stipulation's terms with respect to financial and other benefits are still too vague to meet the Joint Petitioners' burden to show positive benefits to Atlantic's ratepayers and the State. Rate Counsel's ultimate concern

[15] See, Paragraph 91of the Partial Stipulation.

is this, if a customer of Atlantic City Electric were to ask what lasting benefits he or she would receive if this merger takes place, I would be hard pressed to have an answer. The lack of specificity, the open ended terms, and missing data makes it impossible for Rate Counsel endorse this stipulation. Therefore we respectfully request that the Board reject the Partial Stipulation as proposed and amend the agreement with better defined terms and conditions to ensure ratepayer benefits.