

THE WALL STREET JOURNAL.

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Exelon Rex

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December 1, 2005; Page A17 - SPRINGFIELD, ILL.

Any minute now, an administrative law judge will recommend a method for Illinois electricity deregulation. His recommendation could defend the interests of Illinois consumers, or it could help an Illinois energy company pull a fast one.

In 1997, as part of a move to deregulate Illinois's retail electricity market, Exelon Corp.'s utility subsidiary, Commonwealth Edison Co. (which serves the northern third of Illinois), and other Illinois utilities were barred from increasing retail electricity rates for 10 years. Now, with the end of the rate freeze in sight, ComEd has proposed an auction market for electricity in what has heretofore been a highly regulated industry. But before we describe ComEd's auction proposal, a little background goes a long way to illuminate just why ComEd's proposal is what it is.

ComEd is a wholly owned subsidiary of the Exelon Corp., which also owns Exelon Generation. Exelon Generation is a huge generator of electricity derived primarily from nuclear power plants once owned by ComEd and then transferred to Exelon Generation. It's all quite incestuous and confusing but nonetheless important to understand: ComEd is owned by the same company that owns Exelon Generation. Exelon Generation is the principal supplier of electricity to ComEd, which no longer owns any generating plants. It is obviously in ComEd's interest to have Exelon Generation make as much money as possible. For ComEd's auction proposal or any other proposal to go forward, the Illinois Commerce Commission must approve. An administrative law judge who has heard oral testimony and read briefs will issue a proposed order soon. The ICC is expected to make a final decision in January.

ComEd's proposed auction would start by setting a very high purchase price for electricity and then asking all qualified electricity suppliers how much they would be willing to supply at that very high price. With a high enough price, far more than 100% of ComEd's need would be offered by potential suppliers. The price is then allowed to decline in discrete amounts (a "reverse" auction) until a price is found at which the total amount offered by all suppliers is equal to ComEd's need.

In ComEd's proposal the auction is halted at the so-called market-clearing price and all sellers receive that same uniform price - even those suppliers, like Exelon Generation, that might have been willing to sell at lower prices because their generation costs are very low.

Significantly, under ComEd's proposal all bidders would be told how much energy other bidders are willing to supply at each price as the auction proceeds. ComEd spokespeople describe this as transparency. But to us, it is simply an inducement for the suppliers to collude.

ComEd's proposal makes sense from its perspective. Higher prices for electricity supply directly benefit

Exelon Generation, and thereby the parent company of both ComEd and Exelon Generation. Any proposal by ComEd that didn't benefit Exelon Generation disproportionately would be a breach of Exelon Corp.'s fiduciary duty to its shareholders.

ComEd's "uniform price" approach, however, violates a basic tenet of public policy: providing the lowest prices for consumers. Stopping the auction when the amount offered equals the amount needed starts at the wrong end of the supply curve. Meanwhile, showing each bidder all the other bids encourages implicit collusion. You don't have to be an industry expert to predict that ComEd's approach will result in consumer prices well above those reached in a truly free market. ComEd's proposal is particularly objectionable in Illinois because utility consumers long ago paid to build the nuclear plants now owned by Exelon Generation.

It would be much better to let the market operate freely under a "pay as bid" reverse auction, instead of the "uniform price" auction ComEd proposed. A pay-as-bid approach allows suppliers to continue to bid in the auction until no bidder is left willing to supply electricity at lower prices.

Under such an approach, some bidders could not afford to lose out on any sales because most of their costs are fixed and

there is substantial excess generating capacity in the Illinois market. Therefore, they would continue to offer supply at ever-lower prices in order to guarantee full sales. This way, bidders with generating plants that produce low-cost electricity (read Exelon Generation) would bid much closer to their costs of production in order to ensure success in the auction.

And obviously, bids would have to be kept private so no one could game the auction. Under this approach, Exelon Generation would still come out ahead because its costs of production are low, but consumers would benefit as well through lower electricity charges. This method would best facilitate real electricity competition.

We suggested this to the ICC in testimony on behalf of the Building Owners and Managers Association of Chicago. Not surprisingly, Exelon Corp. strongly disagrees with us. Exelon CEO John Rowe has even raised the specter of a ComEd bankruptcy if ComEd does not get its way. But Gov. Rod Blagojevich's office summarily dismissed the threat, saying, "This is a debate over what is best for consumers in Illinois, not what is best for Exelon."

Energy costs have arguably become the single most important cost factor in our nation's economy. Month after month, the energy component of U.S. price indexes dominates overall measures of inflation, and energy imports are the largest swing factor in our balance of trade. Therefore, it is essential to ensure that energy markets are fully competitive so that energy prices can be as low as possible. The battle in Illinois could yield a significant step toward effectively functioning competitive energy markets and lower prices; or it could signal a retreat to the days of undue utility power, creating pressure to return to the days of prohibition of electricity competition - a scenario that would benefit no one.

It's all up to the ICC.

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