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Phila, PA

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BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION

APPLICATION OF PECO ENERGY :  
COMPANY, PURSUANT TO CHAPTERS :  
11, 19, 21, 22, AND 28 OF THE PUBLIC :  
UTILITY CODE FOR APPROVAL OF :  
(1) A PLAN OF CORPORATE :  
RESTRUCTURING, INCLUDING THE :  
CREATION OF A HOLDING COMPANY :  
AND (2) THE MERGER OF THE NEWLY :  
FORMED HOLDING COMPANY AND :  
UNICOM CORPORATION :

Docket No. A-110550F0147

DOCUMENT BOKETED  
FOLDER  
MAY 17 2000

TESTIMONY

OF

RICHARD LACAPRA

RECEIVED  
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SECRETARY'S BUREAU

On behalf of:

PENNSYLVANIA OFFICE OF CONSUMER ADVOCATE

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May 2, 2000

**Richard La Capra's Testimony  
in Support of the Joint Petition for Settlement**

1 **PART I: INTRODUCTION**  
2

3 **Q. Mr. La Capra, please identify yourself for the record and summarize your**  
4 **experience and qualifications.**  
5

6 A. My name is Richard La Capra and my business address is 333 Washington Street,  
7 Boston, Massachusetts 02108. I am a principal of La Capra Associates, a Boston-based  
8 consulting firm specializing in energy planning and regulatory economics. I hold degrees  
9 in electrical and mechanical engineering from Stevens Institute of Technology. In  
10 addition, I also hold a Master of Business Administration degree from Fairleigh  
11 Dickenson University, and have done advanced studies in Finance at New York  
12 University. I founded La Capra Associates in 1980 with a goal of providing state-of-the-  
13 art, innovative technical analysis to the utility industry. I had previously been in charge  
14 of the utility business division of Charles T. Main, Inc.  
15

16 My experience has encompassed a broad range of utility ratemaking and planning issues.  
17 Over the last 30 years, I have worked on behalf of more than 100 clients in 28 states, and  
18 in several different countries, on issues involving utility and energy markets. Although  
19 my primary interest has been in the area of electric and gas utility regulation, I have also  
20 testified on telecommunications, water resources, and the regulated taxicab industry. I  
21 have contributed to seminal research in ratemaking and load research, and my clients  
22 have relied upon me for technical analysis, strategic guidance, and difficult negotiation  
23 assistance.  
24

25 Of particular relevance to this proceeding is my knowledge of electric industry  
26 restructuring concepts and proposals, competitive market pricing in a restructured  
27 generation market, and utility finance and ratemaking. I am also experienced in the  
28 analysis of utility mergers. I have previously presented testimony in proceedings  
29 involving mergers and similar corporate restructurings. For example, I recently presented  
30 expert testimony in proceedings to address the proposed Northeast Utilities /  
31 Consolidated Edison merger within the context of the restructuring proceedings in New  
32 Hampshire. I have addressed the Boston Edison and COM Energy merger and the  
33 National Grid (New England Electric System) and Eastern Utilities Associates merger on  
34 behalf of the Massachusetts Division of Energy Resources. I have also testified in  
35 proceedings that brought about the merger of the Brooklyn Union Gas and Long Island  
36 Lighting companies. I have testified as an expert witness on numerous occasions before  
37 public utility commissions around the country on electric industry restructuring and  
38 market price issues. Exhibit RLC-1 is my resume which summarizes my experience and  
39 qualifications.

1  
2 **Q. Who are you testifying for?**  
3

4 A. I am testifying on behalf of the Pennsylvania Office of Consumer Advocate.  
5  
6

7 **Q. Have you presented testimony to the Pennsylvania Public Utility Commission on**  
8 **prior occasion?**  
9

10 A Yes, I have presented testimony to the Pennsylvania Public Utility Commission  
11 (“Commission”) on a number of occasions. I recently presented testimony regarding the  
12 level of stranded costs that might be realized by PECO Energy Company (“PECO” or  
13 “Company”) in its electric restructuring proceeding, and in the proceeding that led to a  
14 qualified rate order for securitization for the Company. I have also presented testimony  
15 in the PP&L, GPU Companies and UGI electric restructuring proceedings.  
16  
17

18 **Q. What is the purpose of your testimony?**  
19

20 A. My testimony provides an assessment of the Joint Petition for Settlement (“Settlement”),  
21 of which the Office of Consumer Advocate is a signatory party, in resolution of issues  
22 related to the PECO proposal to merge with Unicom Corporation (together,  
23 “Companies”). Based on my review of the PECO filing (including its application and  
24 related testimonies) and extensive discovery in this proceeding, I identified a number of  
25 concerns related to how approval of the merger by the Commission, as initially proposed,  
26 might have adversely affected ratepayers. In this testimony I identify my concerns and  
27 address the ways in which the Settlement would mitigate those concerns.  
28  
29

30 **Q. What documents have you reviewed in preparing this testimony?**  
31

32 A. Filings to the Commission (including initial and supplemental testimonies submitted by  
33 the Company), extensive discovery, PECO’s 1998 Electric Restructuring Settlement  
34 Agreement,<sup>1</sup> the instant Settlement, Statements in Support of the Settlement, and  
35 subsequent comments (i.e., objections and reply comments) addressing the Settlement.  
36 These documents contain extensive and detailed information regarding PECO’s plans

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<sup>1</sup> On April 29, 1998, the Company entered into a settlement agreement in resolution of PECO’s restructuring plan, which established (among other things) stranded cost recovery provisions, and transmission and distribution rate caps through June 30, 2005 and generation rate caps through 2010. That agreement was approved by the Commission in an order dated May 14, 1998.

1 regarding the merger, including detailed exhibits regarding the level of merger savings  
2 projected to be achieved. These documents also contain extensive and detailed  
3 information regarding PECO's financial condition, as is reflected in its recent annual  
4 reports to the Federal Energy Regulatory Commission, the minutes from the Company's  
5 annual meeting with shareholders, and current and pro-forma (post merger) financial  
6 statements that have been issued by the Company to the Securities and Exchange  
7 Commission ("SEC").  
8  
9

10 **Q. How is your testimony organized?**

11  
12 **A.** Part 1 of my testimony presents basic introductory information.

13  
14 In Part 2 of my testimony, I discuss the wave of mergers that is currently sweeping the  
15 electric utility industry, and explain the PECO/Unicom merger in this context. I also  
16 provide selected background information on the proposed merger between PECO and  
17 Unicom.

18  
19 In Part 3 of my testimony, I discuss the significant concerns that I see in the merger as  
20 initially proposed by PECO (i.e., through its application, initial testimonies and discovery  
21 responses). Finally, based on my review of the Settlement, I explain which provisions  
22 will serve to mitigate the concerns that I identify.  
23  
24

25 **PART 2: BACKGROUND, PECO'S APPLICATION AND TESTIMONY**

26  
27 **Mergers in the Electric Industry**

28  
29 **Q. What are the forces that have precipitated mergers such as that between PECO and**  
30 **Unicom?**

31  
32 **A.** The proposed PECO/Unicom merger is just one of a great many mergers in the electric  
33 utility industry over the past four to five years. Historically, the principal driver of utility  
34 mergers was the expectation of large savings from the synergies of combined company  
35 operations. Labor and power production savings typically accounted for the majority of  
36 the projected savings. While cost savings remain a major factor in merger decisions, I  
37 believe it is competition, or more accurately, the promise of new opportunities to expand  
38 the scale and scope of operations that is driving the current wave of mergers.  
39 Consolidation enables utilities to position themselves to deal more effectively with  
40 opportunities in new markets and to grow their businesses. These forces are having their  
41 effects well beyond the bounds of the electric utility industry. However, the forces  
42 propelling mergers in other markets are largely the same as those that motivate the  
43 PECO/Unicom merger.

1  
2  
3 **Q. Is electric industry restructuring playing a role in the creation of new business**  
4 **opportunities for utilities in regulated and unregulated markets?**

5  
6 A Yes. For some time now electric transmission and distribution utilities have profited  
7 from the installation of cable television, data, and telephone lines on a fee-for-service  
8 basis, without actually participating directly in those markets. With the emergence of  
9 restructuring, I see electric utilities using their utility assets more and more as a  
10 springboard to enter lucrative non-electric markets. For example, with valuable assets  
11 such as telecommunications systems, rights-of-way, frequent contacts with customers  
12 through billing and advertising, and large amounts of market data on every customer,  
13 telecommunications affiliates of transmission and distribution utilities have entered  
14 markets to utilize competitive advantages that may not be available to their competitors.  
15

16  
17 **Q. What evidence of the motivations of new business opportunities do you see with**  
18 **respect to the PECO/Unicom merger?**

19  
20 A. The proposed merger of PECO and Unicom can be regarded as thoroughly consistent  
21 with the general industry overview I have just presented. In this respect, the very market  
22 forces that the Commission has sought to unleash in the form of retail competition also  
23 contribute to the desire for companies such as PECO and Unicom to merge. Information  
24 contained in testimony and discovery responses in this proceeding indicates that the  
25 PECO/Unicom managements have expressed interest in expanding the scale of their  
26 operations. Moreover, they are clearly attracted to opportunities to expand both their  
27 regulated and unregulated businesses.  
28  
29

### 30 **The PECO/Unicom Merger**

31  
32 **Q. What approvals has the Company requested through its merger application?**

33  
34 A. On November 22, 1999, PECO Energy Company submitted an application to the  
35 Commission for approval of (1) a plan of corporate restructuring, including the creation  
36 of a holding company, and (2) the merger of the newly formed holding company and the  
37 Unicom Corporation, a holding company organized and existing under the laws of the  
38 State of Illinois. In addition, PECO seeks approval of various affiliated interest  
39 agreements between it and other members of the new holding company system. Finally,  
40 PECO asks the Commission to make the findings needed for its new generating company  
41 affiliate to obtain "exempt wholesale generator" ("EWG") status and to engage in certain  
42 affiliated power sales under Sections 32(c) and 32(k) of the Public Utility Holding  
43 Company Act of 1935 ("PUHCA").

1  
2 **Q. Please provide an overview of the proposed merger, as is relevant to the testimony**  
3 **that you present.**

4  
5 A. On September 22, 1999, PECO entered into an agreement with Unicom, framing what  
6 has been termed a “merger of equals.” The merger has been unanimously approved by  
7 both companies’ boards of directors. The merger between PECO and Unicom will create  
8 a new holding Company, to be called Exelon Corporation (White Supplemental Direct  
9 at 2), with a total value of approximately \$31.8 billion. The combined company will own  
10 over 22,500 MW of generating capacity, three-quarters of which will be represented by  
11 nuclear generating units.<sup>2</sup> The combined work force of the Companies will be 22,500.  
12 Exelon will be headquartered in Chicago (Application at 7).

13  
14  
15 **Q. How will corporate reorganization along with the merger affect PECO’s operations?**

16  
17 A. The reorganization will affect regulated utility operations in several ways. PECO Energy  
18 Distribution will keep its headquarters in Philadelphia (Application at 7), and the  
19 Company has indicated that Ken Lawrence will continue to manage PECO’s electricity  
20 and gas distribution functions as its president. It appears that Mr. Lawrence will report to  
21 John Rowe, who currently heads Unicom. In addition, documents filed by the Company  
22 reveal that a new corporate structure will be implemented whereby generation operations  
23 will be consolidated in a separate, affiliated company. PECO will transfer its generating  
24 assets and wholesale power contracts to that newly-formed generation affiliate  
25 (Application at 5).<sup>3</sup> PECO’s wholesale marketing operations (i.e., Power Team) will be  
26 located within the generating company (Application at 5). PECO’s retail generation  
27 marketing operations will be consolidated within either the generating company or  
28 another affiliate focusing on unregulated ventures.

29  
30 The Company indicates that its electric and natural gas distribution services will remain  
31 subject to the Commission’s jurisdiction with respect to retail rates and the terms and  
32 conditions of service. It also indicates that its dealings with affiliates will be governed by  
33 the provisions of Chapter 21 of the Public Utility Code and, in the case of its generation

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<sup>2</sup> Unicom currently has roughly 9,400 MW in nuclear generating capacity. PECO has just over 4,000 MW in nuclear generating capacity, while AmerGen (in which PECO has a fifty percent share in a partnership with British Energy) owns or is seeking to acquire another 3,500 MW.

<sup>3</sup> Tab 4 to Mr. White’s Supplemental Direct Testimony contains an “updated” list of assets and liabilities to be transferred to the generating company.

1 affiliate, by the code of conduct and competitive safeguards set for in PECO's 1998  
2 Electric Restructuring Settlement. Application at 8.

3  
4 The Companies have also indicated their intent to share "best practices," through the  
5 combination of their distribution operations. Mr. Lawrence states in testimony that,  
6 through such action, the Company will be better positioned to meet future customer  
7 demands and ensure a high quality of service. Recommendations on processes and  
8 activities that can effectively be transplanted from one company to improve costs and  
9 performance at the other are to be developed. Mr. Lawrence indicates that PECO may be  
10 able to draw direct benefits from combining portions of its call centers with those of  
11 ComEd in order to provide better phone coverage for each distribution company during  
12 high-volume call periods.

13  
14 Following the corporate restructuring and merger, services that are currently furnished by  
15 separate business units within PECO will be provided by separate corporate entities.  
16 Certain routine functions such as accounting, legal, human resources, finance and  
17 information systems will be conducted by a service company. Those services will be  
18 provided by the service company to PECO Energy Distribution under a contract that will  
19 fall under the jurisdiction of the SEC. Application at 12.

20  
21  
22 **Q. As initially proposed by the Company, would the merger have had any immediate**  
23 **impact on regulated rates to PECO customers?**

24  
25 A. No. The Company's rates for electric services are currently governed by the 1998  
26 Electric Restructuring Settlement. The Company had anticipated that the rate cap  
27 implemented through that settlement would continue to remain in effect until  
28 July 1, 2005.

29  
30  
31 **Q. Is PECO's financial health likely to be enhanced through the merger?**

32  
33 A. Testimony presented by Mr. Flaherty indicates that the merger is expected to create  
34 savings in traditionally regulated transmission and distribution operations. He estimates  
35 that "net regulated" savings (i.e., savings related to regulated operations, net of the costs  
36 to implement the merger) for the combined PECO and Unicom operations will average  
37 \$66 million per year over the first five years (i.e., 2001 through 2005). Exhibit TJF-2.  
38 Mr. Flaherty also projects that the merger will also yield "non-regulated" savings related  
39 to the Companies' other business activities. I estimate that "non-regulated" savings to the  
40 two companies will average \$44 million per year for the first five years of the merger,  
41 based on a report by the Company's chief financial officer to Wall Street analysts  
42 indicating that 40 percent of the total cost savings will come from savings in unregulated  
43 businesses. OCA-I-18, Slide 20. The Company's response to OTS-11 suggests that

1 reductions in the costs of operations in Pennsylvania will account for roughly 30 percent  
2 of total "net regulated savings" predicted by Company Witness Flaherty. I note that the  
3 Settlement would implement average rate reductions of \$50 million per year across the  
4 years 2002 through 2005.<sup>4</sup>  
5  
6

7 **Q. Is the merger expected to enhance the financial position of the Company, beyond the**  
8 **savings opportunities identified?**

9  
10 A. Yes. The merger is anticipated to be accretive to the Companies' earnings per share in  
11 the first year after closing, excluding one-time merger-related charges. September 23,  
12 1999 letter to shareholders. OCA-I-16. This derives in part from new sales opportunities  
13 that are expected to derive from the expanded generation company. The Companies  
14 report that the best growth opportunities are in the generation part of the business.  
15 OCA-I-18, 9/24/99 Meeting Transcript.  
16  
17

18 **Q. Are there other ways in which the merger is anticipated to enhance the Company's**  
19 **financial position?**

20  
21 A. Yes. The Companies believe that the complementary nature of the unregulated  
22 businesses will jumpstart growth into a national company: the infrastructure services  
23 business; the micro-turbine joint venture; and the installed fiber optic system. OCA-I-18,  
24 9/24/99 Meeting Transcript.  
25  
26

### 27 **PART 3: SETTLEMENT ENHANCEMENTS TO PECO'S INITIAL PROPOSAL**

28  
29 **Q. Did you identify a number of concerns related to the Company's initial proposal to**  
30 **the Commission in relation to the effects that the merger might have on ratepayers?**

31  
32 A. Yes, I performed an extensive review of the documents submitted by the Company in  
33 support of its initial proposal to the Commission (i.e., the Company's application, initial  
34 testimonies, and discovery responses). Based on this review I identified several  
35 significant concerns that I believed should be addressed before the requested approvals  
36 were granted. Very generally, these are as follows:  
37

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<sup>4</sup> The Settlement would implement a \$60 million rate reduction (from levels that would otherwise be in effect) in 2002 and 2003, and a \$40 million rate reduction in 2004 and 2005, for a total of \$200 million across the four-year period. See Joint Petition for Settlement at 8.

1 (1) PECO's initial proposal failed to offer ratepayers an equitable share of the  
2 projected merger benefits;

3  
4 (2) PECO's initial proposal threatened to impose on ratepayers unacceptable  
5 levels of risk related to its expanding nuclear operations;

6  
7 (3) PECO's initial proposal failed to offer ratepayers adequate protection from  
8 risks that might lead to a degradation of service quality;

9  
10 (4) PECO's initial proposal failed to address potential effects on the  
11 competitiveness of the new retail electricity market in Pennsylvania; and

12  
13 (5) PECO's initial proposal presented risks that the Commission might lose a  
14 measure of jurisdictional control over the Company's ongoing operations.

15  
16 I note that these concerns parallel those presented to the Commission by the Office of the  
17 Consumer Advocate in its Protest and Prehearing Memorandum in this proceeding.

18  
19  
20 **Q. Does the Settlement address the concerns that you identified with PECO's initial**  
21 **filing?**

22  
23 A. Yes. The Settlement addresses each of the above concerns in the Company's initial  
24 presentation to the Commission. It introduces essential enhancements to the Company's  
25 merger proposal, ultimately achieves a much-improved balance of the costs, risks and  
26 benefits that the merger would bring to ratepayers. I address below the Settlement's  
27 enhancements to the Company's initial proposal, in light of each of the concerns that I  
28 identified. I would also note that the Settlement addressed a wide variety of concerns and  
29 was joined by a diverse group of parties. In this testimony, I address certain issues  
30 identified by the OCA in its Protest in this proceeding. My failure to discuss each  
31 provision of the Settlement should not be interpreted as not supporting the provision, as I  
32 understand that others will be addressing these provisions.

33  
34  
35 **Equitable Sharing of Merger Benefits**

36  
37 **Q. Did you have concerns regarding the level of savings that were to accrue to**  
38 **ratepayers as a benefit of the merger?**

39  
40 A. Yes. As initially proposed, the allocation of merger benefits was too one-sided. The  
41 merger is made possible by a restructuring of regulated markets, the costs of which  
42 ratepayers have largely underwritten. The Company predicts substantial financial  
43 benefits to result from the merger, but had proposed to retain the lion's share of those

1 benefits for itself. As suggested above, the merger would bring to ratepayers a number of  
2 risks. While the Companies and their shareholders might profit handsomely through the  
3 ventures that they are planning to pursue, the initial proposal offered little to ratepayers  
4 by way of fair compensation for imposed risks. Ratepayers were to receive none of the  
5 savings generated during the period of the rate cap (i.e., through June 30, 2005). As  
6 noted above, the Company's response to OTS-11 suggests that, after expiration of the rate  
7 cap, Pennsylvania ratepayers could have enjoyed the benefits of roughly 30 percent of  
8 total "net regulated savings" predicted by Company Witness Flaherty. However, these  
9 benefits could be delayed until the conclusion of a future base rate proceeding that may or  
10 may not occur. In short, nothing was certain where ratepayer benefits were concerned.  
11

12  
13 **Q. Does the Settlement address the level of savings that would accrue to the benefit of**  
14 **ratepayers?**

15  
16 A. Yes. The Settlement introduces an appropriate change to the ratemaking treatment of the  
17 merger, to ensure that ratepayers will receive concrete, immediate, affirmative benefits in  
18 the form of rate reductions. The settlement provides for \$200 million of rate reductions  
19 over a four-year period beginning on January 1, 2002.<sup>5</sup> It also extends the cap on  
20 PECO's transmission and distribution charges, which would otherwise expire on June 30,  
21 2005 under the 1998 Restructuring Settlement, until December 31, 2006. These represent  
22 important improvements to the benefits-sharing mechanisms of the merger proposal, and  
23 offer ratepayers a level of benefits that is well beyond that encompassed by PECO's  
24 initial proposal.  
25

26  
27 **Q. Does the Settlement address the sharing of merger benefits in other ways?**  
28

29 A. Yes. The Settlement provides for enhancements to and the expansion of PECO's  
30 universal service programs for both PECO electric and PECO gas customers. PECO has  
31 agreed to contribute up to \$3 million over three years to local hardship funds throughout  
32 its service territory so that those hardship funds are better able to address the needs of the  
33 very low income customers. This contribution is intended to reach a group of customers  
34 who most require assistance even after a rate reduction.  
35

36 Additionally, the Settlement provides for an expansion of PECO's electric CAP and  
37 addresses any costs of this expansion. Significantly, the Settlement provides that PECO

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<sup>5</sup> I note that PECO has separately agreed to reduce its retail rates by \$60 million for the duration of 2001 pursuant to the terms of a separate settlement of PECO's recent securitization filing in Docket No. R-00005030, as approved by the Commission on March 16, 2000.

1 will receive no additional recovery of CAP costs for up to 90,000 customers beyond what  
2 is already included in its rates. For additional customers that are enrolled in the CAP,  
3 PECO's recovery of costs, which was permitted under the 1998 Electric Restructuring  
4 Settlement, is limited. PECO has agreed that it will recover only the revenue shortfall  
5 associated with customers above the 90,000 level and will forego any right to recover any  
6 other costs of its universal service program. This provision will allow the universal  
7 service programs to serve significantly more customers—again customers who most  
8 require assistance beyond the rate reductions provided—and helps to ensure that the needs  
9 of these customers are not overlooked as the Company merges and increases in size.

10  
11 For the gas CAP, PECO has agreed not to seek recovery of any costs of this program for  
12 the first 17,500 customers. For those customers over 17,500, PECO has again agreed to  
13 only seek recovery of the revenue shortfall amount from ratepayers through its Universal  
14 Service Fund Charge (“USFC”) mechanism. This provision will eliminate a potential  
15 deferral that PECO's gas customers may have been required to pay in the future. It also  
16 allows this program to further expand as the Company merges.

#### 17 18 19 **Risks of the Expanding Nuclear Fleet**

20  
21 **Q. Did you identify a concern related to the various risks to ratepayers presented by**  
22 **the expanding nuclear generating fleet?**

23  
24 A. Yes, I did. The press release issued by the Companies announcing the merger included a  
25 statement by Mr. McNeill to the extent that “We intend to become the premier nuclear  
26 operator in the nation.” I would entertain no reservations with respect to this goal, but for  
27 the fact that PECO ratepayers could become entwined in the risks that will accompany  
28 this ambition. These risks include those related to extended nuclear plant outages,  
29 unanticipated capital additions, nuclear incidents, and escalating decommissioning costs.  
30 The notes from the Companies' conference with Wall Street analysts reveal that some  
31 investors may be concerned about the “great deal of nuclear capacity now housed in one  
32 entity;” suggesting that consolidation may give rise to public policy issues that may need  
33 to be addressed. Conference notes, OCA-I-18, at 19. I was concerned that these various  
34 risks might ultimately manifest in the form of increased capital costs to PECO Energy  
35 Distribution, or diversions of capital away from distribution operations.

36  
37  
38 **Q. Can ratepayers be shielded from these risks?**

39  
40 A. Steps can be taken to mitigate the risks that ongoing nuclear operations present to  
41 ratepayers served by an affiliated electric distribution company. The Settlement  
42 introduces a number of notable improvements in this regard. The Settlement secures  
43 PECO's agreement that it will not seek to recover through Pennsylvania retail electric

1 distribution rates the costs associated with the ownership and operation of any nuclear  
2 generating plants, or any fractional interests in such nuclear generating units, except for  
3 decommissioning costs related to the nuclear generating units that it held on December  
4 31, 1999 (i.e., "PECO's pre-existing nuclear interests"). Importantly, PECO has also  
5 agreed that the cost of capital to be used in establishing rates for electric and gas  
6 distribution services will not reflect any risk adjustment associated with its affiliates  
7 engaged in nuclear operations (or otherwise).  
8

9 In addition, the Company has agreed that, to the extent decommissioning costs for which  
10 ratepayers would remain responsible increase, it will forego recovery through regulated  
11 rates of (1) the first \$50 million of any increase in its decommissioning cost obligations  
12 and (2) five percent of any additional increases.<sup>6</sup> The Settlement also limits PECO's  
13 ability to make investments in and issue debt guarantees for its nuclear (and other)  
14 affiliates. It also includes provisions related to monitoring and waste storage.  
15

16 Finally, the Settlement provides a measure of protection against the capital drain that  
17 could accompany significant problems at a nuclear facility. It requires that, in the event  
18 any nuclear generating unit owned by PECO or a PECO affiliate experiences an incident  
19 or accident that results in uninsured damage claims in excess of \$1 billion, PECO will  
20 notify the Commission and must demonstrate that its net cash flows are sufficient to  
21 support the provision of "safe, adequate, continuous, efficient, reliable and reasonable"  
22 distribution service to Pennsylvania customers "at reasonable rates."  
23  
24

25 **Q. Is it appropriate to assign a portion of the anticipated merger benefits to protect**  
26 **ratepayers from the risk that decommissioning costs might exceed the total amount**  
27 **that is currently being collected through rates?**  
28

29 **A.** As is discussed above, the PECO/Unicom corporate strategy appears focused on pursuing  
30 an expanding nuclear fleet, which does create risks for ratepayers. As a quid pro quo, it is  
31 fair to expect the Companies to set aside a portion of the benefits that they project to  
32 mitigate the concomitant risks.  
33  
34  
35  
36  
37

---

<sup>6</sup> Under the 1998 Electric Restructuring Settlement and the Electricity Customer Choice Act, ratepayers remained responsible for additional nuclear decommissioning cost obligations. PECO was permitted to recover these costs through a nuclear decommissioning adjustment clause ("NDAC").

1     **Degradation of Service Quality, Diversion of Resources**  
2

3     **Q.     Could the merger, as proposed by PECO, threaten to affect the quality of service**  
4     **that might otherwise be enjoyed by distribution customers?**  
5

6     A.     I have identified a number of factors that could have caused service quality to degrade,  
7     or -- equally important -- fail to improve at rates that could otherwise be expected. As I  
8     have indicated above, this merger has been termed a "merger of equals." However, in  
9     some important ways it is not. Unicom is quite a bit larger than PECO, both in terms of  
10     employees (Unicom had nearly 16,000 to PECO's 6,500), utility customers (ComEd has  
11     3.4 million to PECO's 1.5 million) and revenues (Unicom had "more than \$7 billion in  
12     1998," PECO had just over \$5 billion). The new holding company's headquarters will  
13     remain in Chicago. Thus, an imbalance exists that could lead to outcomes that adversely  
14     affect the quality of service enjoyed by Pennsylvania ratepayers.  
15

16  
17     **Q.     In regard to the merger, what other factors raised concerns that service quality**  
18     **could suffer?**  
19

20     A.     There is no secret to the fact that ComEd has experienced some significant reliability  
21     problems at the distribution level across the last few years. In its 1998 annual report to  
22     shareholders, Unicom stated that "outages have occurred at an unacceptable rate in  
23     certain areas for several years." OCA-I-7. That company has found it necessary to make  
24     a number of presentations to the Illinois Commerce Commission, and to authorities in  
25     Chicago. It is not surprising that in his comments at the Annual Meeting of Shareholders  
26     of the Unicom Corporation, John Rowe identified "maintaining reliable service" as first  
27     among the five principal challenges facing the company. OCA-I-15. Nor is it surprising  
28     that, in 1998 ComEd's board of directors approved a plan to implement reliability  
29     improvements by investing \$307 million in T&D capital improvements -- in addition to  
30     the \$1.3 billion already budgeted over the subsequent three years. Thus, the solution to  
31     Commonwealth Edison's reliability problem appears likely to require a sizeable  
32     commitment of management time and financial resources. I was concerned that PECO  
33     ratepayers could experience the adverse consequences if resources necessary to preserve  
34     and enhance distribution reliability were to flow from Pennsylvania to Illinois.  
35

36  
37     **Q.     Do you see potential problems as workforces are combined and reduced, as well as**  
38     **in the expanded range of career offerings that will be presented to PECO employees**  
39     **through the merger?**  
40

41     A.     Yes, ratepayers could be at increased risk for suffering a loss in operational efficiencies at  
42     the distribution level, as employees moved within the Company or positions are  
43     combined and eliminated. This loss could be made manifest in the form of reductions in

1 service quality, customer service, or a diminished rate at which productivity or  
2 distribution service quality might otherwise improve.

3  
4  
5 **Q. Does the Settlement contain provisions that will mitigate the risks that service**  
6 **quality might experience a degradation as a consequence of the merger?**

7  
8 A. Yes. The Settlement also introduces important provisions that will significantly improve  
9 the likelihood that service quality will continue to improve in the years following the  
10 merger. The Settlement would commit PECO to implement a Quality of Service Plan  
11 designed to provide “higher levels” of reliability and customer service in its service  
12 territory. In particular, to implement the Company’s commitment in its testimony to  
13 continue to enhance reliability, the Company has agreed to a level of reliability that is  
14 ten percent higher than its five-year historic average. Additionally, the Company has  
15 committed to reduce the number of customers with repeat outages and to address service  
16 problems on its five worst circuits each year. These commitments will help to ensure that  
17 management attention is appropriately focused on PECO’s service territory.

18  
19 The Company has also committed to targets for its customer service that reflect higher  
20 levels of performance than its recent past, or maintains already high levels of  
21 performance. These customer service commitments are also important in the context of a  
22 merger that could result in the consolidation of some of these customer service functions.

23  
24 The Settlement anticipates a collaborative effort among affected parties to achieve this  
25 end. The Settlement indicates that a number of indices focusing on key aspects of  
26 distribution reliability and customer service will be measured and reported. The  
27 Settlement also specifies the steps to be taken in the event that its performance falls short  
28 of established standards.

29  
30  
31 **Concerns Related to Market Power and Competitiveness**

32  
33 **Q. Please address the Company presentation related to market power?**

34  
35 A. The Company submitted a market power study performed by Dr. William H.  
36 Hieronymus. Dr. Hieronymus’ study focused on the competitiveness of the wholesale  
37 power market. Critical issues related to PECO’s opportunity to engage in  
38 anti-competitive conduct in Pennsylvania’s retail electricity markets were of concern.  
39 Absent suitable controls designed to protect the nascent competition, the merger could  
40 tend to consolidate PECO’s dominant position in retail markets and inhibit the  
41 Commission’s efforts to foster a robust competitive market in Pennsylvania.

1 **Q. Is it appropriate to address issues related to the competitiveness of Pennsylvania's**  
2 **retail markets in this docket?**

3  
4 A. The Commission's investigation into the competitiveness implications of the  
5 PECO/Unicom merger is affected by Section 2811(e) of the Public Utility Code. That  
6 Section indicates that, if a merger is likely to result in anti-competitive conduct,  
7 conditions should be applied to the merger that will "preserve the benefits of a properly  
8 functioning and workable competitive retail electricity market."  
9

10 To avoid the possibility that a further consolidation of PECO's dominant position in its  
11 service territory could tend to diminish competition, it is my view that conditions applied  
12 to the merger that will at least offset this potential effect should be considered. The  
13 Settlement contains several provisions, as addressed below, intended to ensure the  
14 competitive balance such that, taken as a whole, the merger would not adversely affect  
15 market competitiveness. The implementation of these provisions would appear fully  
16 consistent with the terms of Section 2811(e) of the Public Utility Code.  
17

18  
19 **Q. Does the Settlement offer provisions that would offset the potential negative effects**  
20 **that the merger could otherwise have on retail markets in Pennsylvania?**

21  
22 A. It does. Retail suppliers seeking to sell in PJM generally, and PECO's service area in  
23 particular, have complained about an inability to secure cost-effective installed capacity  
24 that they require to meet requirements as load serving entities within PJM. While this  
25 issue may have its root in a problem that extends well beyond PECO, any limited actions  
26 by PECO to alleviate the situation cannot but improve the competitive landscape.  
27

28 The Settlement introduces a mechanism that will give alternate suppliers access to  
29 installed capacity within the Company's control. Appendix C to the Settlement provides  
30 that, at a price of \$52 per MW-day, PECO will make available to licensed electric  
31 generation suppliers 600 MW per day of capacity. This capacity will be made available  
32 on a contract basis, each year, for three years, beginning January 1, 2001. Access to  
33 reasonably priced installed capacity is essential if alternate suppliers are to compete  
34 effectively for retail load. Moreover, PECO's capacity should be surplus to it to the  
35 extent that its customers begin to take advantage of competitive options. Thus, the access  
36 to installed capacity achieved through the Settlement represents an enhancement to the  
37 merger proposal. It should bolster competition in the retail market.  
38  
39

1 **Q. Does the Settlement contain other provisions likely to improve the competitive**  
2 **landscape in PECO's service territory?**

3  
4 A. Yes it does. The Settlement contains provisions intended to facilitate the interconnection  
5 of distributed and renewable energy sources. Among other things, these provisions seem  
6 likely to enhance the range of choice in generation supplies for customers. The  
7 Settlement also contains provisions related to customer billing data, and provisions  
8 related to business interactions with competitive suppliers. These might also serve to  
9 support competitive suppliers in their efforts to expand into Pennsylvania.

10  
11  
12 **Loss of Jurisdictional Control**

13  
14 **Q. Please explain how the Commission actions could have been limited in the future.**

15  
16 A. The Company's application makes clear that, after the corporate restructuring, certain  
17 functions, including accounting and information technology functions, will be performed  
18 by the corporate service company pursuant to a contract that is to be subject to the  
19 jurisdiction of the SEC. In future proceedings, the Company may have argued that  
20 federal law would require the Commission to pass through to ratepayers any costs that  
21 might be incurred by the corporate service company pursuant to the SEC-approved  
22 contract.

23  
24  
25 **Q. Might these same dynamics limit the Commission's ability to control the levels of**  
26 **costs that are recovered through distribution rates, more generally?**

27  
28 A. Yes. The Company's application makes clear that, once the merger and corporate  
29 restructuring are implemented, PECO Energy Distribution may be charged for a range of  
30 services provided by its service company affiliate. The Company has proposed a contract  
31 to govern such transactions, which is jurisdictional to the SEC. It is my understanding  
32 that, if the Commission wanted to disallow (e.g., as excessive or imprudent) some charge  
33 from the service company, the Company may have asserted a claim of federal  
34 preemption.

35  
36  
37 **Q. What provisions would the Settlement implement to ensure that these potential**  
38 **jurisdictional problems do not arise?**

39  
40 A. First, as noted above, the Settlement would impose limitations on PECO's ability to  
41 invest in and guarantee the debt of its affiliates. It also commits PECO to maintain  
42 reasonable accounting controls and other procedures for the allocation of overhead and  
43 other costs, in its transactions with affiliates. Second, the Settlement contains a provision

1 that specifies that the Commission's approval of the corporate reorganization and merger  
2 would not affect PECO's existing legal obligation to comply with all provisions of  
3 Pennsylvania Code, including Chapters 11 and 21 thereof. Third, provisions of the  
4 Settlement will ensure that access to books, records, and personnel will not be inhibited  
5 by the corporate reorganization or merger.  
6

7  
8 **Other Settlement Enhancements to the Merger**  
9

10 **Q. Are there other ways in which the Settlement offers enhancements relative to**  
11 **PECO's initial proposal for implementing the merger?**  
12

13 A. Yes. The Settlement contains a number of provisions that appear likely to offer  
14 additional value to the parties in this proceeding, who represent a broad array of interests  
15 in PECO's service territory. For example, PECO has made commitments related to its  
16 corporate presence in Philadelphia, employment levels at its 2301 Market Street location,  
17 and levels of charitable contributions in Pennsylvania.<sup>7</sup> I do not address these additional  
18 provisions in detail, but observe that they do appear to represent enhancements to the  
19 initial proposal put forth by the Company.  
20

21  
22 **Q. Do you see any evidence that the savings and costs sharing provisions of the**  
23 **settlement will preclude PECO from (1) achieving the reliability and service quality**  
24 **improvements targeted in the Settlement, (2) fulfilling its obligations to safely and**  
25 **effectively decommission its nuclear generating facilities, or (3) meeting its service**  
26 **obligations?**  
27

28 A. I do not. PECO's current financial health is clearly very good. The evidence presented in  
29 this case indicates that the rate reductions accommodated through the Settlement will  
30 represent only a portion of the total financial benefits that will accrue to the merged  
31 companies. Information provided by the Companies suggests that these monies will be  
32 available in full to support the rate reductions. OCA-I-18, 9/24/99 Meeting transcript  
33 at 15. Indeed, the Company indicates that "PECO expects to 'pay for' the rate reductions,  
34 at least in substantial part, with synergies generated by the [corporate] restructuring and  
35 merger. As such, no impairment of PECO's financial condition is anticipated." Hill  
36 Supplemental Testimony at 8. There is no reason to believe that any future commitments  
37 for cost sharing would be in jeopardy.

---

<sup>7</sup> I note that Company Witness Hill's Supplemental Testimony identifies some more recent commitments related to staffing levels in Philadelphia. An April 27, 2000 letter from PECO to James J. McNulty, Secretary, Pennsylvania Public Utility Commission, documents several additional commitments to the City.

1     **Q.    Does this conclude your testimony?**

2

3     **A.    Yes, it does.**

4

5     58150

**RICHARD LA CAPRA**  
*La Capra Associates*  
Principal

**Richard La Capra**, Principal, has over thirty years of experience in consulting to the electric industry in various capacities. His experience has encompassed financial, ratemaking, load research, and supply planning issues. His background also encompasses overseeing competitive power and contract negotiations. Mr. La Capra has negotiated restructuring settlements and provided direction for both feasibility and siting of new power plants. He has been involved in major restructuring activity in all six New England states, as well as other parts of the country and overseas. In his career, Mr. La Capra has served over 100 domestic clients and foreign clients. His primary interest has been in the energy arena, but he has also testified on telecommunications, water resources, and the regulated taxicab industry. Mr. La Capra has been an invited lecturer at many conferences along with authoring articles which have been published in professional journals. Mr. La Capra is the Principal in charge of La Capra Associates.

**ACCOMPLISHMENTS**

Provided expert testimony in over 25 states and federal jurisdictions in the areas of pricing policy, industry restructuring, project feasibility, auction procedures, and wholesale markets.

Advised on several major U.S. and international utility mergers.

Reconfigured VEC power supply and negotiated with management the restructuring of \$100 million of federal debt through negotiation and bankruptcy.

Provided advice to numerous public and private utilities in the areas of contract negotiations, mergers, asset divestitures and acquisitions, and power procurement.

Served as Principal Consultant to the Electric Power Research Institute in the areas of electric utility costing and ratemaking.

Assisted in the financial reorganization of a cooperative utility, including restructuring \$100 million of debt and reconfiguring its power supply assets and contracts.

Negotiated transmission contracts, wheeling rates, and distributions leases for a number of utilities and independent power producers.

Managed developmental load research programs in six mid-western and eastern states.

Developed and presented professional development programs for the Electric Council of New England, the Center for Professional Advancement, the New England Rate Forum, the Electric Power Research Institute, the American Gas Association and the University of Missouri.

Directed feasibility studies assessing privatization potential for publicly owned facilities.

Served as Economic Advisor to the City of Boston in the development of hackney carriage rates and the establishment of a market based number of hackney medallions.

Managed the analyses and sponsored valuation assessment of utility distribution and production property from income and market bases both utilities and municipal governments.

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CERTIFICATE OF SERVICE

Re: Application of PECO Energy Company, Pursuant to Chapters 11, 19, 21, 22, and 28 of the Public Utility Code for Approval of (1) A Plan of Corporate Restructuring, Including the Creation of a Holding Company and (2) The Merger of the Newly Formed Holding Company and Unicom Corporation  
Docket No. A-110550F0147

I hereby certify that I have this day served a true copy of the foregoing document, OCA's Testimony of Richard LaCapra upon parties of record in this proceeding in accordance with the requirements of 52 Pa. Code § 1.54 (relating to service by a participant), in the manner and upon the persons listed below:

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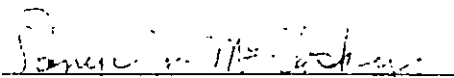
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