

**Comments of
Exelon Corporation**

**Committee on Ways and Means
Energy Tax Reform Working Group
United States House of Representatives**

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Exelon Corporation is a holding company headquartered in Chicago. Our retail utilities, ComEd in Chicago, PECO in Philadelphia, and BG&E in Baltimore, serve 6.6 million customers in central Maryland, northern Illinois, and southeastern Pennsylvania, making Exelon one of the largest electric and natural gas utility companies. Our generation subsidiary, Exelon Generation, is one of the top competitive power generators in the country and owns or controls approximately 35,000 MW of generating facilities, including fossil, hydro, nuclear, and renewable energy. Exelon is the largest owner and operator of nuclear power plants in the nation and the third largest in the world. Our nuclear fleet consists of 17 reactors, as well as an ownership interest in an additional seven reactors.

Exelon supports the efforts of the House Ways and Means Committee to reform the Internal Revenue Code (Code), as does the electric sector more broadly. The Edison Electric Institute (EEI) is submitting comments on behalf of the industry overall and we support those comments, as well.

Exelon is supportive of meaningful corporate tax reform because we recognize that a simplified tax code without special interest provisions will allow competition in domestic markets to work more efficiently while at the same time permitting a reduction of the corporate tax rate to enable the U.S. to compete more effectively on a global basis.

Exelon does not support market-distortive subsidies. The most egregious example in the electric power industry is the wind production tax credit (PTC), which undermines the value of existing generation resources and deters future private investment by distorting competitive markets and incentivizing new power plants where none are needed. Nor do we support changes to the tax code that seek to advantage one energy technology over another. Tax reform presents an opportunity to promote competitiveness at home as well as abroad and end costly and destructive tax policies.

As Congress embarks on tax reform, we would like to offer the following recommendations:

- Broaden the tax base – Tax reform should simplify and streamline deductions, exclusions, credits, and other tax benefits. To the extent practical, such benefits should be industry and technology neutral. The proliferation of these provisions has driven the excessive complexity in the current code and has allowed for a certain degree of abuse, which drives higher rates and adversely impacts competitiveness. Broadening the base

also would allow the U.S. Treasury to collect revenues more representative of the marginal rate, which would be reduced in conjunction with broadening the base.

- Lower the corporate tax rate – The proceeds of the broadened tax base should be utilized to lower the corporate tax rate. The current 35 percent corporate tax rate is the highest in the developed world. Lowering the rate will make the U.S. more competitive with the rest of the world.
- Recognize that the electric power sector is no longer monolithic – With nearly half of Americans living in states with competitive energy markets, policy solutions that may have a minimal impact in some regions of the country can have significant negative unintended consequences in other regions.
- End energy tax subsidies, particularly the PTC for renewable energy resources, the PTC for advanced nuclear power facilities,¹ as well as the alternative fuel mixture, marginal well, and enhanced oil recovery tax credits for oil and gas – These costly subsidies are distorting power markets and preventing unsubsidized investments needed to maintain the reliability of the electric grid.

Our comments will focus on the latter recommendation, which is a prime example of how ad hoc tax policy can yield harmful unintended consequences and why there is a need to reform the tax code.

Competitive Markets for Electricity

As the nation's leading competitive energy provider, Exelon maintains a strategic presence in key competitive power markets and believes that competitive electricity markets deliver choice, innovation and value for residential and business customers. Exelon's competitive wholesale and retail energy businesses serve approximately 100,000 business and public sector customers and approximately 1 million residential customers across the U.S. and Canada.

Competition has been growing rapidly:² customers using competitive suppliers have grown by more than 53 percent, from 8.7 million in 2008 to 13.3 million in 2011. Residential accounts served by competitive suppliers have increased by more than 3.8 million, or 54 percent, to nearly 11 million in the same period. However, while competitive markets for power have flourished in places like the Mid-Atlantic, Northeast, Midwest, and Texas, to name a few, a significant portion of our nation is still served by vertically integrated utilities.

The distinctions between the competitive and vertically integrated or regulated models are especially salient to consideration of tax reform in the utility context because tax policies impact utilities in each sphere differently. We would encourage policymakers to be mindful of this in

¹ Unlike the PTC for wind and other renewable sources, the advanced nuclear PTC is limited to (1) a total national capacity of 6,000 megawatts, (2) the ratio of the allocated capacity that the taxpayer receives from the Treasury Department to the rated nameplate capacity of the taxpayer's facility, and (3) \$125 million in tax credits per 1,000 megawatts of allocated capacity in a given year. Additionally, the only entities qualified to take advantage of the nuclear PTC operate in regulated environments, where the market impacts would be muted.

² Phillip R. O'Connor, PhD, "Customer Choice in Electricity Markets: From Novel to Normal," November 15, 2010.

crafting policy: policy solutions that may have a minimal impact in some regions of the country can have significant negative unintended consequences in other regions.

Energy competition promotes numerous benefits, including customer choice; innovative energy; technologies and services; long-term savings opportunities; economic development and job creation; energy supply reliability; improved generation performance; and clean energy resources. However, for much of the utility sector's history, the businesses that developed and maintained our electric system were vertically integrated utilities, most but not all of which were investor owned utilities or IOUs. These utilities historically have been subject to regulation by the Federal Energy Regulatory Commission and its predecessors under the Federal Power Act (FPA) and by state regulatory commissions.

Vertically integrated utilities control all segments of the utility business, owning generation, transmission, and distribution (or delivery) facilities that provide power to their captive retail customers. Vertically integrated utilities built their systems with approval from state utility commissions that permitted them to recover their costs along with a reasonable rate of return from their customers in exchange for providing service to all entities within their respective service territories.

In competitive markets, power suppliers compete against each other at both the wholesale and retail levels to provide the best possible service at the lowest cost in order to attract and retain customers. Comparatively, in monopoly-regulated states, incumbent power providers have no incentive to innovate or lower costs because ratepayers are captive to their monopoly-protected supplier. Indeed, these monopoly providers earn a higher return if their expenses are higher. Competitive electricity markets are well-structured, with effective regulatory oversight while delivering economic and environmental benefits to consumers. These markets have been restructured to promote competition among energy market participants, while maintaining strict regulatory oversight to protect customers.

Renewable Energy Subsidies in Competitive Markets

Tax subsidies in the Code are having a strongly adverse effect on competitive markets today. Tax subsidies, some of which are over 20 years old, have been used to incent the development of renewable energy resources throughout the U.S. However, these incentives are actually distorting markets to the point of driving the retirements of existing baseload power resources, as well as precluding critical investments in new unsubsidized generation needed to maintain a reliable electric grid.³ Distortive energy subsidies come in a variety of flavors. Since 1992, the renewable sector has been able to utilize subsidies like the PTC, investment tax credit, and even take a grant in lieu of tax credits under the section 1603 grant program. The PTC is proving to be perhaps the most distortive of these subsidies to U.S. electricity markets because it provides renewable project developers with an incentive to produce power regardless of whether or not there is a market demand for new production.

³ When discussing the announced retirement of Kewaunee nuclear power plant, Dominion CEO Thomas Farrell stated "low natural gas prices and large volumes of new wind generation made it impossible for the company to continue operating the plant [Kewaunee Nuclear Plant] in a market that did not pay for capacity."

First established by the Energy Policy Act of 1992, the PTC was intended to be a temporary measure to jump start renewable energy production. Since its establishment more than 20 years ago, the PTC has expired three times and been extended on eight occasions – most recently as part of the American Taxpayer Relief Act of 2012 (ATRA) or fiscal cliff legislation. Most of these extensions have been for a period of one or two years, and several extensions have amended the list of qualifying facilities or factors. Under current law, the credit will expire on December 31, 2013. However, the extension included in ATRA revised section 45(d) of the Code, which defines “qualified facilities” for purposes of determining eligibility for the PTC. Most notably, Section 45(d) of the Code now requires construction to “begin” on the property in question before January 1, 2014, instead of placing such property in service before the designated date, which was the previous standard. Depending upon how the Treasury Department interprets this language, this last extension could, for all practical purposes, effectively equate to an indefinite extension of the subsidy.

Originally, the PTC allowed wind power producers to claim a tax credit of 1.5 cents per kWh of electricity produced from wind and sold to unrelated parties. Since 1992, the PTC subsidy amount, which was indexed for inflation, gradually increased over time. The credit amount for 2013 is 2.3 cents per kWh.⁴ An installed wind project is eligible for the credit for the first 10 years after it is placed in service. Despite other qualifying technologies, wind is overwhelmingly the most prominent PTC resource.

And the PTC does not come without a cost. In fact, the Joint Committee on Taxation estimated that the latest extension of the PTC for just one year would cost taxpayers \$12.18 billion. The recent increase in the value of the PTC by the U.S. Department of the Treasury has been estimated to increase that cost by an additional \$540 million. Even if the credit were allowed to expire at the end of this year, the federal government is still committed to nearly \$10 billion in future tax credits for previously qualifying wind projects. Additionally, wind power received additional subsidies valued at over \$10.8 billion from the stimulus or ARRA legislation.⁵

Wind Energy’s Profile

Unlike conventional nuclear, coal, and gas power plants, wind is intermittent and produces power only when it blows, mainly at night. Wind rarely blows when it is needed the most during the day’s hottest hours. For instance, in Texas, which is the second largest U.S. producer of wind and sixth in the world, the state’s grid operator, the Electric Reliability Council of Texas (ERCOT), reports that 91.3 percent of its wind capacity fails to perform during periods of greatest demand. More recently, during the Midwest’s July 2012 heat wave, 95 percent of wind in Illinois failed to produce power, resulting in only 120 MW of electricity from more than 2,700 MW installed. On July 6, 2012, a record-breaking, 100 degree plus, high electricity demand day, wind was virtually non-existent, producing a paltry 4 MW of power.⁶ In the Pacific Northwest, on October 16, 2012, Bonneville Power Administration’s (BPA) system experienced

⁴ Before tax this equates to 3.5 cents per kWh or \$35 per MWh, assuming a 35 percent federal corporate income tax rate.

⁵ According to the U.S. Department of the Treasury the Section 1603 Amount for large wind is over 10.8 billion as of December 5, 2012. See <http://www.treasury.gov/initiatives/recovery/Pages/1603.aspx>.

⁶ Jonathan Lesser, “Wind Power in the Windy City: Not There When Needed,” Energy Tribune, July 25, 2012.

approximately six-hours where wind generation accounted for 70 percent of the load. Similar to the Illinois example and highlighting the unpredictability of wind generation, the next day, wind output fell to close to zero MW. This drop in wind generation was replaced with more reliable megawatts from hydro power which ramped up to about 6,750 MW and thermal generation which climbed to about 5,250 MW, according to BPA.⁷

While the unpredictability and unreliability of wind may appear to be a problem that only affects the wind generators themselves, it is a problem that could eventually jeopardize the reliability of the power grid for everyone as subsidized wind displaces more reliable generation sources that can be dispatched to meet demand.

Although they generate an extremely small percentage (2.3 percent in 2010) of total U.S. electricity, and fail to produce power when it is needed the most, wind companies receive 42 percent of all direct federal energy subsidies and support.⁸ In comparison, coal, natural gas, and nuclear electricity generated 90 percent of the country's electricity in 2010, but only received 36.5 percent of the federal subsidies and support. In addition, wind power receives a much higher level of subsidies per megawatt produced than other forms of generation. A July 2011 U.S. Department of Energy study found that oil, natural gas, and coal received an average subsidy of 64 cents per MWh in 2010. In comparison, wind power received nearly 100 times more or \$56.29 per MWh. Between 2007 and 2010, total energy subsidies rose 108 percent, but wind's increased 1,000 percent.

The wind PTC has accomplished its goal of jump-starting the wind industry and should be allowed to expire. Over 60,000 megawatts of wind generation have now been built in the United States, and wind has accounted for over 35 percent of all new generation built in the last five years.

But, even with the PTC, wind power remains very expensive. EIA estimates the levelized costs of wind generation resources entering service in 2016 to be approximately \$149 per MWh while a natural gas-fired conventional combined cycle generator's are projected to be approximately \$83 per MWh. Additionally, this levelized cost of wind does not include the costs from needed back-up generation when the wind is not blowing or needed expensive transmission to bring the wind power to load centers.

A common misconception is that expanding wind enhances the nation's energy independence and serves to wean the U.S. from foreign oil. The reality is that wind plays virtually no role in improving U.S. energy security. The vast majority of oil consumed in the U.S. is in the transportation sector; oil accounts for less than one percent of U.S. electric generation. Thus, increasing wind power will not reduce U.S. consumption of foreign oil and is not a solution for energy independence. Ironically, the retirement of baseload generation attributable to subsidized wind may actually result in increased consumption of oil in the power sector as those units,

⁷ Ethan Howland, "In a first, wind exceeds hydro in BPA region," Platts Megawatt Daily, October 9, 2012.

⁸ Energy Information Administration (EIA), *Direct Federal Financial Interventions and Subsidies in Energy in Fiscal Year 2010*, July 2011, <http://www.eia.gov/analysis/requests/subsidy/pdf/subsidy.pdf>. (Among the specific fuels and technologies, wind plants received the largest share of direct federal subsidies and support in FY 2010, accounting for 42 percent of total electricity-related subsidies.)

rarely called upon today, are utilized more to fulfill demand for power that baseload generation will no longer be present to meet.

Unintended Consequences of the PTC

In all electricity markets, supply and demand must be matched precisely at all times. Too much supply, or too much demand, can destabilize the power grids and lead to blackouts and brownouts. During times of peak demand, prices rise as supply tightens. Higher price signals tell power plants to run. Conversely, in times of low demand, prices fall, telling generators to shut down so that the grid is not overloaded.

Since the PTC is directly tied to the amount of electricity generated, wind producers routinely sell their electricity for nothing or even pay wholesale consumers to take their power as long as the subsidy exceeds this negative price. In some areas, negative pricing occurs as much as 12 percent of the time. This market distortion forces clean, but unsubsidized, energy generation to operate at losses or not at all.

For example, a wind generator would still make money even if prices in the market were \$0 or below because of the value it receives from the PTC which equals \$35 per megawatt-hour (MWh) of wind produced on a pre-tax basis. Therefore, even if the market price was zero, the wind producer would receive \$35 for each MWh produced. In fact, even if the market price was -\$25 per MWh, meaning the generator would have to pay the grid operator to take the power, the wind producer would still make \$10 per MWh. However, other unsubsidized and more reliable forms of generation would also have to pay the market \$25 per MWh to operate, forcing a loss. To add some additional perspective to these numbers, consider that the PTC at \$35 per MWh is alone worth more than the average U.S. wholesale commodity price for electricity, which is approximately \$28 per MWh.

According to the Breakthrough Institute, many private firms have focused principally on ramping up production for the PTC-subsidized market rather than pioneering next generation designs and manufacturing processes for the long-term. They argue that over a long period of time, blunt subsidies like the PTC can disincentivize innovation or support “dead end technologies that have no viable path to long-term competitiveness.” In fact, the Congressional Research Service (CRS) has stated that “[a]llowing the PTC to expire may motivate wind equipment manufacturers and developers to take certain actions (e.g., maximize turbine performance, minimize manufacturing costs) necessary to make wind electricity more broadly competitive on an unsubsidized basis. These actions could potentially result in a stronger and more robust, although possibly smaller, wind industry that can compete directly with all sources of power generation.”⁹ This is a position echoed just last month by Patrick Jenevein, CEO of Dallas-based wind developer Tang Energy. Jenevein noted that “[g]overnment subsidies to new wind farms have only made the industry less focused on reducing costs. In turn, the industry produces a product that isn't as efficient or cheap as it might be if we focused less on working the political system and more on research and development.”¹⁰

⁹ Phillip Brown, “U.S. Renewable Electricity: How Does the Production Tax Credit (PTC) Impact WindMarkets?” Congressional Research Service, June 20, 2012.

¹⁰ Patrick Jenevein, “Wind Power Subsidies? No Thanks.” The Wall Street Journal, April 1, 2013.

The PTC Alone Does Not Drive Wind Development

It is important to note that the PTC is only one factor that drives wind development. Other factors include state renewable portfolio standards (RPS), U.S. electricity demand growth, and natural gas prices.¹¹ Twenty years ago, when the PTC was created, there were no state RPS policies. Today, according to the CRS, state RPS policies are the primary driver for renewable electricity growth, including wind. Thirty states and the District of Columbia have mandates for renewable electricity and seven other states have renewable energy goals. Analysis by the Lawrence Berkeley National Laboratory indicates that approximately 27 gigawatts (GW) of non-hydro renewable electricity capacity was added in states with RPS policies between 1998 and 2010 with 92 percent of these additions coming from wind. Approximately 4-5 GW of annual renewable electricity capacity will be needed to meet existing state RPS standards between 2011 and 2025. When existing state mandates are met, wind will represent 8-10 percent of our electricity supply. Thus, even without the PTC, significant quantities of wind will continue to be built.

Natural Gas Is a Game Changer

The final factor impacting wind development is the price of natural gas. Natural gas drives which generating technologies are economic and which are not. When natural gas prices are high, wind and other resources are more cost competitive. When prices are low, it reduces or eliminates the economic competitiveness of wind and other resources.

When the PTC was created, natural gas prices were expected to remain moderate to high. As few as four years ago, natural gas prices were at all-time highs. However, the shale gas revolution has provided the U.S. with easy access to cheap, abundant, domestic natural gas resources. The U.S. is now the second largest producer of natural gas in the world. The Colorado School of Mines estimates that from 2000 to 2010 supplies of natural gas in the U.S. increased by 71 percent. These new supplies have caused the price of natural gas to drop significantly. At its peak, gas traded for more than \$13 per mmbtu, but today it is trading at about \$4 per mmbtu (after falling below \$2 per mmbtu during 2012). Today, shale gas has dramatically lowered the price of natural gas and challenged the economics of every generating technology, including nuclear, wind, and coal generation. New wind development costs more than \$1000 per MWh when one considers its relatively low output and low capacity factor. Federal subsidies, including the PTC, can shift a portion of these costs from electric ratepayers to federal taxpayers and disguise the cost to consumers, but they do nothing to improve the overall economics. Wind, like other technologies, simply does not make economic sense in the current low gas price environment.

¹¹ See David E. Dismukes, Removing Big Wind's "Training Wheels": The Case for Ending the Federal Production Tax Credit (American Energy Alliance, November, 1, 2012). Available at: <http://www.enrg.lsu.edu/news/492>

The PTC Is Driving Baseload Retirements and Deterring Unsubsidized Investments

The anticompetitive effect of the wind subsidy is already being felt in power markets today, driving retirements of existing baseload resources and deterring unsubsidized investments – both of which are needed to retain a reliable and affordable electric system in the long term. PPL Montana COO Pete Simonich in discussing the closure of a baseload coal plant in Billings, Montana, stated that “[w]ind farms can make a profit even in low demand time of the season . . . because they can pay people to take their electricity.” He also noted that “[t]here’s nothing wrong with wind. It’s a good, clean energy source. What we want to see is a level playing field for our plants. What bothers us is that there are actually companies paying people to take their power.”

Similarly, Dominion closed its Kewaunee nuclear plant in Wisconsin citing low wholesale electricity prices. These low prices are due in significant part to low natural gas prices and large volumes of new wind generation in the Midwest.¹²

The wind PTC is also preventing investments necessary for maintaining an adequate supply of around-the-clock power. This is particularly a problem in Texas where growth in demand necessitates new generation. Public Utility Commission of Texas Chair Donna Nelson noted the following:

“Federal incentives for renewable energy . . . have distorted the competitive wholesale market in ERCOT. Wind has been supported by a federal production tax credit that provides \$22 per MWH of energy generated by a wind resource. With this substantial incentive, wind resources can actually bid negative prices into the market and still make a profit. We’ve seen a number of days with a negative clearing price in the west zone of ERCOT where most of the wind resources are installed. . . . The market distortions caused by renewable energy incentives are one of the primary causes I believe of our current resource adequacy issue. . . . [T]his distortion makes it difficult for other generation types to recover their cost and discourages investment in new generation.”¹³

New Tax Subsidies for Renewable Energy Are Not Needed

As the cost and detrimental impacts of current policy are still being felt, many proponents of renewable energy are seeking not merely a continuance of current policy, but also the addition of new costly tax subsidies. The power industry is one of the most capital intensive industries in the U.S. and, regardless of whether a company operates in a vertically integrated model or a competitive market, securing cheaper financing is critical to reducing costs for customers and building new resources. While we recognize the need to seek new ways to lower our costs of capital, we do not support new tax policies that would pick technology winners and losers. One such proposal seeks to change the Code to allow renewables to qualify for Master Limited

¹² Dominion CEO Thomas Farrell in comments at *The Wall Street Journal's* ECO:nomics Conference on March 22, 2013: “low natural gas prices and large volumes of new wind generation made it impossible for the company to continue operating the plant [Kewaunee Nuclear Plant] in a market that did not pay for capacity.”

¹³ Testimony of Donna Nelson, Chair, Public Utility Commission of Texas before the Texas Senate Natural Resources Committee, September 6, 2012.

Partnerships (MLPs). An MLP is a special business entity that is permitted to raise capital like a corporation and be traded on public exchanges, yet be taxed as a partnership. This means that, unlike corporations, any MLP income – 90 percent of which must be passed through to its investors – would only be subject to one layer of taxation. While permitting renewable projects to qualify as MLPs would lower such projects' cost of capital, it would do so at the expense of more reliable baseload generation, as other technologies capable of meeting the around the clock need for power would not be eligible for such treatment and placed at a competitive disadvantage. It is counterproductive to tax reform efforts to allow certain tax subsidies like the PTC to expire only to add new market-distorting subsidies for select energy technologies on a preferential basis.

Conclusion

Exelon is the leading U.S. competitive energy provider, with one of the cleanest and lowest-cost power generation fleets and largest retail customer bases in the country. It is also the nation's 11th largest wind generator and anticipates making future investments in new wind generation.

Exelon has publicly expressed opposition to the extension of the PTC and questions the merits of this subsidy. However, Exelon has long maintained that we would avail ourselves of prevailing law for future projects. Why should federal taxpayers continue to pay for companies to develop these projects, many of which are not needed? The fact that companies like Exelon that own wind and have utilized the credit are advocating for its expiration should speak volumes as to the merits of addressing the end of this unnecessary subsidy in corporate tax reform efforts. Wind generation is now a mature energy technology with more than 60,000 megawatts of installed generated capacity and no longer needs this subsidy to sustain and grow the industry.

In conclusion, Exelon recommends that in reforming the Code, the Committee: 1) broaden the tax base to remove unnecessary tax loopholes; 2) reduce the corporate tax rate to promote greater competitiveness; and 3) eliminate energy tax subsidies such as the PTC that undermine unsubsidized investment and the reliable operation of the electric grid.

The Members of the Ways and Means Committee have an important and quite rare opportunity to dispatch with policies like the PTC that have outlived their usefulness and develop the low rates that will drive us towards a more competitive future at home and abroad.