BEFORE THE
NEW YORK STATE
PUBLIC SERVICE COMMISSION

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Joint Petition of IBERDROLA, S.A.,
Energy East Corporation, RGS Energy Group, Inc.,
Green Acquisition Capital, Inc.,
New York State Electric & Gas Corporation and
Rochester Gas and Electric Corporation for
Approval of the Acquisition of
Energy East Corporation by IBERDROLA, S.A.

Case 07-M-0906
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**REPLY BRIEF OF JOINT PETITIONERS
IBERDROLA, S.A. AND ENERGY EAST CORPORATION**

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I. EXECUTIVE SUMMARY

This proceeding involves a straightforward purchase of the stock of Energy East Corporation ("Energy East"), the parent company of New York State Electric & Gas Corporation ("NYSEG") and Rochester Gas and Electric Corporation ("RG&E"), by Iberdrola, S.A. ("Iberdrola") (collectively, the "Joint Petitioners") (the "Proposed Transaction"). The Joint Petitioners have demonstrated with a preponderance of evidence that the Proposed Transaction will provide significant, wide-ranging benefits to NYSEG's and RG&E's ratepayers and the State of New York, including but not limited to financial stability, global energy expertise, a focus on efficiency and the environment, and job retention. In addition to these benefits, the Joint Petitioners accepted a number of the parties' positions in this proceeding (the "Partial Acceptance") (Exh. 50), including acceptance of over $201 million in proposed positive benefit adjustments ("PBAs") which translates into approximately $54.8 million in immediate annual delivery rate reductions (on average a 4.4% reduction) for Energy East's New York customers. The Joint Petitioners also stipulated to seventeen additional conditions.[1] The record shows that the benefits of the Proposed Transaction clearly outweigh any perceived risks and, thus, the Public Service Law ("PSL") standard applicable to the Proposed Transaction - whether the transaction is in the public interest (PSL Section 70) - is satisfied.

On April 11, 2008, a number of parties, including the Joint Petitioners, filed Initial Briefs. In reviewing the Initial Briefs, it became apparent to the Joint Petitioners that they could accept and commit to additional conditions proposed by the parties beyond those already identified in the Partial Acceptance. Although not necessary to meet the public interest standard, the Joint Petitioners would agree to accept the following additional conditions:

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1 Case 07-M-0906 - *Initial Brief of Joint Petitioners Iberdrola, S.A. and Energy East Corporation*, at 3-6 (Apr. 11, 2008) (hereinafter "Joint Petitioners IB").

- **Divestiture Auction Proceeds** - The Joint Petitioners commit to share with ratepayers, in a manner and amount to be determined by the Commission, the above-book proceeds resulting from the auction of Energy East's divested fossil assets. The Commission's discretion on sharing of above-book proceeds could mean that Joint Petitioners would retain as low as 10% of net auction proceeds as a sales incentive, with the remaining proceeds being returned to customers.[2]

- **Post-Auction Collaborative** - The Joint Petitioners commit to participate in and accept the result of a post-auction collaborative process with interested parties following closing of the Proposed Transaction to determine how and when the net proceeds will be returned to customers (*Id.* at 8).

- **Economic Development Incentives** - The Joint Petitioners commit to the continued use of economic development incentives, including the use of Flex Rate contracts, to retain and attract industry and large customers to upstate New York. The Joint Petitioners commit to directing NYSEG and RG&E to continue and, if possible, enhance these programs as part of the subsequent rate proceedings.[3]

- **Economic Development Collaborative** – The Joint Petitioners commit to establish a collaborative process with interested parties following closing of the Proposed Transaction to discuss possible allocations to customers of the energy component of the hydroelectric power produced by NYSEG and RG&E (*Id.* at 10).

- **RGS Costs -** The Joint Petitioners commit that they will not seek recovery of the acquisition premium or costs associated with the Energy East/RGS merger in future rate proceedings (*see* discussion *infra* at 58).

- **Affiliate Transaction Rules –** The Joint Petitioners commit, following closing of the Proposed Transaction, to comply with the existing Affiliate Transaction Rules, (sometimes referred to as a "Code of Conduct"), and will agree to substitute Iberdrola for the term "Energy East" in those Affiliate Transaction Rules (*see* discussion *infra* at 35).

The benefits of the Proposed Transaction and the conditions accepted by the Joint Petitioners, including those outlined above, are set forth in more detail in Attachment 1. The Joint Petitioners' commitment to provide these substantial and immediately quantifiable ratepayer benefits (in addition to the myriad other public interest benefits that are not

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2 Case 07-M-0906 - *Initial Brief of the New York State Consumer Protection Board*, at 7-8 (Apr. 11, 2008) (hereinafter "CPB IB").

3 Case 07-M-0906 - *Initial Brief of Nucor Steel Auburn, Inc.*, at 9-10 (Apr. 11, 2008) (hereinafter "Nucor IB").

immediately quantifiable) simplifies the Commission's evaluation of the Proposed Transaction. Based on the evidence, the Proposed Transaction is clearly in the public interest and, therefore, should be approved by the Commission.

Importantly, none of the other parties' Initial Briefs successfully rebut the Joint Petitioners' demonstration, through testimony and the Partial Acceptance, that the Proposed Transaction is in the public interest. When reviewing the briefs, the Administrative Law Judge (and the Commission) may also find that no matter what benefit, acceptance or commitment the Joint Petitioners have identified or offered, the Department of Public Service Staff ("Staff") seeks to turn it on its head, labeling it as a risk or a detriment or as wholly inadequate.

For example, according to Staff, Iberdrola's *higher* credit rating than Energy East is a *risk* rather than a benefit that somehow justifies extensive financial protection conditions as well as exorbitant concessions. Another example is that, even though the Joint Petitioners already have committed not to seek to recover in rates any of the premium that Iberdrola will pay Energy East shareholders, or record any of the resulting Goodwill on the books of NYSEG, RG&E or Energy East, Staff still asserts that (a) Goodwill at the Iberdrola level somehow poses a "risk", and (b) the premium Iberdrola will pay to Energy East shareholders (above the market price of the shares when the initial acquisition was announced) somehow confers a "benefit" that justifies excessive Staff demands. These arguments are not supported by the record and are contrary to common sense.

Because Staff is faced with a Proposed Transaction that is clearly a net positive for ratepayers and the State, it chooses to use an outcome-determinative approach and relies upon faulty logic. By isolating each step in Staff's analysis (there are five), the flaws in Staff's approach become more clear.

First, Staff posits risks, which the Joint Petitioners demonstrate are illusory, exaggerated, or actually reflect benefits of the Proposed Transaction. Second, Staff proposes excessive conditions that Staff claims are necessary to neutralize fully each of these non-existent or overblown alleged risks. Third, Staff dismisses or diminishes the true value of each of the numerous benefits resulting from the Proposed Transaction. Fourth, Staff maintains that unquantifiable and illusory risks remain even after implementation of Staff's mitigation measures and the Joint Petitioner's benefits and conditions - and that these risks are at a level that somehow justifies exorbitant PBAs, one-time rate adjustments and rate concessions that, together, would reduce the delivery revenues of NYSEG and RG&E by over 26% and have a negative financial impact on the Joint Petitioners totaling $1.6 to $1.7 billion.

As the fifth and last step in its flawed analytic approach, Staff seeks to justify its otherwise indefensible rate concessions by arguing that the Proposed Transaction, a first-mover non-synergy merger for Iberdrola which has no regulated operations in the United States, creates "benefits" for Iberdrola and third-parties of $1.6 billion. Staff treats these supposed benefits as a "proxy" for synergy savings that would occur in a synergy-driven transaction, which this is not. The alleged "proxy" benefits in Staff's fifth step, however, are neither independently justified nor justifiable, but rather amount to: (1) *costs* to Iberdrola that Staff treats as alleged windfall benefits to Iberdrola; (2) *uncertain and unrelated US federal tax credits* related to Iberdrola Renewables' wind projects that have already been utilized by third parties and have nothing to do with the Proposed Transaction; (3) *highly speculative and unrelated Spanish tax deferrals/amortizations* that have nothing to do with the Proposed Transaction, and which Iberdrola is unlikely to receive under Spanish law; and (4) *invented synergy savings* that (according to Staff) the Joint Petitioners have "hidden" from the parties to this proceeding.[4] This nonsensical approach demands unjustified rate concessions that are so far removed from any relevant precedent under PSL Section 70 that they must be rejected out of hand.

Under the Commission's precedent, the public interest standard of review as applied to a utility merger does not equate to a singular focus on squeezing every last possible rate concession from a utility as a "toll" to obtain approval of a merger in New York. Rather, the public interest requires a careful balancing of ratepayer and utility shareholder interests, along with interests of various stakeholder groups, such as the municipalities and electric cooperatives that have intervened in this proceeding.

Moreover, as the Joint Petitioners demonstrate, and contrary to Staff's position, where a merger does not itself produce synergy savings, the Commission has not required quantifiable ratepayer benefits as a condition of approval. In fact, the Commission has distinguished between synergy and non-synergy mergers (such as the Proposed Transaction) and found that tangible monetary benefits are not required where a transaction does not itself generate synergy savings. As the Joint Petitioners explain, in several recent water utility merger decisions, the only precedent where the Commission has applied the same "public interest" standard to non-synergy mergers, the Commission has approved mergers without a specific showing of tangible monetary benefits. Staff's attempt to distinguish these cases is unavailing.

Nonetheless, even if the Commission were to determine that its merger policy should change and that the public interest standard should now be construed to require tangible monetary benefits in a non-synergy merger, the Joint Petitioners meet and exceed that standard. In the Partial Acceptance, the Joint Petitioners are committing to provide customers and the State

[4] Case 07-M-0906 - *Staff Initial Brief*, at 111 (Apr. 11, 2008) (hereinafter "Staff IB").

of New York with tangible benefits that include over $201 million in PBAs that will translate into an average annual decrease in rates of 4.4% and will result in an immediate $54.8 million annual delivery rate reduction, as well as a commitment to invest a minimum of $100 million in renewable development in the State over the next three years, which will bring economic development and new jobs, particularly in upstate New York. The Joint Petitioners also commit to provide reliability and other service enhancement benefits to the electric cooperatives and to address the concerns of the City of Rochester. The Partial Acceptance is in addition to the benefits of the Proposed Transaction outlined in testimony and the stipulations outlined in the Joint Petitioners' Initial Brief and here.

Finally, Staff spends significant effort attempting to turn this merger proceeding into multiple new rate cases for the electric and gas divisions of NYSEG and RG&E. The Commission should reject this effort. Indeed, other parties have expressed disagreement with many of Staff's rate demands. For example, Strategic Power Management, LLC ("SPM") has stated that there is "no legal or logical justification on the record for further rate relief without the Joint Petitioners' consent"[5] and Nucor Steel Auburn, Inc. ("Nucor") expresses a desire to have rate issues addressed in subsequent rate proceedings (Nucor IB at 11-13).[6] Even though the Joint Petitioners submit fundamentally that these rate issues should not be part of this merger proceeding, the Joint Petitioners find themselves compelled to address and respond to Staff's rate issues in Sections VIII through X below.

For the reasons set forth below and in the Initial Brief, the Joint Petitioners respectfully request that the Commission approve the Proposed Transaction without any

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5 Case 07-M-0906 - *Initial Brief of Behalf of Strategic Power Management, LLC*, at 25 (Apr. 11, 2008) (hereinafter "SPM IB")

6 The New York State Consumer Protection Board ("CPB") also appears to agree that rates should be determined in subsequent proceedings.

conditions beyond the commitments and concessions offered by the Joint Petitioners (set forth in Attachment 1). The record demonstrates that the Proposed Transaction will bring extensive benefits to NYSEG's and RG&E's ratepayers and to the State of New York. The Proposed Transaction clearly meets the public interest standard of PSL Section 70 and should be approved without delay so that those benefits can be realized as soon as possible.

II. STANDARD OF REVIEW

A. Staff Seeks To Impose A Standard Of Review To This Non-Synergy Merger That Is Contrary To The Law, Facts And Good Public Policy

To obtain approval of the Proposed Transaction under Section 70 of the PSL, Staff asserts that the Joint Petitioners must show that they have eliminated unacceptable risks and flowed through tangible monetary benefits to ratepayers "that are sufficient to outweigh any remaining risks related to the transaction" (Staff IB at 13). Multiple Intervenors ("MI") recommends that the Commission approve the Proposed Transaction subject to conditions intended to "produce financial and other tangible benefits and enforceable protections for customers in the NYSEG and RG&E service territories."[7] Consistent with Staff's and MI's assertions that the Joint Petitioners must provide risk protections to justify approval of the Proposed Transaction under the public interest standard (*see* Joint Petitioners IB at 13-18),[8] the Joint Petitioners have committed to a large number of conditions that mitigate any risks that could conceivably be associated with the Proposed Transaction (even though the Joint Petitioners

7 Case 07-M-0906 - *Initial Brief of Multiple Intervenors*, at 7 (Apr. 11, 2008) (hereinafter "MI IB")

8 Staff disingenuously argues that the Joint Petitioners believe that "they need only show that 'no harm' will come to utility ratepayers as a result of the transaction" (Staff IB at 14 (citing testimony of Mr. Meehan)). The Joint Petitioners have not limited the applicable standard to "no harm" but rather recognize that the Commission must find net benefits (regardless of whether they are quantifiable or not). As Mr. Meehan explains, "[t]he Commission has approved a number of non-synergy mergers, taking care to identify the non-quantifiable but real benefits of the merger *and* to assure that no harm comes to consumers" (Tr. 934) (emphasis added). Further, Mr. Meehan defines his understanding of the public interest standard as requiring that "there are benefits to the state, including ratepayers, and I think we have that here" (Tr. 982).

disagree that the Proposed Transaction can reasonably be viewed as posing any real and substantive risks). However, the Joint Petitioners disagree with Staff and MI that the public interest standard requires a showing of tangible monetary benefits, let alone the unreasonable level of concessions Staff seeks here that are unrelated to the Proposed Transaction and that are otherwise unwarranted. Requiring tangible monetary benefits that do not flow from synergy savings as part of the public interest standard is contrary to Commission precedent and sound public policy.[9]

In arguing that the Joint Petitioners have not satisfied the public interest standard, Staff and other parties muddle the undeniable distinction between "synergy" and "non-synergy" utility mergers. In support of Staff's argument that satisfaction of the public interest standard requires tangible monetary benefits, Staff points to all of the synergy-driven savings in recent gas and electric mergers that were achieved by combining utility operations (Staff IB at 10-13). MI takes the same view (MI IB at 9-10 (relying on the synergy merger between National Grid and KeySpan[10] to assert that monetary benefits are required)).[11] However, both Staff and MI fail to cite any instance where tangible monetary benefits were provided in a non-synergy utility

9 Even though no tangible monetary benefits are required under Section 70, the Joint Petitioners have nonetheless committed to a number of conditions (in the Partial Acceptance) that, in fact, would meet and exceed any rational tangible monetary benefits that might be reasonably required. In doing so, the Joint Petitioners in no way concede that such benefits are appropriately *required* under Section 70 as interpreted by this Commission in non-synergy cases.

10 Case 06-M-0878 - *National Grid plc and KeySpan Corp., Order Authorizing Acquisition Subject to Conditions and Making Some Revenue Requirement Determinations for KeySpan Energy Delivery New York and KeySpan Energy Delivery Long Island* (Sept. 17, 2007) (hereinafter "*NG/KS Order*")

11 MI acknowledges that the Grid/KeySpan merger and the Proposed Transaction "present certain differences," but asserts that "the similarities are overwhelming and cannot be ignored" (MI IB at 9). In fact, these allegedly similar facts and circumstances have been fully rebutted by the Joint Petitioners in this proceeding (Joint Petitioners IB at 57-59). *See also, e.g.,* discussion *infra* Section III.H (comparing the Grid/KeySpan merger with the Proposed Transaction regarding why imposing a "golden share" is not necessary).

merger, and further fail to identify any instance in which the Commission has found that the public interest standard requires a showing of tangible monetary benefits in all utility mergers. In fact, the contrary is true – the Commission has not required tangible monetary benefits in non-synergy mergers.

The Commission has approved prior non-synergy utility mergers based on its recognition of a wide range of meaningful and substantive benefits without requiring *any* particular level of quantifiable benefits, let alone the imposition, through the merger review process, of immediate rate reductions (Joint Petitioners IB at 13-18).[12] That the Commission has not seen a non-synergy merger recently in the New York electric and gas utility industry is purely an historical happenstance. Nevertheless, because Iberdrola does not currently own any U.S. regulated utility assets, the Proposed Transaction is unquestionably a non-synergy first-mover transaction which does not result in immediately quantifiable synergy savings as a result of combining utility operations. The Commission should follow its precedent in other non-synergy merger cases (discussed below) and reject Staff's proposed new requirement that monetary benefits must be created as a condition of a non-synergy merger approval.

B. The Water Utility Cases Provide The Most Relevant Guidance For The Commission's Evaluation Of The Proposed Transaction

Staff argues that the Joint Petitioners have ignored the electric and gas utility merger precedent over the past decade and instead improperly rely on water utility merger

[12] *See also, e.g.,* Case 01-W-1949 - *Long Island Water Corp., et al. Order Adopting Terms of a Joint Proposal,* at 6 (Nov. 27, 2002) (hereinafter "*Long Island Water/Thames Order*") (foreign parent acquirer's ability to provide the local utility with better access to capital markets, and the benefits of knowledge, research and development the parent had acquired elsewhere, satisfied the public interest standard); Case 99-W-1542 - *United Water Resources, Inc. and Lyonnaise American Holding, Inc., Order Approving Stock Acquisition,* at 7 (July 27, 2000) (as modified by Errata Notice issued Aug. 1, 2000) (hereinafter "*UWR/LAH Order*") (finding that the foreign parent acquirer's ability to provide technological best practices and financial assets satisfied the public interest standard).

precedent (Staff IB at 14). This is incorrect. These gas and electric merger cases, each of which involved a synergy merger, are not applicable and cannot be used to define the public interest standard in a non-synergy merger case (*see* Joint Petitioners IB at 14-18). As the Joint Petitioners have explained, the Commission's non-synergy merger cases provide the most relevant guidance on how the Commission should apply the public interest standard to an acquisition such as the Proposed Transaction (Joint Petitioners IB at 17).

Rather than disputing that the Commission has approved non-synergy utility mergers, Staff tries to discount this precedent by arguing that the electric and gas industries are different. Staff claims that cases involving water companies are "irrelevant" and "in no way comparable" to this non-synergy merger case (Staff IB at 14). However, Staff refers to no precedent involving a non-synergy merger that the Commission could or should use for guidance in assessing the Proposed Transaction (or any other non-synergy merger). This is a serious analytical error. The factual circumstances pertaining to a first-mover, non-synergy merger such as this one, in which the acquiring entity has no existing utility operations in the Northeastern U.S., are far more relevant to the question of whether tangible monetary benefits can be required than any bald assertions about purported "risk" differences between a water company and a gas or electric company.

While Staff attempts to distinguish between the challenges confronted by the electric and water industries, Mr. Meehan explains that water and electric companies indeed "are comparable in nature" because "the water companies certainly faced the need for infrastructure improvement and capital investment, and . . . [electric] utilities also face that need" because approximately "14 billion a year nationally in distribution investment over the next ten years" is required (Tr. 970). Unable to rebut this point, Staff relies on the Commission's Statement of

Policy regarding consolidation of small water utilities to argue that the challenges water companies face, such as the need to raise capital, are "acute" (Staff IB at 14-15).[13] This Statement of Policy in no way undercuts the relevance of the water utility merger precedent relied on by the Joint Petitioners; none of this precedent involved small water utilities (*see* Joint Petitioners IB at 15, n.6 (list of Commission orders approving non-synergy mergers of water utilities)). Therefore, no "deep and fundamentally unbridgeable" distinctions between the water utility merger precedent relied on by the Joint Petitioners and the circumstances of NYSEG and RG&E exist (Staff IB at 15).[14]

The lack of any relevant distinction between the water cases and this proceeding is underscored by the facts of the 2002 acquisition of Long Island Water's parent company, American Water Works Company ("AWW"), by Thames, a large foreign holding company. Long Island Water is the largest regulated water utility in New York, serving more than 200,000

13 The Statement of Policy does not use the term "acute." Rather it states that "[s]mall water companies typically cannot attract capital and often have small cash reserves, or none at all. Frequently, these companies are run by part-time managers possessing little technical training." Case 93-W-0962 - *Acquisition and Merger of Small Water Utilities, Statement of Policy* (Aug. 8, 1995).

14 Many examples of this level of exaggeration persist throughout Staff's argument. For example, Staff asserts that Mr. Meehan "was unable to demonstrate that the water utility precedents he cited should guide the Commission in their review of the instant transaction involving Iberdrola and Energy East" (Staff IB at 15). As support for this statement, Staff cites Mr. Meehan's response to information request IBER-0246 (*Id.*). In his response to that information request, however, Mr. Meehan merely confirms basic factual information about the acquisition of United Water Resources ("UWR") by Lyonnaise American Holding, Inc. ("Lyonnaise") (Exh. 19, Response to IBER-0246). Staff then quotes Mr. Meehan out of context for the proposition that he admitted he had not compared the circumstances of NYSEG and RG&E to that of "any of the water utilities whose acquisitions were approved in the Orders he cited" (Staff IB at 15). What Mr. Meehan actually said was that he did not think it was necessary to compare the allowed returns at NYSEG and RG&E to the water company return that was at issue in the 2000 transaction between UWR and Lyonnaise (Tr. 971). Staff obviously makes a quantum leap from a statement about one particular order to a sweeping admission about all the orders Mr. Meehan cites.

people in 31 communities.[15] Staff implies on brief (without citation) that AWW's financial stability needed improving and that this need somehow influenced the Commission's merger approval (Staff IB at 17); however, in the order approving the acquisition the Commission makes no finding, much less suggests, that Long Island Water faced significant challenges that necessitated its indirect acquisition by Thames. Indeed, the Commission observed that Long Island Water's customers had "enjoyed stable rates since 1997"[16] and, as recently acknowledged by Chairman Brown, Long Island Water was a well-performing utility prior to the acquisition by Thames and has continued to perform well since then.[17] In approving Thames' acquisition of AWW, the Commission found that Long Island Water's indirect acquisition by a foreign holding company was in the public interest, without requiring rate reductions, because Thames "has an acceptable financial standing and it is therefore reasonable to expect that [AWW's] and Long Island Water's affiliation with Thames will provide them better access to capital markets on favorable terms."[18]

Staff also unsuccessfully attempts to distinguish the UWR acquisition case, another non-synergy merger in which no rate concessions were required (*see* Staff IB at 15-17). Staff acknowledges that the new parent in the UWR case provided "the New York regulated subsidiary with 'enormous technological and financial assets to help the subsidiary, by supplying it with capital and expertise needed to meet its financial and infrastructure challenges'" (*Id.* at

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15 Long Island American Water (f/k/a Long Island Water), http://www.amwater.com/nyaw/about-us/index.html (last visited Apr. 23, 2008).

16 *Long Island Water/Thames Order*, *supra* note 12, at 6.

17 Press Release, Garry A Brown, Chairman, *PSC Approves Three-Year Rate Plan for Long Island Water* (Feb. 13, 2008). *See also* Case 07-W-0508; 05-W-0339 - *Long Island Water Corporation, Order Determining Revenue Requirement and Rate Design*, at 8-9 (Mar. 5, 2008) (noting in particular the operating utility's long history of rate stability).

18 *Long Island Water/Thames Order*, *supra* note 12, at 6.

16).[19] Staff, however, claims that in the UWR case the Commission believed the new parent entities would closely supervise the New York water utility subsidiaries, as opposed to in the Proposed Transaction, where Staff claims that Iberdrola has disavowed any intent to supervise closely NYSEG and RG&E (*Id.*). There is nothing in the Commission's order in the UWR case suggesting that the Commission believed that transmission of expertise and knowledge from UWR required *close supervision* of the operating utilities. Moreover, as a practical matter, a new holding company (like Iberdrola) does not have to supervise its newly acquired utilities closely to provide them with the benefit of the new holding company's global expertise and knowledge. As Iberdrola has done with other utility operations around the world, Iberdrola commits to assist NYSEG and RG&E with Iberdrola's global experience and utility expertise through sharing of information regarding best practices without interfering with the utilities' day-to-day affairs (Tr. 514), a benefit of the Proposed Transaction discussed further in Section IV.E below.

Fundamentally, Staff disregards the fact that the same legal standard applies to evaluate mergers in the energy, water, and other utility industries. Section 70 of the PSL, which governs gas and electric utility mergers, and Section 89-h of the PSL, which governs water utility mergers, are worded *identically* to require a "public interest" finding.[20] Similarly phrased and similarly intended statutory provisions are *in pari materia* and thus "are to be construed

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19 Staff actually misquotes the Commission's Order, which states: "The public interest standard under §89-h is satisfied here because SLDE--one of the world's largest water distribution and treatment companies--can provide enormous technological and financial assets to help the subsidiary *meet precisely those unique local challenges cited by the opponents.*" *UWR/LAH Order, supra* note 12, at 7 (emphasis added). That finding is similarly applicable here because Iberdrola will offer similar benefits to NYSEG and RG&E (Joint Petitioners IB at 15-16). The Commission's holding in that case precisely illustrates the Joint Petitioners' point that the sorts of non-rate benefits Iberdrola will provide, *e.g.*, global expertise and better access to capital, are sufficient to satisfy the public interest standard in a non-synergy merger (*see id.*).

20 *Compare* N.Y. Pub. Serv. Law § 70 (McKinney 2008) *with id.* §§ 89-h, 100. *See also Spring Brook Water Co. v. Hudson Falls,* 56 N.Y.S.2d 722, 725 (N.Y. App. Div. 1945) (noting the similar phrasing of five sections of the Public Service Law, including § 70 and § 89-h, that require the Commission's consent for utility transfers, and interpreting all five sections together).

together and 'as intended to fit into existing laws on the same subject unless a different purpose is clearly shown.'"[21] The water utility cases that the Joint Petitioners reference above and in their Initial Brief are the only known Commission precedent applying the public interest standard under the PSL to non-synergy utility mergers (*see* Joint Petitioners IB at 15). Contrary to Staff's assertions that non-synergy water utility merger cases are inapplicable because they involve a different type of utility (Staff IB at 14), these cases are far more relevant than merger cases of the past decade involving two gas and electric companies planning to combine neighboring operations.[22] Staff's claim otherwise defies precedent and the sound public policy of consistent regulation (Tr. 942-93).[23]

C. The Joint Petitioners Satisfy The Standard For Approval, Even If The Commission Were to Impose a New Tangible Benefits Standard

Even if the Commission were to change its policy and find that Section 70 of the PSL requires that tangible monetary benefits be flowed through to ratepayers in the context of a non-synergy utility merger, the Joint Petitioners have demonstrated that the Proposed

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21 *Lower Manhattan Loft Tenants v. New York City Loft Bd.*, 487 N.E.2d 889, 892 (N.Y. 1985). *See also, e.g., Plato's Cave Corp. v. State Liquor Auth.*, 498 N.E.2d 420 (N.Y. 1986) (affirming reliance on Penal Law definition of "gambling" for use under Alcoholic Beverage Control Law because the two statutes are *in para materia*).

22 Staff oddly claims that the water utility merger cases are irrelevant but then cites the Commission's experience with Jamaica Water Supply for its argument that the problems of the parent can cause service degradations at the utility subsidiary (Staff IB at 36-37), and then later cites a recent case involving an initial public offering for AWW to argue that Goodwill impairments at the holding company level could threaten safe and reliable service at the utility operating company level (*Id.* at 70-71). This inconsistency discredits Staff's arguments.

23 Staff points to the fact that the Commission's jurisdiction over utility transactions has been applied in the same manner under three similarly-worded provisions: PSL § 89-h, PSL § 70 and PSL § 92 (regarding telephone utilities) (Staff IB at 30-31), but this actually undermines Staff's claims that water cases are irrelevant. Staff tries to explain this away in a footnote, without citation to any authority, by stating that even though the identical legal standard applies under these provisions, "the extent of review, and the conditions required for approval, vary depending upon the nature of the entity that is being transferred" (*Id.* at 31, n. 21). Of course, every merger has its own set of facts. However, these provisions show that the Commission applies the same *legal standard*, regardless of the industry.

Transaction satisfies this requirement. In the Partial Acceptance (Exh. 50), the Joint Petitioners commit to provide customers and the State of New York with numerous tangible benefits, including over $201 million in one-time rate adjustments that will result in an immediate $54.8 million annual delivery rate reduction. The Joint Petitioners also commit to: (a) the divestiture of Energy East's fossil generation facilities in New York; (b) the sharing of the resulting divestiture proceeds with ratepayers; (c) support for substantial investment for the development of renewable generation in the State; (d) resolution of the concerns of the electric cooperatives, as well as various issues raised by the City of Rochester; and (e) conditions to mitigate any perceived risks of the Proposed Transaction (Exh. 50). Together these substantial tangible benefits unquestionably demonstrate that the Proposed Transaction is in the "public interest" under Section 70.

III. STAFF'S ALLEGED "RISKS" ARE ILLUSORY AND EXAGGERATED; SIMILARLY, MANY OF STAFF'S PROPOSED CONDITIONS TO MITIGATE RISK ARE OVERREACHING AND UNREASONABLE

In opposing the Proposed Transaction, Staff raises the question whether certain purported "risks" associated with ownership of Energy East by Iberdrola are adequately "compensated" by tangible benefits. Other parties to this proceeding vary significantly in their assessment of potential "risks" associated with the Proposed Transaction. Most importantly, contrary to Staff's position, the majority of the parties in this proceeding (including ratepayer advocacy groups such as CPB and MI) do not agree with Staff's assessment of the potential vertical market power concerns, and have urged the Commission to resolve Staff's concerns in a manner that does not impose any restrictions on Iberdrola's ability to develop wind generation in the State of New York[24] (MI IB at 55-56; CPB IB at 12-15; SPM IB at 9).[25]

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[24] Moreover, contradicting Staff's and certain other parties' statements of alleged risk, many parties, including CPB, praise Iberdrola as a large company that has substantial expertise, a strong

Staff's inquiry into risks associated with a proposed merger would seem, in theory, to be a legitimate part of any Section 70 merger proceeding. In practice, however, Staff has distorted its "risk" inquiry into an exercise in invention, exaggeration and worst-case scenario speculation that renders much, if not all, of the Staff Policy Panel's analysis meaningless and unjustified. Because Staff has engaged in such an exaggerated and speculative analysis of risk, the remedies or mitigating factors proposed by Staff as conditions are similarly exaggerated. The Commission should reject these onerous and unnecessary conditions. The weight of the evidence demonstrates that there will be net positive benefits if the Proposed Transaction is approved with the tangible benefits proposed in the Partial Acceptance, plus the additional commitments made by the Joint Petitioners, many of which correspond to conditions proposed by Staff (*see* Attachment 1).

A. Vertical Market Power

While Staff has attempted to demonstrate that the Proposed Transaction will raise vertical market concerns, most other parties have found no merit in Staff's position on this point. CPB, for example, finds Staff's position on vertical market power issues associated with Iberdrola's affiliated wind generation to be simply "unreasonable" (CPB IB at 14). SPM also concludes that, given the significant renewables benefits that Iberdrola Renewables can bring to the State, Staff's "hyper-theoretical vertical market concern" with respect to Iberdrola

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financial position, and a helpful commitment to the environment (CPB IB at 25-28). In fact, CPB states that "[t]he record in this case gives no indication that Iberdrola is not a highly capable company" (CPB IB at 25). Finally, although noting that "there are always risks inherent with a change in ownership," SPM argues that "[i]n this case change is for the better" and "[i]t is not likely that a suitor superior to Iberdrola will be found" (SPM IB at 11).

[25] *See also* Case 07-M-0906 - *Initial Post-Hearing Brief of the New York State Department of Economic Development*, at 7 (Apr. 11, 2008); Case 07-M-0906 - *Brief on Behalf of the New York State Department of Environmental Conservation*, at 4 (Apr. 11, 2008); Case 07-M-0906 - *Natural Resources Defense Council NRDC Letter in Lieu of Post-Hearing Brief*, at 3 (Apr. 11, 2008) (hereinafter "NRDC IB").

Renewables' development activities would result in "cutting one's nose off to spite one's face" (SPM IB at 9). Greater Rochester Enterprise ("GRE") similarly concludes that Staff's requested divestiture of renewable generation, and prohibitions on Iberdrola Renewables' development activities in New York "should be rejected."[26] Independent Power Producers of New York, Inc. ("IPPNY") raises some, but not all, of the vertical market concerns raised by Staff. Furthermore, despite the evidence proving no vertical market power issues exist in this proceeding, the Joint Petitioners have nonetheless committed to divest all of Energy East's fossil generation in New York in an effort to ameliorate Staff's and IPPNY's concerns.

Effectively ignoring the Joint Petitioners' extensive divestiture commitments and their expert's economic analyses in this proceeding, Staff argues that the Proposed Transaction raises vertical market power concerns and recommends that the Commission require, as a condition for approval of the Proposed Transaction, the divestiture of all of NYSEG's and RG&E's existing generation and Iberdrola Renewables' wind projects in New York. Staff also urges the Commission to prohibit the Joint Petitioners and their affiliates from constructing any new generation in the State (even renewable wind generation through unregulated subsidiaries), except as needed to preserve system reliability after approval through the New York Independent System Operator's ("NYISO") Reliability Needs Assessment process and approval by the Commission (Staff IB at 134). IPPNY seeks a prohibition against Iberdrola's (or its affiliates') ownership of electric generating facilities interconnected with RG&E's or NYSEG's transmission or distribution systems.[27] Both Staff and IPPNY rely on the Commission's 1998

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26 Case 07-M-0906 - *Greater Rochester Enterprise Reply Letter*, at 1 (Apr. 24, 2008) (hereinafter "GRE Letter").

27 Case 07-M-0906 - *Initial Brief of Independent Power Producers of New York, Inc.*, at 5, 12 (April 11, 2008) (hereinafter "IPPNY IB").

Vertical Market Power Policy Statement[28] to support their demands.[29] These divestiture requests and requests to prohibit and restrict future wind power development go too far. They are unsupported by any empirical analysis and are unneeded for the reasons discussed below.

Contrary to the positions taken by Staff and IPPNY, the VMP Policy Statement does not create an absolute prohibition against a transmission owner ("TO") acquiring or being affiliated with generation in New York State. Rather, the VMP Policy Statement establishes that "a rebutt[able] presumption will exist for purposes of the Commission's Section 70 review of the transfer of generation assets, that ownership of generation by a [TO] affiliate would unacceptably exacerbate the potential for vertical market power."[30] The VMP Policy Statement expressly provides that this presumption can be overcome by a demonstration that "vertical market power could not be exercised because the circumstances do not give the T&D company an opportunity to exercise market power, or because reasonable means exist to mitigate market power" or "that substantial ratepayer benefits, together with mitigation measures, warrant overcoming the presumption."[31] As recently as last month, the Commission left open the question as to whether the VMP Policy Statement would prohibit the development and operation of generation by a utility (and this was with respect to utility-owned rate base generation, rather than non-utility

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[28] Case No. 96-E-0900, et al. - *In the Matter of Orange & Rockland Utilities, Inc's Plans for Electric Rate Restructuring Pursuant to Opinion 96-12*, *Statement of Policy Regarding Vertical Market Power*, at Appx. I (July 17, 1998) (hereinafter "VMP Policy Statement").

[29] As IPPNY's members consist of entities that are incumbent generators in New York State that are commercially opposed to utilities competing in the generation market and may bid on any generation facilities that are divested as a result of this proceeding, IPPNY's arguments in support of divestiture and prohibitions on generation development activity should, accordingly, be viewed with skepticism.

[30] VMP Policy Statement, at Appx. I, pp. 1-2.

[31] *Id.* at Appx. I, p. 2.

owned intermittent competitive power generation).[32] As described in the Joint Petitioners' Initial Brief and below, the record demonstrates that the VMP Policy Statement's presumption is inapplicable or has been satisfactorily rebutted.

1. There Are No Vertical Market Power Concerns with Respect to the Existing Fossil Generation of NYSEG and RG&E, Which Joint Petitioners Have Nonetheless Agreed to Divest

Although the Joint Petitioners have already committed to divest all of the existing fossil generation owned by Energy East in New York (Exh. 50), Staff continues to raise this non-issue. In an effort to exaggerate the risks associated with the Proposed Transaction, Staff devotes a significant amount of discussion in its Initial Brief to explaining why it believes that Energy East's existing generation in New York, including any future RG&E plans for re-powering of the Russell site (Staff IB at 99) and the operation of the Carthage Facility by an unregulated affiliate, raises vertical market power concerns, and therefore why those plants should be divested as a condition to closing (Staff IB at 97-100). Despite the lack of evidence in the record that the ownership of these facilities by NYSEG and RG&E has created market concentration issues in the past, the Joint Petitioners have already committed in the Partial Acceptance to divest the Carthage Facility and Russell Station, in addition to all of Energy East's other fossil-fired generation in New York. Therefore, the Joint Petitioners have fully addressed Staff's stated concerns with respect to these facilities and they should not be included in Staff's

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[32] *See* Case No. 07-E-1507, et al. - *Proceeding on Motion of the Commission to Establish a Long-Range Electric Resource Plan and Infrastructure Planning Process, Order Initiating Electricity Reliability And Infrastructure Planning,* at 23 (Dec. 24, 2007) ("While, it would not be prudent to conclude that utility construction and operation of power plants would never be in the public interest, the Commission is not anxious to foist upon customers all of the risks we removed in creating competitive markets."). *See also* Case No. 07-E-1507 - *Proceeding to Establish a Long-Range Electric Resource Plan and Infrastructure Planning Process, Order Denying Petitions For Reconsideration Or Clarification* (Mar. 21, 2008) (rejecting argument asserted by utilities that a "'presumption'" was created in the December 2007 order "which is biased against the traditional utilities building or owning generation").

basket of alleged "risks" associated with the Proposed Transaction. As CPB states, "[a]ll vertical market power issues related to these facilities were removed by the Partial Acceptance Document" (CPB IP at 6).

2. There Are No Vertical Market Power Concerns with Respect to the Existing Hydroelectric Generation of NYSEG and RG&E

While IPPNY supports the Joint Petitioners' commitment to divest NYSEG's and RG&E's existing fossil generating facilities (IPPNY IB at 3), IPPNY argues that the Commission should also require NYSEG and RG&E to divest their hydroelectric facilities to mitigate purported market power concerns arising from the Proposed Transaction (*Id.* at 8). Staff also seeks a divestiture of these facilities (Staff IB at 109-10). These units are currently owned by NYSEG and RG&E and do not create any vertical market power concerns. As CPB correctly concludes: "The continued ownership and operation of these low-cost, renewable energy facilities by the utilities provides direct benefits to ratepayers while creating no problems for the continued development of a competitive generation market that any party has been able to identify or quantify. There is no justification for a Commission order directing the divestiture of these assets" (CPB IP at 9; *see also* Tr. at 716). GRE also concludes that these hydroelectric facilities provide "a clean, renewable and economic source of energy for the Rochester region" and that "RG&E should not be required to divest these facilities" (GRE Letter at 1).

Neither IPPNY nor Staff even attempts to explain how such a *de minimis* amount of pre-existing hydroelectric generation could potentially be utilized to exercise vertical market power. Moreover, it strains credulity for IPPNY to contend that NYSEG's and RG&E's continued ownership of this 110 MW of run-of-the-river hydroelectric generation (Tr. 847), which by its nature is ill-suited to the exercise of vertical market power, could create any vertical market power concerns (*Id.*). CPB points out (with apparent disbelief) that, despite the

Commission's many previous opportunities to have raised vertical market power concerns with respect to Energy East's existing hydroelectric facilities in New York, "vertical market power disputes [with respect to these facilities] do not appear to have been a problem until now" (CPB IB at 11).

IPPNY argues that a divestiture of the hydroelectric facilities would result in additional ratepayer benefits because "a greater percentage of electricity [would be] supplied by a renewable resource, which furthers the State's renewable energy goals" (IPPNY IB at 8). However, a sale of pre-existing hydroelectric facilities from one owner to another would not increase the percentage of electricity supplied by renewable resources in the State. IPPNY speculates that a new owner could redevelop or enlarge those existing hydroelectric facilities (*Id.* at 8), but there is no evidence in the record that suggests that any potential purchaser would undertake such expansion. Moreover, as IPPNY further concedes, RG&E has already announced that it has plans to invest more than $20 million over the next three years to increase the capacity of its hydroelectric facilities (*Id.* at 8-9). As a consequence, the potential benefit identified by IPPNY (*i.e.*, "a greater percentage of electricity . . . supplied by a renewable resource") would more likely be provided through NYSEG's and RG&E's *retention* of these facilities, rather than through their divestiture.[33]

[33] Staff's and IPPNY's proposal for the divestiture of the hydroelectric facilities could also create the very situation that Staff asserts is problematic with the Asset Sale Gain Account ("ASGA") depletion as a result of the market cost of replacing power from Ginna (Staff IB at 221-23). While ratepayers may receive a short-term gain from the sale of the hydro facilities, the cost to replace the power in the market may ultimately result in increased power costs to customers, particularly as the price paid for the hydro power after divestiture would include a level of profit for the new owners of the hydro facilities.

3. There Are No Vertical Market Power Concerns with Respect to the Iberdrola Renewables' Wind Projects and Development Activities in New York

Vertical market power concerns do not present a valid excuse for placing any restrictions on the ability of Iberdrola Renewables to develop renewable generation in New York, other than those restrictions that are imposed on wind developers in the State generally. Indeed, as MI has concluded, there are certain unique characteristics of wind that may warrant a different treatment for purposes of evaluating vertical market power than more traditional, fossil-fuel generation (MI at 56; *see also* Tr. 863-64). SPM has similarly determined that, "[t]o say that Iberdrola will be able to manipulate both the wind and its transmission assets under the control of NYISO to exert vertical market power is such a remote theoretical construct as to be outside of the zone of rational discourse" (SPM IB at 32). CPB believes that Staff's vertical market power concern with respect to Iberdrola Renewables' wind projects is "unreasonable" (CPB IB at 14). GRE has similarly concluded that the limitations and requirements requested by Staff and IPPNY with respect to the divestiture of, and prohibitions on, Iberdrola Renewables' development activities "should be rejected" (GRE Letter at 1).

Despite the evidence in this proceeding, Staff argues that the Commission should condition its approval of the Proposed Transaction on the divestiture of Iberdrola Renewables' existing wind projects in New York, as well as a forward-looking prohibition on Iberdrola Renewables' development of additional wind capacity in the State (Staff IB at 134). IPPNY argues that Iberdrola Renewables should be prohibited from constructing, acquiring or otherwise owning any interests in any wind projects interconnected with RG&E's or NYSEG's transmission or distribution systems, unless ordered by the Commission (IPPNY IB at 5; 12). As described in the Joint Petitioners' Initial Brief and below, Iberdrola Renewables' ownership and continued development of wind generation in New York State does not present vertical market power issues, and prohibiting Iberdrola Renewables from participating in that market is contrary to State policy encouraging the development of renewable energy. Additionally, from a commercial perspective, Iberdrola cannot accept restrictions on the ability of Iberdrola Renewables to develop and own wind generation in New York State.

Iberdrola Renewables is separately managed and operated, and has a mandate to seek to develop renewable energy projects around the country in its discretion.[34] Indeed, any restrictions on the ability of Iberdrola Renewables to build renewable generation in New York, other than those restrictions that are imposed on wind developers generally in the State, would be inimical to Iberdrola's commitment in the Partial Acceptance to support investments to develop wind projects in New York by Iberdrola Renewables of at least $100 million over the next three years (Tr. 618-19).

Neither Staff nor IPPNY provides any economic analyses or reasoned response to Dr. Hieronymus' economic analyses. Nor do they rebut with empirical analysis his discussion of the impact of market rules and other oversight mechanisms that have been adopted by the Federal Energy Regulatory Commission ("FERC") and NYISO since the issuance of the VMP Policy Statement that directly address any purported vertical market power concerns arising from Iberdrola Renewables' development activities in New York (Tr. 825-35; 857-61). These market rules and oversight mechanisms include:

(i) NYISO's Open Access Transmission Tariff and Market Administration and Control Areas Services Tariff, pursuant to which NYISO offers open access to its transmission system, including the transmission facilities owned by NYSEG and RG&E, to all market participants on a non-discriminatory basis (Joint Petitioners IB at 53);

[34] Iberdrola Renewables recently completed a successful Initial Public Offering which resulted in 20% of that company being owned by unaffiliated entities (*See* Tr. 671).

(ii) NYISO's control of the planning process for new transmission required for the New York Control Area (*Id.*);

(iii) the Agreement between NYISO and TOs pursuant to which TOs are prevented from engaging in unduly discriminatory actions with respect to the operational control of lines and outage and maintenance scheduling (*Id.*);

(iv) the standardization of interconnection procedures in New York pursuant to FERC's Order No. 2003, which ensures that "TOs are not able to exercise vertical market power by favoring affiliated generators in the interconnection process" (*Id.* at 54);

(v) NYISO's "robust market monitoring program" under which NYISO has "the ability to mitigate market effects of any conduct that would substantially distort competitive market outcomes" (*Id.* at 55), which includes the NYISO market monitor's own internal authority to investigate claims and take appropriate actions if it finds that a TO may have intentionally delayed certain transmission efforts for the TO's own financial gain;

(vi) FERC's Standards of Conduct for Transmission Providers, which governs the relationship between public utility transmission providers, including NYSEG and RG&E, and their generation affiliates (*Id.*);

(vii) FERC's ability to impose substantial penalties for violations of the Federal Power Act ("FPA") and FERC's regulations and rules promulgated thereunder (*Id.* at 55-56); and

(viii) FERC's Office of Enforcement, which "assist[s] it in applying these greatly enhanced powers and has already taken significant enforcement action against a TO for, among other things, violating interconnection and OASIS-related Standards of Conduct" (*Id.* at 56).

In response to the Joint Petitioners' discussion of these specific mechanisms and their effectiveness at addressing any potential vertical market power concerns, Staff can only point to a generalized concern about "subtle" actions that a transmission owner could potentially take to disadvantage non-affiliated generation (Staff IB at 91; 94; 95; and 102), "[n]otwithstanding the nearly decade-long experience with NYISO and FERC since the issuance of the VMP Statement" (Staff IB at 91). Given that the VMP Policy Statement only establishes a rebuttable presumption against a transmission owner acquiring or being affiliated with generation in New York rather than an absolute prohibition, Staff's claim of possible, unspecified and speculative "subtle" actions is insufficient to justify placing any restrictions on Iberdrola Renewables' wind development activities. Moreover, Staff's hypothetical risks related to discriminatory access and/or actions that could potentially be taken by NYSEG or RG&E could easily be addressed, for example, through increased transparency measures, rather than the extreme prohibitions and divestitures advocated by Staff.

Indeed, Staff and IPPNY rely solely on the Commission's order on the Grid/KeySpan transaction[35] to support their proposed prohibition of Iberdrola Renewables' wind development activities in New York notwithstanding the comprehensive regulatory framework that has been put in place since the issuance of the VMP Policy Statement to prevent the exercise of vertical market power (Staff IB at 91; IPPNY IB at 4; 13). However, Staff's and IPPNY's reliance on the *NG/KS Order* is misplaced. The Commission's decision in the *NG/KS Order* was dependent on the specific facts surrounding KeySpan's Ravenswood Station in New York City, a situation that is fundamentally different from that presented by Iberdrola Renewables' wind development activities in western New York. In the *NG/KS Order*, the Commission required the divestiture of the Ravenswood Station, which is a large part of the New York City market, a load pocket with wholly inflexible capacity requirements (Tr. 855).[36] Moreover, the Commission had already determined prior to the KeySpan merger proceeding that the Ravenswood station should be divested (*see* CPB IB at 10). Ravenswood represents approximately 25% of the in-City capacity, and is pivotal in both the energy and capacity markets. In fact, Ravenswood is *the* marginal unit in the City, setting the locational-based marginal price (Tr. 855-56). By contrast, Iberdrola Renewables' wind projects are infra-marginal, and represent only a small share of the

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35 *NG/KS Order*, *supra* note 10.

36 *Id.* at 16.

NYISO Western market which has excess supply and, significantly, is connected to other Regional Transmission Operators that provide additional supply elasticity in the energy and capacity markets (Tr. 856). In addition, in the *NG/KS Order*, the Commission appears to have relied on Staff-sponsored evidence that the energy price received by Ravenswood can be, and has been, significantly affected by the operation of National Grid's New York transmission system.[37] By contrast, there has been no demonstration as to how NYSEG or RG&E would be able to use their respective transmission systems to increase the prices received by Iberdrola Renewables' wind generators in New York.

Staff's reference to a FERC complaint filed by the owner of the Ginna nuclear generating facility against RG&E in June 2007[38] similarly provides no support for Staff's conclusion that divestiture of Iberdrola Renewables' wind projects and a prohibition on future projects is required to address vertical market power concerns. Staff's suggestion that wind generation developers may become hesitant to invest in New York unless there is an absolute separation between generation and transmission (Staff IB at 106-07) is belied by the robust number of wind development projects currently active in New York, despite RG&E's existing generation holdings and the pending Ginna complaint against RG&E (Staff IB at 94-95; Tr. 816).[39] If generation developers viewed RG&E's existing generation holdings and the pending Ginna complaint as so problematic, then according to Staff's theory, there would have already been reductions in the NYISO queue for interconnections with the NYSEG and RG&E transmission facilities. Nothing in the record shows this is the case, and Staff does not assert that

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37 *Id*. at 34-40.

38 *See* FERC Docket No. EL07-77-000 (June 25, 2007).

39 Staff appears to imply that the pending Ginna complaint is evidence of NYSEG's and RG&E's ability to exercise market power. There is no support for Staff's implication. The pending Ginna complaint involves a complex, technical contract dispute between RG&E and the current owner of the plant.

RG&E has acted in an improper manner to favor its own generation. As Dr. Hieronymus explains, "If vertical market power arising from the ownership of small amounts of generation were viewed by entrants as a real problem, one would not expect to see this level of queue activity" (Tr. 859).[40]

Moreover, Staff and IPPNY have not rebutted the fact that the intermittent and unpredictable nature of wind "makes wind-powered generating facilities ill-suited to be used in the exercise of vertical market power" (Tr. 842). For related reasons, the nameplate ratings of wind projects "substantially overstate their fossil-equivalent generation capability" and wind projects typically have a maximum capacity factor (*i.e.*, average availability) of only about 30% (Tr. 816). Indeed, Staff does not contest the accuracy of the Joint Petitioners' wind capacity calculations which were used to show that there were only *de minimis* impacts of the Proposed Transaction on generation holdings by the Joint Petitioners (Staff IB at 103). Staff seeks to marginalize the importance of capacity levels by asserting that the "analysis [using energy production capacity] would be primarily directed to horizontal market power concerns. Here, the concern with the wind generator is primarily vertical market power…" (*Id.*). Staff does not explain why the energy capability of the units is relevant to horizontal, but not vertical, market power analysis. That the capability of wind generators to participate in markets is limited and

40 Staff further claims that the affiliation of Iberdrola Renewables' wind projects and the NYSEG and RG&E transmission systems would "undo the successful divestiture of RG&E's Ginna nuclear plant, and retreat from the slow progress made towards full divestiture of that utility" (Staff IB at 92). Staff provides no explanation as to the relationship between RG&E's divestiture of Ginna in 2004 and the wind development activities of Iberdrola Renewables in New York, and none is found in the record. Indeed, it would be difficult, if not impossible, for Staff to support its position that the development of intermittent wind resources by subsidiaries of Iberdrola Renewables could have any impact whatsoever on RG&E's divestiture in 2004 of a rate-based nuclear generating facility.

the effects of this transaction are consequentially *de minimis* is every bit as important to vertical analysis as it is to horizontal analysis.[41]

Staff criticizes Dr. Hieronymus for citing Case 07-E-1507 - *Long Range Electric Resource Plans* (Dec. 24, 2007) (the "ERP Order") as indicative of a softening of the Commission's policy with respect to vertical integration (Staff IB at 104). Staff states that "[n]othing in the ERP Order, however, is even relevant to the VMP Statement" (*Id.* at 105). As an initial matter, it was IPPNY's witness, Mark Younger, who first cited the ERP Order in an attempt to identify an instance in which the Commission had "reaffirmed its position that the generation function should remain separate from the T&D function" (Tr. 909). In his rebuttal testimony, Dr. Hieronymus responded to Mr. Younger's argument by pointing out that the ERP Order signals a willingness on the part of the Commission to contemplate long-term contracts that transfer some cost and performance risk from generators to customers, and it "has long been recognized that horizontal and vertical market power issues can arise from certain types of contracts just as readily as from generation ownership" (Tr. 852-53). Dr. Hieronymus concluded that the market power incentives that NYSEG and RG&E have as a result of their long-term contracts "are precisely the same as they would be if the companies" owned the facilities and, thus "any generation divestiture will not cure the vertical market power concern that Mr. Younger and Staff have raised" (Tr. 853).[42]

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41 Also, as explained in the Joint Petitioners' Initial Brief (at 51-52), the intermittent and unpredictable nature of wind makes it ill-suited for the exercise of vertical or horizontal market power (e.g., wind power cannot reasonably be sold in the larger day-ahead market (Tr. 818), and it would be economically irrational to withhold intermittent wind power (*Id.* at 818-19)).

42 Staff asserts that Dr. Hieronymus "admit[ted]" that a fixed price purchase creates no incentive to raise market prices (Staff IB at 105). In fact, Dr. Hieronymus testified to the exact opposite at the transcript page referenced by Staff – he confirmed that "[o]wnership and a long-term contract for renewable power are fully equivalent in terms of vertical and horizontal market power concerns'" (Tr. 875) (quoting Hieronymus' Rebuttal Testimony at Tr. 855). Moreover, Staff's attempt to distinguish between the role of long-term contracts in horizontal market analyses and vertical

Staff's conclusion that the ERP Order does not change the Commission's vertical market power policies that were set out in the VMP Policy Statement (Staff IB at 104) completely misses the point of Dr. Hieronymus' testimony. In the ERP Order, the Commission recites its ongoing and continued support for bilateral contracts. Dr. Hieronymus notes that, from a vertical market power standpoint, a long-term contract has the same effect as ownership, so an absolute prohibition on *ownership* on vertical market power grounds ignores the reality that the incentive to exercise vertical market power is not dependent on ownership. It is therefore the case that, in the ERP Order, the Commission expresses its support for long-term bilateral contracts that have the same incentive effects of direct ownership and, in fact, the ERP Order contemplates continuing and perhaps even expanding support for such contracts.

4. No Vertical Market Power Concerns Are Raised By Iberdrola's Minority Interests In Other European Energy Companies

In an attempt to support its claim that the Proposed Transaction will create vertical market power problems, Staff makes a number of erroneous and unsupported assertions about the nature of Iberdrola's relationship with other European energy companies with holdings in the U.S. (Staff IB at 107). For example, Iberdrola currently holds an approximately 24% interest in Gamesa Corporación Tecnológica, S.A. ("Gamesa"). Staff speculates that Iberdrola's interest in Gamesa is "surely. . . large enough to influence [Gamesa's] operations," including Gamesa's indirectly-owned wind development projects in the NYISO interconnection queue (*Id*). In fact, the record demonstrates that Iberdrola does not have access to any non-public

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market analyses is incorrect, and supported only by its mischaracterization of Dr. Hieronymus' testimony. As Dr. Hieronymus testified, a long-term contract that transfers the equity-like interest in the value of a plant's output to the buyer provides the same incentive to exercise vertical market power to increase the value of that output as would exist if the plant were owned outright (Tr. 876-77).

information on Gamesa's projects or activities by virtue of its interest in Gamesa (Exh. 55).[43] Indeed, Iberdrola's 24% interest in Gamesa is considered a non-controlling interest under the Commission's own precedent for determining what constitutes control in the context of Section 70 of the PSL.[44]

In an attempt to suggest that Iberdrola somehow exercises influence over, or has access to, non-public information about Gamesa's development activities, Staff notes that Iberdrola has purchased various U.S. wind development projects from Gamesa in other states (Staff IB at 108).[45] Staff speculates, again without providing any evidentiary support, that "most likely [Iberdrola's] initial interest in these projects arose out of its ownership of Gamesa" (*Id.*). In fact, subsidiaries of Iberdrola Renewables negotiated and entered into this agreement with Gamesa as a part of a bilateral, arm's length transaction in the context of an asset purchase agreement between the two companies with respect to projects located outside of New York (Tr. 728 and Exh. 55). Contrary to Staff's suggestions, Iberdrola Renewables' acquisition of these projects was wholly unrelated to Iberdrola's interest in Gamesa (Tr. 728-29). This agreement does not provide Iberdrola with any access to non-public information on Gamesa's development activities in New York and is irrelevant to any market power considerations in this case and Staff has not offered any evidence (other than unsupported speculation) suggesting otherwise.

Staff states that "Iberdrola owns some of its interests in Gamesa indirectly, in cooperation with another partner" (Staff IB at 108). To the extent that Staff is referring to the

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43 *See* Case 07-M-0906 - *Joint Petitioners' Responses to On the Record Requests and Items Subject to Check* (Apr. 4, 2008) (response to on-the-record request at Tr. 601).

44 *See* Case 07-E-0288 - *Astoria Energy, LLC et al., Declaratory Ruling on Review of an Ownership Interest Transfer and Making Other Findings* (May 16, 2007) (finding that the indirect ownership of 30.45% "is less than a controlling interest" for purposes of triggering Section 70 of the PSL).

45 To be precise, the entities that have acquired wind development projects from Gamesa in the U.S. are subsidiaries of Iberdrola Renewables.

interests in Gamesa held by Corporación IBV Participaciones Empresariales, S.A. ("IBV"), which is owned 50% by Iberdrola and 50% by Banco Bilbao Vizcaya Argentaria, S.A. ("BBVA"), Iberdrola already has shown that IBV sold its interest in Gamesa in March 2008.[46] Staff speculates that Iberdrola "carefully evaluated its investment in Gamesa with that other partner ([Tr.] 599-607), based on information that most likely went beyond that available to the general public, notwithstanding its protestations to the contrary" (Staff IB at 108). As described above, Iberdrola does not have access to any information on Gamesa that is "beyond that available to general public."[47] In fact, because IBV acquired its initial interest in Gamesa in 1990 and Iberdrola did not acquire a direct interest in Gamesa until approximately fourteen years later, it would have been unrealistic for Iberdrola to have used any non-public information gained from its direct investment in Gamesa (even if it had access to such information, which it does not) to evaluate IBV's investment in Gamesa.[48] Accordingly, Staff's concerns regarding Iberdrola's relationship with Gamesa are unsupported by the record and without merit.

Staff makes a similar assumption about Iberdrola's indirect interest in Horizon Wind Energy ("Horizon"), which has a 50% interest in the Flat Rock and Flat Rock II Projects in New York (Staff IB at 109). Iberdrola holds a 9.5% equity interest in Energías de Portugal, S.A. ("EdP"), which holds a 70% interests in Horizon, but Iberdrola may not exercise voting rights that represent more than 5% of EdP's voting share capital and does not have any seats on the EdP Board (Tr. 520-21). Despite Staff's unsupported speculation to the contrary, Iberdrola simply has no access to non-public information on Horizon Wind's development activities, and

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[46] *See* Case 07-M-0906 - *Joint Petitioners' Responses to On the Record Requests and Items Subject to Check* (Apr. 4, 2008) (response to on-the-record request at Tr. 601).

[47] *Id.*

[48] *Id.*

is not involved in the decision-making with respect to those activities (*Id*.). In fact, this 5% voting interest (and even a 9.5% interest) would be considered a non-controlling interest under both Section 70 of the PSL and Commission precedent.[49] As such, neither Iberdrola's interest in Horizon nor its interest in Gamesa has any vertical market power impact in New York.

B. Staff's Analysis Of Affiliate Risk And Related Issues Unjustifiably Exaggerates The Impact Of Alleged Holding Company Risk On NYSEG And RG&E

Staff raises generalized concerns regarding the risk of affiliate transactions upon consummation of the Proposed Transaction, and risks associated with having Iberdrola step in as a new upstream holding company of NYSEG and RG&E (Staff IB at 40). Staff improperly disregards important regulatory tools at the Commission's disposal, as well as additional commitments made by the Joint Petitioners to guard against any potential incentive for affiliate abuse. As discussed below and reflected in Attachment 1, Iberdrola would be willing to accept Energy East's existing Standards Pertaining to Affiliates and the Provision of Information ("Affiliate Transaction Rules") by effectively "stepping into the shoes" of Energy East in the current document; however, Staff has proposed unnecessary and inappropriate additional changes to the existing Affiliate Transaction Rules applicable to Energy East, NYSEG and RG&E that should be rejected. Staff also contends that the "regulatory compact" discussed by Dr. Makholm does not exist in New York and therefore offers no assurances to ratepayers; however, this position is based on Staff's own misunderstanding of Dr. Makholm's use of that term and a misinterpretation of applicable caselaw on this issue.

[49] *See supra*, note 44.

1. The Commission Has Extensive Regulatory Authority To Monitor Affiliate Transactions

The Commission has many tools to ensure that the ratepayers of NYSEG and RG&E are protected against the potential risks that Staff claims are associated with the Proposed Transaction. Apart from its broad powers to ensure that rates are just and reasonable under Sections 65 and 72 of the PSL, the Commission has extensive authority over affiliate transactions pursuant to Section 110 of the PSL. The Commission has the power to review the accounts and records relating to affiliate transactions and records of joint or general expenses.[50] Any management, construction, engineering or similar contract with an affiliated interest must be filed with the Commission before it becomes effective and no charge for any such service shall exceed the reasonable cost of such service. The Commission may disapprove such a contract if found not in the public interest. In any proceeding to determine the reasonable cost of such charge or service, the burden of proof is on the utility.[51] As Dr. Makholm further explains, there is nothing about Iberdrola stepping in as the upstream owner of Energy East that "changes the way in which this Commission will continue to work to protect ratepayers" (Tr. 1076-77).

2. The Joint Petitioners Have Committed To Additional Measures To Assure That There Will Be No Potential Incentives For Cross-Subsidization

For additional protection, the Joint Petitioners have committed to a number of measures to ensure that there are no potential incentives for cross-subsidization among NYSEG, RG&E and Iberdrola's unregulated affiliates, including:

- The continued utilization of Energy East's cost allocation methodologies and a commitment that Energy East will allocate centralized costs from Iberdrola to NYSEG or RG&E only to the extent that such costs are properly chargeable to utility operations and accepted by the Commission (Tr. 560);

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50 N.Y. Pub. Serv. Law § 110(2) (McKinney 2008).

51 *Id.* § 110(3).

- NYSEG and RG&E maintaining separate and independent accounting records and financial statements from those of Iberdrola and all other affiliates (*id.*);

- Strict limitations on asset transfers from NYSEG and RG&E (*id.*);

- Strict limitations on NYSEG and RG&E loans to Iberdrola or any unregulated affiliate (*id.)*;

- Strict limitations on NYSEG and RG&E providing guarantees, collateral, or pledges, or any other type of credit support for the benefit of Iberdrola or any affiliate (*id.)*; and

- The continued implementation of the Commission's Affiliate Transaction Rules by having Iberdrola step into the shoes of Energy East in the language of those Rules.

With respect to the last item, Iberdrola commits to accept Energy East's existing Affiliate Transaction Rules, by effectively replacing Energy East in the current document. Staff acknowledges that the existing affiliate transaction rules are adequate to govern the relationship between Energy East holding and service companies, NYSEG and RG&E (Tr. 1425-26). Staff remains concerned, however, that these rules will no longer suffice after the consummation of the Proposed Transaction even though the record provides no basis for adopting Staff's nebulous proposal to revisit the Affiliate Transaction Rules (Exh. 111) "to capture the nuances and unknowns related to future dealings between Iberdrola, Energy East and the utilities" (Tr. 1426). The Commission's broad statutory authority, the currently existing protections governing dealings between utility operating companies and their affiliates, and the additional protections that the Joint Petitioners have committed to in this proceeding will provide the Commission with ample means to ensure that NYSEG and RG&E ratepayers remain protected against any unnecessary or unreasonable charges relating to affiliate transactions.

3. Staff's Proposal To Revise The Affiliate Transaction Rules Is Unnecessary And Inappropriate

Despite the Joint Petitioners' extensive commitments, discussed above, Staff proposes numerous alleged "enhancements" to the Affiliate Transaction Rules (Staff IB at 166), which were set forth in Appendix B to the 2002 Energy East/RGS Merger Joint Proposal (Exh. 111).[52] In its testimony, Staff attaches a revised clean copy of its proposed revised Affiliate Transaction Rules, without providing a complete list or analysis of Staff's proposed changes.

Although seemingly an obvious point, it is important to remember what the Affiliate Transaction Rules are intended to cover: requirements that govern the *transactions* between regulated utilities and their affiliates.[53] Staff claims that its proposed revisions to the Affiliate Transaction Rules are required to reflect the changes contemplated in the Proposed Transaction (Staff IB at 166). However, the most problematic of Staff's proposed changes have nothing to do with the Proposed Transaction, but rather, are reflective of a desire to expand the scope of the Affiliate Transaction Rules beyond *"affiliate transactions."* Staff would have the Affiliate Transaction Rules control all possible business, operational and financial aspects of any affiliated business regardless of whether those businesses ever have any contractual dealings or other business relationship with NYSEG or RG&E (Exh. 111, at 14-17). The record provides no basis for adopting Staff's proposed changes to the Affiliate Transaction Rules. Moreover, in combination with the many protections set forth in the existing Affiliate Transaction Rules, the

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52 Notably, the existing Affiliate Transaction Rules were the result of careful negotiations among all interested parties to the Energy East/RGS merger.

53 In Staff's statement supporting the 2002 Energy East/RGS Merger Joint Proposal, Staff Counsel noted that the Joint Proposal established the currently existing Affiliate Transaction Rules for Energy East, RGS, NYSEG and RG&E to set up "rules governing *affiliate relationships* among regulated entities, unregulated affiliates, and Staff" and to facilitate "the auditing of *transactions* for goods and services and cost allocations *between* the NYSEG, RG&E and any affiliates." Case 01-E-0359 and Case 01-M-0404 - *Energy East Corp., RGS Energy Group, Inc., et al., Staff Statement in Support of Joint Proposal*, at 10-11 (Jan. 23, 2002) (emphasis added) (included as Exh. 124 in the record of Case 01-E-0359 and Case 01-M-0404).

Joint Petitioners have already committed to numerous measures to resolve Staff's concerns regarding affiliate transactions (Joint Petitioners IB at 6; Tr. 560; Attachment 1). These commitments are set forth above and in the Joint Petitioners' Initial Brief.

Staff's Initial Brief downplays the extent of the changes Staff recommends to the Affiliate Transaction Rules (Staff IB at 167-68). Staff focuses on three relatively minor changes to these Affiliate Transaction Rules (*Id.*). For instance, Staff recommends that any management corporation that receives certain information enter into a protective order with the utility (Staff IB at 167; Tr. 1428-29). Although administratively burdensome and seemingly unnecessary, this modification is not a significant problem. Similarly, the Joint Petitioners have relatively minor concerns with the other two changes Staff identifies in its Initial Brief.[54]

However, Staff does not provide any discussion or analysis supporting its most significant modifications to the Affiliate Transaction Rules. For example, the preface to the books and records provisions in the existing Affiliate Transaction Rules appropriately provide: "The following provisions govern the access by Staff to books and records, in order for Staff to have the ability to audit all transactions for goods and services and cost allocations that occur between the DISCO and any affiliates."[55] Staff's proposed changes to those books and records requirements would eliminate this affiliate transaction qualifier entirely, and provide overly

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54 For example, the Joint Petitioners oppose Staff's proposed modifications to restrictions on NYSEG's and RG&E's use of trade dress (Staff IB at 167). If implemented, it would prevent dissemination of important factual information regarding the relationship between the various affiliated companies and would increase rather than reduce potential customer confusion. The proposed change to the Trade Dress section, if adopted, might also require Energy East's unregulated ESCO affiliate, NYSEG Solutions, Inc., to change its name and marketing, thus destroying the value of its current brand and causing harm to the competitive energy services company marketplace. Similarly, Staff's proposed changes to the transfer of goods and services requirements of the Affiliate Transaction Rules (*id.* at 167-68) would unfairly penalize affiliates. Transactions between NYSEG and RG&E and affiliates should, at a minimum, be symmetrical.

55 Case 01-M-0404 - *Energy East Corp., RGS Energy Group, Inc., et al., Joint Proposal,* at Appx. B (Jan. 15, 2002).

broad access to *all* books and records of *any* Iberdrola affiliate, regardless of whether they are relevant to transactions with NYSEG and RG&E (Exh. 111, at 7). This attempt to expand the scope of the Commission's Affiliate Transaction Rules beyond such affiliate transactions is unsupported by the facts or the law.

Additionally, provision 5(a) of Staff's revised Affiliate Transaction Rules would prohibit Iberdrola affiliates from providing any goods and services to NYSEG and RG&E (Exh. 111, at 13). Such a provision effectively prohibits NYSEG and RG&E from ever identifying future opportunities to increase service quality or create efficiencies (which could, in turn, reduce rates following future rate proceedings (Tr. 526; 982-83)) through possible future affiliate arrangements, including through the sharing of information regarding best practices. The Commission should preserve its own flexibility and discretion to review transactions between Iberdrola affiliates and NYSEG or RG&E so that the Commission could determine, on a case-by-case basis, whether to permit such transactions (*i.e.*, particularly if, indeed, they create valuable service enhancements or efficiencies that the Commission deems worthwhile).

Moreover, Staff's revised Affiliate Transaction Rules (Exh. 111) are riddled with errors and illogical provisions. For example:

- Provision 4(f) relating to Personnel states that "the compensation of the officers of RGS, Energy East or Management Corp. who are also officers of the DISCO may be based upon the performance of the DISCO" (Exh. 111, at 12). Yet, provision 4(c) prohibits officers of Energy East, RGS, or Management Corp. from ever being officers of the DISCO in the first place (*Id.* at 11).

- The newly added last sentence of provision 4(d) is nonsensical: "After the DISCO will be entitled to compensation resulting from transfers of its employees to unregulated affiliates[sic], equivalent to 25% of the employees [sic] salary and benefits..[sic]" (*Id.* at 12).

- Provision 5(c), which is also nonsensical, states: "Iberdrola affiliates may not provide services to Energy East, RGS, Management Corp. and the DISCO, not [sic] may they engage in "chaining transactions" (*Id.* at 14).

- That same Provision 5(c) also seeks to prohibit "chaining transactions," but never defines what Staff means by that term and why such a prohibition would not already be covered in the other provisions Staff recommends (*Id.* at 14).

- Without any support in the record, Staff has added multiple other provisions to its revised Affiliate Transaction Rules in an attempt to impose conditions related to various issues ranging from financial reporting (*id.* at 8) to credit quality goals to dividend restrictions to money pools, etc. (*id.* at 14-17), all of which are conditions that the Joint Petitioners rebut in other Sections below.

These errors and illogical provisions make it impractical for the Commission to adopt Staff's revised Affiliate Transaction Rules. As stated above, Iberdrola is willing to accept Energy East's existing Affiliate Transaction Rules along with the Joint Petitioners' additional commitments in Attachment 1. Staff's proposed modifications should be rejected and the existing Affiliate Transaction Rules, which have functioned well and were approved by the Commission previously, should remain intact without modification.

4. Despite Staff's Assertions, And Regardless Of Terminology, The Principles Behind The Regulatory Compact As Discussed By Dr. Makholm Are Alive And Well In New York

Staff also claims that the "regulatory compact" will not shield NYSEG and RG&E from the harm it believes may result from purported risks of the Proposed Transaction because, according to Staff, the regulatory compact does not exist in New York (Staff IB at 35). Staff criticizes Dr. Makholm's testimony regarding basic tenets of U.S. utility regulation, namely that "compensation for the owners of utilities depends on the adequacy and quality of service to the public" and that if the public "is not well served" regulators "can apply specific sanctions to the company" (Tr. 1051). Staff's position amounts to quibbling over semantics, namely, how "regulatory compact" is defined, and, tellingly, no other party raises any similar objection.[56]

[56] This does not present an important issue for the ALJ or the Commission and the resolution of this debate is of no consequence to the issues in this proceeding. Joint Petitioners are responding on this point because they submit that Staff's analysis of this issue is incorrect.

Staff latches onto the term "regulatory compact" used by Dr. Makholm, but ignores how Dr. Makholm actually uses the term in his testimony, *i.e.*, by defining it with reference to the ability of regulators to modify rates and/or apply sanctions as needed if there are problems with the adequacy and quality of service to the public. Staff suggests that, in New York at least, these bedrock principles of cost-of-service regulation were thrown out in a 1996 decision by a lower court in Albany County.[57] This claim is not accurate, and in any event, misses Dr. Makholm's point. The case cited by Staff, *Energy Association,* merely rejected the petitioning utilities' attempt to invoke and define the "regulatory compact" as a guaranteed right of a utility to recover 100% of certain "stranded costs" caused by utility restructuring. By contrast, the cornerstone of the regulatory compact and cost-of-service regulation as discussed by Dr. Makholm is very much alive and well in New York State. Traditional regulation provides the Commission with the ongoing ability to shield ratepayers effectively from any potential harm that Staff claims may result from the Proposed Transaction.[58] If the Staff's declaration that the "regulatory compact" (as Dr. Makholm defines the term) is dead is given any weight, the Commission would also need to find that its traditional cost-of-service regulatory authority is similarly moribund. Furthermore, Staff's arguments do not bear on any issue relevant to the Commission's determination and the Commission should disregard them.

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[57] *See* Staff IB at 35 (citing *Energy Ass'n v. Pub. Serv. Comm'n*, 169 Misc. 2d 924, 938 (Sup. Ct., Alb. Cty. 1996) ("*Energy Association*")).

[58] *See, e.g.*, Case 29124 - *Proceeding on Motion of the Commission to Investigate the Prudence of Costs Incurred for the Construction of the Nine Mile Point II Nuclear Generating Facility*, 1986 N.Y. PUC LEXIS 365, *82 (Feb. 21, 1986) (in the Commission's investigation of the prudence of costs incurred for the construction of the Nine Mile Point II nuclear facility, the Commission confirmed that ratepayer protections are derived from the Commission's fundamental obligations under the PSL and that "the doctrine that ratepayers will not be charged for expenses that are imprudently incurred, derives from the duty of the commission to set just and reasonable rates.").

5. The Commission Should Reject Staff's Alleged Miscellaneous "Holding Company Risks"

Staff points to certain sanctions and fines that have been imposed on Iberdrola and its operating utilities around the world to suggest that Iberdrola has "problems with regulatory compliance" (Staff IB at 41). No other party identifies this as a potential risk of the Proposed Transaction in its Initial Brief, and Staff's concern in this regard is clearly misplaced. The mere fact that Iberdrola's operating utilities in other parts of the world have been fined in connection with certain regulatory matters is not indicative of an overall regulatory compliance problem, nor is it relevant to Iberdrola's potential ownership of NYSEG and RG&E. In fact, Staff admits that it has not compared Iberdrola's compliance record with those of any other domestic or foreign utility or utility holding company (Exh. 42, IBER/EE IR No. 12).

Staff also continues to assert that "problems may arise from affiliation with unregulated subsidiaries" (Staff IB at 46). Staff believes that Iberdrola has "complex webs of affiliations [that] are difficult to track, and expand upon the potential that Iberdrola will exercise market power" (*Id.*). For the reasons described in Section III.A, the record demonstrates that the VMP Policy Statement's presumption is inapplicable or has been satisfactorily rebutted with respect to the Proposed Transaction.

Staff's generalized concerns about Iberdrola's organizational structure are also unconvincing (*see, e.g. id.* at 40; 44-45). Iberdrola's organizational structure is not particularly complex and is similar to other organizations that include a variety of operating utilities and an unregulated entity that holds separately financed generation projects (Tr. 559). Iberdrola has significant experience in the ownership of both regulated and unregulated operating companies (*Id.*). There is nothing about this acquisition, moreover, that "prevents the Commission, or the Staff, from regulating NYSEG and RG&E as it has always done" given the "traditional care and methods that state regulatory agencies apply in regulating utility operating companies," as Dr. Makholm explains (Tr. 1070).

Staff attempts to use the existing agreement between Community Energy, Inc. ("Community"), a subsidiary of Iberdrola Renewables, and NYSEG to support its claim that the Proposed Transaction will raise affiliate abuse concerns. Staff's position on this point is unreasonable. As Staff acknowledges, the agreement between Community and NYSEG was executed *prior to* the initiation of merger discussions between Energy East and Iberdrola (Staff IB at 47). The Joint Petitioners have committed to comply fully with the Commission's and FERC's standards, regulations and policies with respect to the relationship between their regulated and unregulated affiliates (Tr. 559), which would include the relationship between Community and NYSEG. Moreover, the Joint Petitioners have also committed to additional measures to ensure further that there are no potential incentives for cross-subsidization among NYSEG, RG&E and Iberdrola's unregulated affiliates (Joint Petitioners IB at 78). Staff has not even attempted to explain why these enhanced measures would be insufficient to prevent affiliate abuse with respect to the Community contract or any other affiliate relationships.

Staff also alleges that there may be risks pertaining to Iberdrola's confidentiality designations in future litigated proceedings (Staff IB at 47-49). While Staff cites two instances of concern in this proceeding where Staff now thinks that confidentiality designations should not have attached (neither of which Staff raised as a concern to the Joint Petitioners, let alone challenged with the ALJ), Staff does not clarify what risk purportedly exists here. Staff does not claim that it was unable to review the materials marked as confidential or that Staff would be unable to review such materials in future proceedings. Similarly, Staff does not claim that it was unable to raise its concerns about such designations with the Joint Petitioners or to challenge such designations with the ALJ and the Commission, or to raise either such concerns in future proceedings. Staff retains all of its rights on these matters – both in the pending and in future proceedings.

C. Staff Exaggerates Credit Rating Risk Through Its One-Sided Interpretation Of Credit Reports And, As A Result, Proposes Certain Overreaching Structural "Protections" That The Commission Should Reject

It is undisputed that Iberdrola maintains a higher credit rating than Energy East, NYSEG and RG&E (*see* Staff IB at 52; Joint Petitioners IB at 29-30). Staff, however, stands Iberdrola's higher credit rating on its head, and takes the irrational position that the Commission should view Iberdrola's stronger credit profile as a "risk." Staff relies on two flawed arguments: (1) that it is reasonable to presume that Iberdrola's credit quality will deteriorate in the future after consummation of the Proposed Transaction; and (2) that, if Iberdrola's credit is analyzed through Staff's own "credit quality lens," it would actually have a worse credit rating than that assigned by major credit ratings agencies themselves.

There is, however, only one salient and irrebuttable fact relevant to the Commission's determination on this issue: the financial profiles, business structures and relative risks of Iberdrola and Energy East have been analyzed extensively by professional credit analysts at S&P, Moody's and Fitch, and all three agencies reach the same conclusion—Iberdrola has a stronger credit profile than Energy East, NYSEG and RG&E. Staff's deviations from the approach used by the primary credit rating agencies and Staff's misapplication of selected financial ratios should be dismissed and not given any weight. The ALJ and the Commission have credit ratings and credit rating agency reports they can review and rely upon. Misreading those reports in an outcome-determinative fashion, as Staff appears to be requesting here, is inconsistent with the type of regulatory paradigm that the Joint Petitioners believe this Commission should endorse. Furthermore, although Iberdrola has already committed to undertake several of the steps that Staff advances as its proposed conditions to address potential financial risks, most of the other conditions proposed by Staff are overreaching and unreasonable.

1. Staff's Assessment Of Future Credit Downgrade Risk Is Speculative And Exaggerated

Staff argues that, although pre-funding the acquisition of Energy East with an equity issuance was "the most fiscally-prudent avenue for Iberdrola to finance the transaction" the ability to fund with equity is "squandered" because of increased Goodwill that will be placed on Iberdrola's balance sheets (Staff IB at 53). Staff claims that Iberdrola will have a *pro forma* post-acquisition capital structure of 42% equity and 58% debt and that a "58% debt figure is inconsistent with" Iberdrola's current "A" category credit rating (*Id.*). Ignoring the credit ratings agencies' uniform "stable" outlook, Staff further claims that "trends" and "uncertainties" in the future indicate possible downgrades (*Id.* at 54-55).

Staff's claims make no sense. Shortly after acknowledging that credit agencies have affirmed "A" category ratings for Iberdrola, Staff argues that Iberdrola's debt ratio is "inconsistent" with that rating. Inconsistent by whose standard? Certainly not with the standards applied by any of the major credit ratings agencies, which have reaffirmed "A" category ratings with "stable" outlooks. Instead, Staff's argument that Iberdrola's debt ratio would be more "consistent with a BBB bond rating" rests on an invented rating based on two faulty assumptions: (1) Iberdrola will have a 58% debt ratio; and (2) 2004 ratings guidelines by S&P remain valid and applicable. The record shows that Iberdrola has a debt ratio of approximately 50%, not a 58% debt ratio (*see* Exh. 70 (Moody's, affirming that Iberdrola is committed to "maintain a leverage of 50%")); Tr. 778 (citing S&P's December 13, 2007 affirmation that it expects Iberdrola to maintain gearing (*i.e.*, its debt ratio) below 50%); *see also*

Exh. 20).[59] The record also shows that the dated S&P guidelines from 2004 that Staff relies upon (Exh. 102) applied only to domestic U.S. utilities (and therefore not Iberdrola) and were, in any event, replaced in November, 2007 (Joint Petitioners IB at 64-65 (citing Tr. 749; 782)). Staff ignores the currently applicable (and not obsolete) guidelines from Moody's that are part of the record evidence in this proceeding. These guidelines are indisputably the best evidence in the record of financial ratio guidelines and show that Iberdrola remains safely within an "A" category rating based on the debt/capital ratio metric that those guidelines recommend (Exh. 114, IBER/EE IR No. 164, Figure 5).[60]

Staff's argument about future "pressures" on Iberdrola's credit ratings is also unavailing (Staff IB at 54-57). Staff notes that the Proposed Transaction "itself" may "cause further downgrades," but fails to explain why or how, or to provide the basis for such a pessimistic prediction. S&P's November 16, 2007 report on Energy East provides an explanation of why there is pressure on NYSEG and RG&E—S&P has expressed specific concerns that this Commission will take adverse regulatory action in this proceeding that "could impinge on cash flow metrics" of the New York operating utilities (Exh. 69; *see also* Exh. 70, at 11 (Moody's February, 2008 credit analysis of Iberdrola, noting that Moody's negative outlook for Energy East reflects that the merger approval could be conditioned on "additional rate concessions")). Thus, to the extent there is any possibility of future pressure on NYSEG's or RG&E's credit ratings, such pressure would appear likely only if, hypothetically (and

59 *See also* Tr. 777-78 (explaining that both S&P and Moody's have "indicated comfort with Iberdrola's debt level").

60 MI echoes Staff's arguments regarding the possibility of a future decline in credit quality, but because MI's position rests solely upon Staff's flawed analysis, its arguments must also be disregarded (*see* MI IB at 37).

unrealistically), Staff's proposed PBAs, one-time adjustments and other rate concessions - which would result in a 26% decline in annual delivery revenues - are accepted.

Although Staff cites statements in Moody's and S&P reports regarding certain business risks of Iberdrola (*see* Staff IB at 55-57), Staff fails to balance its analysis with the many positive statements made by those ratings agencies. For example, S&P, in affirming its "Stable" outlook for Iberdrola, stated that the company can be expected to "focus on consolidating its operations" and "strengthen the group's capital structure" and that "[c]redit metrics should remain in line with the levels indicated" (Tr. 760). Moody's praised Iberdrola's "increased scale" as a positive factor that provides "diversification of risks" (Tr. 761-62). In the Commission's review of the record, however, it need not even delve into Staff's (or Joint Petitioners') comparison of the ratings agencies' various commentaries regarding Iberdrola. This is because the ratings agencies' professionals have undertaken this comparative analysis themselves and concluded that Iberdrola is a stable "A" category rating company with credit quality superior to Energy East, NYSEG and RG&E.

Staff tries to buttress claims already made by its Policy Panel that, based on Staff's own invented ratings criteria, Iberdrola's "risk profile" and Funds From Operations ("FFO") metrics demonstrate credit risk more consistent with a "B" category company—notwithstanding Iberdrola's *actual* "A" category rating (Staff IB at 61-65). No matter how hard Staff tries, however, there is no serious question that the best evidence of Iberdrola's credit strength comes from the credit ratings agencies themselves, and not from Staff.

For example, while Staff must concede that the S&P financial guidelines relied on by the Staff Policy Panel were outdated (*id.* at 62), Staff tries to resurrect its claim that Iberdrola has a "riskier" profile under the new S&P guidelines for business profile risk (which replaced a numeric scale with five categories denominated by adjectives ranging from Vulnerable to Excellent). Significantly, S&P has not rated Iberdrola under these categories because it is not a U.S.-based utility, so there is nothing in the record to support any attempt to assign such a category to Iberdrola. Staff proceeds undeterred, however, and without any evidence in the record, steps into the shoes of S&P and labels Iberdrola as having a "Satisfactory" ranking.[61] Staff then concludes that Iberdrola would "seem to" be placed in a BB+ to BBB range (*Id.* at 63). In short, consistent with Staff's outcome-determinative approach in this proceeding, Staff arbitrarily assigns Iberdrola a category, without any evidentiary support, and then backs into a new rating contradicted by the credit rating agencies' own findings. To the knowledge of the Joint Petitioners, the Commission has never accepted second-guesses on credit ratings from Staff (or any other party) as a substitute for the *actual* credit ratings and analyses from the major credit ratings agencies themselves. The Commission has not (and should not now) assume that Staff's own manufactured credit "analysis" is superior to those analyses issued by the credit professionals at S&P and Moody's.

Staff also responds to Mr. Fetter's showing that Iberdrola's FFO interest coverage and FFO total debt metrics are important measures that properly support the "A" category rating that Iberdrola enjoys (*Id.* at 64 (citing Tr. 757)). While Staff concedes that, as recently as February 2008, Moody's assessed Iberdrola's financial indicators (*id.* at 64) and then reaffirmed Iberdrola's "A" category rating (*see* Exh. 70), Staff then tries to make *its own* comparison under Moody's 2005 guidelines and declare that the results are "not definitive" (Staff IB at 64). Of

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61 Staff cites nothing to support its claim that Iberdrola's "5" ranking from S&P is the equivalent of a "Satisfactory" ranking under the five category rankings S&P is now using for U.S. utilities. The overwhelming number of U.S. utilities that have an "A" category credit rating, like Iberdrola has, have either a "Strong" or "Excellent" ranking under the new S&P guidelines (Exh. 65) (showing rankings of most U.S. utilities).

course, these "results" are not definitive—Moody's never intended for its financial ratio metrics applied to global utility companies to be utilized in an arbitrary manner by Staff, and neither did S&P, which emphasized as much in its discussion of its *indicative* ratios in November 2007:

> Note that even after we assign a company a business risk and financial risk, the committee *does not arrive by rote at a rating based on the matrix.* The matrix is a guide -- it is not intended to convey precision in the ratings process or reduce the decision to plotting intersections on a graph.

(*see* Exh. 66 at 3, "U.S. Utilities Ratings Analysis Now Portrayed In The S&P Corporate Ratings Matrix" (emphasis added)). The Staff-generated, extra-record attachment to its brief which tries to depict Staff's unsupported "comparison" (Staff IB, Attachment 2), based on Staff's rote plotting on various matrices, has no relevance or foundation and must be disregarded.[62]

Not surprisingly, even though Staff has quoted extensively from portions of independent credit agency reports that it likes, it ultimately resorts to claiming that the rating agencies are not reliable because Staff does not like their conclusions. Staff disparages any reliance on credit agency reports because they have "failed to timely warn the public" of instances of corporate decline (Staff IB at 65-66 (citing the sub-prime mortgage crisis)). It is unclear what position Staff is really taking here—no party to this proceeding nor any credit agency can predict future events with certainty and make related guarantees to this Commission (including Staff itself). However, there is nothing in the record that provides any basis for questioning the relative comparisons of Iberdrola's credit strength against that of Energy East, NYSEG and RG&E, based on the analyses of respected and widely used credit ratings agencies.

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62 Joint Petitioners object to the attempt by Staff to "introduce" Attachment 2 post-hearing. Attachment 2 is not simply a compilation of information already in the record, nor is it otherwise public information or information of the type typically updated through non-controversial methodologies. The Joint Petitioners have had no opportunity to test or refute it and urge the ALJ and the Commission not to include Attachment 2 as part of the official record.

Staff's other credit-related claims also lack merit. For example, Staff argues that the Joint Petitioners fail to demonstrate that Iberdrola would yield credit rating improvements or better access to capital markets because (1) the announcement of the acquisition did not result in a positive impact on NYSEG's and RG&E's ratings; and (2) NYSEG issued new debt in November, 2007 at a price 225 basis points above the 10-year Treasury rate (*Id.* at 57-58). The record demonstrates that the reason there has not yet been any positive impact on NYSEG's or RG&E's ratings is because the Proposed Transaction has not yet been consummated, and because there is uncertainty over whether this Commission may propose merger conditions that would create circumstances under which ratings could decline (Tr. 771-72).[63] As for the NYSEG debt issuance, the Joint Petitioners have demonstrated that the reasons for the 225 basis point differential had nothing to do with the Proposed Transaction; instead, the differential was caused by several unrelated factors (Tr. 395; Joint Petitioners IB at 68) (*e.g.*, the issuance was not "index eligible" and therefore was subject to higher pricing, and NYSEG comes to the market relatively less frequently and is therefore less familiar to investors).

Surprisingly, Staff attempts to bolster its point that Dr. Makholm has exaggerated the issue of the harsh regulatory environment in New York by introducing the Commission's recent rate order applicable to Consolidated Edison ("Con Ed").[64] While Staff concedes that Fitch and S&P *downgraded* Con Ed *after* the Commission's decision in that proceeding (Staff IB at 68), which lowered the utility's allowed ROE to 9.1%, Staff incorrectly suggests that only

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[63] The defensive arguments advanced by Staff regarding Dr. Makholm's analysis of the influence that the 2006 NYSEG rate case decision had on the credit ratings of NYSEG and RG&E are also unpersuasive (Staff IB at 67-68). It is uncontroverted that both S&P and Moody's have cited and relied upon the 2006 rate case decision as a factor in their current ratings of NYSEG and RG&E (Tr. 770-71).

[64] Staff IB at 68 (citing Case 07-E-0523 - *Consolidated Edison Co. of New York, Inc., Electric Rates, Order Establishing Rates for Electric Service* (Mar. 25, 2008) ("*Con Ed Rate Order*")).

Fitch linked a negative movement in ratings analysis to comments critical of the Commission (*Id.*). This is untrue. Moody's issued a new negative outlook and noted the following:

> The change to negative rating outlooks for the companies also takes into account *our more guarded view* than we have had in the past about *the extent to which the New York regulatory environment will be supportive*…. [Con Ed's] electric rate case, which granted only about 35% of the $1.2 billion rate increase requested (new rates effective April 1, 2008), also based on a 9.1% allowed ROE (*reportedly the lowest ROE granted to an electric utility in over 30 years*).[65]

Thus, contrary to Staff's position, this example strongly confirms Dr. Makholm's concerns over the impact of adverse regulatory treatment on credit quality.

The Commission also must recognize the inconsistency of Staff positions on credit issues here, as compared to the *Con Ed Rate Order*. In the *Con Ed Rate Order*, Staff's testimony shows that it undertook its rate comparisons and credit analyses based on the actual "A" rating that Con Ed then enjoyed and never tried to "invent" a different credit rating for the utility based on its own substituted analysis.[66] Here, Staff switches its position on credit ratings, apparently because Iberdrola's superior credit, if taken at face value, would detract from Staff's arguments here in opposition to the Proposed Transaction. Picking and choosing inconsistently among credit rating analyses diminishes the credibility of Staff's positions on these issues.

2. Staff's Proposed Conditions To Mitigate Staff's Exaggerated Credit Risks Are Unjustified; Iberdrola Has Made Sufficient Commitments To Address This Issue

Staff proposes five conditions related to its purported credit quality concerns: (1) NYSEG, RG&E and Iberdrola shall maintain credit ratings with S&P and Moody's; (2) Iberdrola, Energy East, NYSEG and RG&E should have a stated goal of maintaining investment

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65 *See* Attachment 2, at 2 (emphasis added).

66 *See generally* Case 07-E-0523 - *Consolidated Edison Co. of New York, Prepared Testimony of Staff Finance Panel* (Mr. Michael Augstell and Mr. Jeffrey Hogan) (Sept. 2007).

grade ratings on their securities; (3) copies of presentations to credit agencies and backups should be provided to the Commission; (4) a credit downgrade at either NYSEG or RG&E by S&P or Moody's will require filing a plan with the Commission to remedy the downgrade; and (5) in any future NYSEG or RG&E rate proceeding, customers should not be responsible for the effect of any downgrading from present debt ratings (BBB+/Baa1) (Staff IB at 139). Certain intervenors support Staff's proposed conditions; however, they proffer no record evidence of their own that would justify them (*see, e.g.*, MI IB at 38-39; 44; CPB IB at 15).

Of these five conditions, Iberdrola has in all material respects committed to Conditions (1) and (2) (Joint Petitioners IB at 5; Tr. 554), and with regard to Condition (3), has agreed to provide slide presentations to credit agencies and copies of credit reports relating to NYSEG and RG&E, thus addressing the substance of Staff's proposed condition (*Id.*). Any further requirement to provide "backup" for these presentations to credit agencies is unsupported and bears no relationship to anything Staff needs to maintain effective regulation over NYSEG and RG&E. The Joint Petitioners have further addressed the concern in Condition (4) by committing to: (i) file with the Commission to notify it in the event that there is a "Credit Event" (defined as the downgrade of Iberdrola's, Energy East's, NYSEG's or RG&E's credit rating below "BBB"/"Baa3," or credit rating of "BBB-"/"Baa3" with a "Watch Negative," by at least two major credit reporting agencies (*e.g.*, S&P and Moody's)), and (ii) identifying the current credit rating during such Credit Event, and provide a plan to remedy such Credit Event, until such Credit Event is eliminated (Joint Petitioners IB at 5). This commitment is set forth more specifically in the Joint Petitioners' Policy Panel testimony (Tr. 554). All of these commitments are set forth in Attachment 1.

The Joint Petitioners disagree with Staff's Condition (5) which would attempt to shield ratepayers from any further downgrade of NYSEG or RG&E's present debt ratings. While ratepayers should be held harmless from actions caused by Iberdrola, ratepayers should not be held harmless from a downgrade caused directly by actions of this Commission, such as the downgrade that occurred after the Con Ed electric rate case order. Staff's proposal would create a negative spiral for NYSEG and RG&E, in which a decline in credit rating could cause Staff to propose a disallowance of interest expense, which in turn could cause a further decline in credit rating, and so forth.

D. Nothing In The Record Warrants Staff's Extensive Concerns With Goodwill

As the Joint Petitioners explain in their Initial Brief, the fact that Iberdrola will place Goodwill on its books reflects the normal state of affairs for a transaction of this type and matches investor expectations that "companies will grow and that share prices will increase" (Tr. 1054-55). The Joint Petitioners have made a firm commitment not to recover any of this Goodwill in NYSEG or RG&E rates (Tr. 491-92). Goodwill "places no pressure on rates" given that rates are calculated based on rate base and "not the current market value of traded shares of utility equities" (Tr. 1055). Goodwill is simply a tool that allows assets to be written up and accounted for in acquisitions, reflecting that market value exceeds book value. Staff misleads the Commission in discussing Goodwill-related "risks" by disregarding earnings growth expectations, engaging in one-sided speculation about future events, misrepresenting case precedent, and discounting altogether the Commission's ability to ensure through its regulatory powers that NYSEG and RG&E ratepayers are not impacted by Goodwill booked at the Iberdrola level.

1. Staff Misconstrues The Goodwill Risk And Mischaracterizes Commission Precedent

There is no dispute in this case as to where Goodwill associated with the Proposed Transaction will be booked -- namely, at the Iberdrola level (Tr. 547; *see also* Exh. 116, IBER/EE IR No. 168). Staff concedes this point in its brief (Staff IB at 69). Staff further concedes that ratepayers are “protect[ed]” to the extent that ratemaking is based on the original cost of utility plant and not on any acquisition premium associated with the price paid for shares of Energy East (*Id.*). Staff unrealistically hypothesizes, however, that if *all* of Iberdrola’s Goodwill were to be written off (including existing Goodwill unrelated to the Proposed Transaction) then Iberdrola’s equity ratio would fall and cause its credit ratings to fall. Staff, however, can only cite its own Policy Panel for speculative testimony that this could ever happen (Staff IB at 69-70 (citing Tr. 1316-19)). In fact, even Staff concedes that presently a write-down of Goodwill is “unlikely” (*Id.* at 70).

In making these arguments, Staff improperly ignores the impact of earnings growth. When any purchaser of utility common stock pays more than book value, “the purchaser expects growth to allow it to earn a return” based on the ability to “manage and run these companies” with “skill, foresight and industry” (Tr. 1055-56), as Dr. Makholm explains. Iberdrola’s successful track record of global growth suggests strongly that this will be the case if the Proposed Transaction is approved.[67] But even if Iberdrola did encounter adverse economic conditions that caused it to write down Goodwill, there is no record evidence to suggest that *all* of Iberdrola’s Goodwill would be impaired, and under the applicable, stringent impairment test,

[67] Staff makes a new argument, without any record support, that suggests Iberdrola would need to show “synergy savings” in order to have cash flow that could support Goodwill (Staff IB at 71-72). This is not the case because, as Dr. Makholm explains, purchasers of utilities at prices above book value reasonably and routinely anticipate growth in earnings to support any booked Goodwill (Tr. 1055-58).

it is very unlikely there would be such a complete impairment of Goodwill; accordingly, there is no reason to expect harm to NYSEG and RG&E ratepayers (*see* Tr. 1054-58; 1109). Even in the extreme example where a utility holding company (Enron) was in poor financial condition and ultimately went bankrupt (which would *not* be the case if the Proposed Transaction is consummated) there was "no material effect" on "rates or quality of service" of the regulated utility subsidiary, Portland General Electric (Tr. 1110).

Next, Staff cites the example of Long Island Water as evidence that Goodwill impairment can occur *and* that it can "threaten service adequacy at a regulated utility" (Staff IB at 70). The purported basis for Staff's claim is that the holding company upstream from Long Island Water, AWW, has been attempting to launch an IPO, in which it would become independent from Long Island Water's ultimate upstream holding company, RWE, and that this IPO has yet to take place—which Staff implies has been due to complications associated with Goodwill. In fact, AWW announced the IPO on April 22, 2008, and AWW's shares began trading on the New York Stock Exchange the following day,[68] so it appears that Staff's claim is moot. In any event, this case is irrelevant to the concerns Staff is identifying in the Proposed Transaction. Here, Staff suggests that a regulated utility company's operations could be negatively affected by Goodwill impairment at the holding company level. In *AWW*, however, an unregulated *holding company* indicated that Goodwill impairment may negatively impact *its own* performance (*see* Exh. 81, at 16 (AWW's amendment to its S-1 registration statement, discussing the results of AWW, *not* Long Island Water)). Moreover, regarding the motivation behind the IPO, Staff mistakenly asserts that Long Island Water's foreign parent, RWE, "sought to rid itself of the presumably under-performing subsidiary" in New York and that it went so far

[68] Press Release, American Water, *American Water Prices Initial Public Offering* (Apr. 22, 2008), http://pr.amwater.com/PressReleases/releasedetail.cfm?ReleaseID=306153

as to inject capital into AWW to "enable it to escape from the subsidiary and exit the New York utility business" (Staff IB at 70). As acknowledged by the Commission, however, RWE is seeking to sell its shares in AWW to focus on its European operations.[69] Staff did not and cannot point to anything in Exhibit 81 where AWW states that impairment of Goodwill will have an impact on service adequacy at Long Island Water. In fact, the Commission states in a Long Island Water rate order issued less than two months ago:

> The Joint Proposal's sponsors have satisfied their burden of showing that adoption of the proposed terms would satisfy the Public Service Law's requirement of *safe and adequate service at just and reasonable rates*. . . . This rate stability has enabled [Long Island Water] to maintain rates in the mid-range of those charged by comparable companies that we regulate, while *also maintaining a low customer complaint rate.*[70]

Staff incorrectly characterizes the Joint Petitioners as having taken the position that "rating agencies are unconcerned with the role of goodwill" in a company's risk profile (Staff IB at 73-74). On the contrary, Joint Petitioners acknowledge that goodwill may be a relevant factor that ratings agencies assess, but point out in the testimony of Mr. Fetter that Staff's generalized claims about Goodwill as a potential credit concern are meaningless. The relevant question is whether any major ratings agency has expressed concern with Iberdrola's Goodwill, which they have not:

> Rating agencies do not base reported credit ratings on factors that are not mentioned in their reports. . . . If Goodwill was the driver of a credit profile

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69 Case 06-W-0490 - *American Water Works Company, Inc. and Thames Water Aqua Holdings GMBH, Order Authorizing Reorganization and Associated Transactions*, at 3 (July 26, 2007).

70 Case 07-W-0508 - *Proceeding on Motion of the Commission as to the Rates, Charges, Rules and Regulations of Long Island Water Corporation for Water Service*, *Order Determining Revenue Requirement and Rate Design*, at 8-9 (Mar. 5, 2008) (hereinafter, "*Long Island Water*") (emphasis added). *See also* Press Release, Garry A Brown, Chairman, New York Public Service Commission, *PSC Approves Three-Year Rate Plan for Long Island Water* (Feb. 13, 2008) (commending Long Island Water for its "relative rate stability over the last decade, while also maintaining a low customer complaint rate").

> decline for Iberdrola or any other rated entity, all three rating agencies would mention it, rather than none.

(Tr. 775).

Finally, in an attempt to rebut Dr. Makholm's testimony that the booking of Goodwill by Iberdrola is routine for a utility transaction of this size, Staff concocts a parade of horribles that, in the future, Iberdrola will need to "cut costs" and risk "preservation of safe, adequate and reliable service" (Staff IB at 74-75). In support, Staff inappropriately cites the *AWW* order which, as discussed above, is inapposite because the recent Long Island Water rate case order actually *affirmed* that the regulated water utility at issue had maintained safe and reliable service. Indeed, in order for Iberdrola to be able to "cut costs" to the detriment of ratepayers, the Commission would need to abrogate altogether its own legal authority under the PSL to regulate closely NYSEG and RG&E which, as Dr. Makholm explains, protects against the ability of a holding company to "raid" the assets of utility operating companies:

> The pressure on utility management to reduce costs has always existed—which is precisely why the Commission has the job of looking out for corner-cutting, listening to ratepayers' complaints, and sanctioning utility companies if for any reason they degrade what the Commission feels is adequate service. This transaction in no way increases this pressure.

(Tr. 1052).

Staff fails to provide any real evidence that a risk exists, or any precedent showing an example of Goodwill impairment at the holding company level negatively impacting service quality. Accordingly, the Commission should disregard Staff's claim that Goodwill at the Iberdrola holding company level increases risk.

2. Iberdrola Has Already Committed To Certain Of Staff's Proposed Acquisition Adjustment Conditions; The Other Conditions Are Unreasonable And Overreaching

Staff proposes three conditions to address the acquisition premium associated with the Proposed Transaction: (1) the acquisition premium and costs associated with the Proposed Transaction and "all past transactions" will not be recorded on the books of NYSEG, RG&E or Energy East; (2) the acquisition premium and related costs associated with the transaction will "not affect rates"; and (3) Iberdrola shall provide, annually, the results of any impairment test made on Goodwill (Staff IB at 136; Tr. 1402-03; *see also* MI IB at 38 (supporting Staff's conditions)).

The Joint Petitioners have already made commitments that, by any reasonable standard, should satisfy Staff's concerns related to the Proposed Transaction, namely: (1) the Joint Petitioners commit "not to seek recovery of costs incurred to consummate the Proposed Transaction from New York ratepayers"; and (2) the "premium paid for Energy East common stock resulting from the Proposed Transaction will remain on the books of IBERDROLA and its wholly-owned affiliates, and will not be recorded on the books of any of the companies acquired, including Energy East, RGS, RG&E, and NYSEG" (Tr. 491-92). Indeed, CPB suggests that conditions related to Goodwill are unnecessary in light of the Joint Petitioners' commitments not to push down Goodwill to the operating utility companies (CPB IB at 15, n.17).

Iberdrola has not made any specific commitment to report annually on impairment tests made on Goodwill; however, this is unnecessary so long as Iberdrola books Goodwill at the holding company level, which it has committed to do.[71] With respect to Staff's

[71] Staff's request is also unneeded because, as discussed herein, Iberdrola commits to providing the Commission with access, in English and in New York, to, among other things, "any books/records of Iberdrola or any Iberdrola affiliates that are related to NYSEG or RG&E" (Joint Petitioners IB at 4 (citing Tr. 549)).

request that Iberdrola commit not to seek recovery of costs and any premium associated with "all past transactions," this request is beyond the scope of and not relevant to this proceeding. Goodwill remains on the books of RGS, and while not relevant to this proceeding, the Joint Petitioners stipulate that they will not seek recovery of costs associated with the RGS transaction in future rates.

E. Capital Structure Is Not A "Risk" Of The Proposed Transaction

The Joint Petitioners explain in their Initial Brief that the appropriate capital structure for ratemaking purposes is not at issue in this Section 70 proceeding, and Staff's arguments regarding the use of a consolidated capital structure are irrelevant and should be disregarded at this time (Joint Petitioners IB at 89). Nevertheless, as explained below, should the Commission choose to address these issues in an appropriate rate proceeding following consummation of the Proposed Transaction, Staff's position on this issue has significant flaws, and its new conclusion in its Initial Brief that a hypothetical capital structure must be used (Staff IB at 81), is one on which no supporting record has been developed. Staff implies incorrectly that if the Proposed Transaction is consummated, the Commission must use Iberdrola's consolidated capital structure as the ratemaking capital structure for NYSEG and RG&E (*Id.* at 75-76). From this faulty presumption, Staff proceeds to argue that two "subsidiary adjustments" be made to address two "classes of non-jurisdictional assets;" these adjustments are: (1) Staff wants to back out $55 billion from Iberdrola's capital structure purportedly to reflect "Iberdrola's pre-existing business operations," at a rate of 50% equity and 50% debt (*Id.* at 78), and (2) Staff wants to make another adjustment to remove approximately $10 billion of Goodwill from Iberdrola's books at the rate of 75% equity and 25% debt (*Id.* at 79-80). After making the unjustified assumption that a consolidated capital structure must be used, as arbitrarily "adjusted" by Staff, Staff concludes that the result is an "untenable" capital structure for ratemaking purposes (*Id.* at 80-81), thus necessitating a "hypothetical" capital structure. Putting aside the Joint Petitioners' disagreement with Staff's analyses, Staff fails to state what an appropriate "hypothetical" capital structure would be. There is nothing on this record to support any hypothetical capital structure being imposed for ratemaking purposes.

First, the Joint Petitioners disagree with Staff's initial premise that there is any reasonable basis on this record for assuming that a consolidated capital structure is required. Both cases on which Staff relies specifically contemplate the possibility of recognizing stand-alone capital structures for ratemaking purposes (*see id.* at 75-76).[72] As the Joint Petitioners explained in their Initial Brief, the Commission has approved rates based either on the stand-alone capital structure of the regulated company, or on a capital structure based on a proxy group of utilities, in several instances where a regulated operating company is in a holding company structure.[73]

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72 *See*, *e.g.*, Case 07-G-0141 - *National Fuel Gas Distribution Corp.*, *Order Establishing Rates for Gas Service* (Dec. 21, 2007) (establishing equity ratio based on risk profile of distribution business in New York). In *National Fuel Gas Distribution Corporation*, the Commission said that it may be proper "*at least in the first instance*" to assume a consolidated structure where the parent raises the capital (*see* Staff IB at 75-76) (emphasis added)). In the NYSEG order that Staff cites, the Commission found that, on the particular record before it, a stand-alone capital structure was not appropriate (*see* Staff IB at 76) (citing Case 05-E-1222 - *New York State Elec. & Gas, Order Adopting Recommended Decision With Modifications* (Aug. 23, 2006)) ("*NYSEG*"). Staff's suggestion that Dr. Makholm is "unfamiliar" with NYSEG and RG&E because he does not accept that the NYSEG order mandates use of a consolidated capital structure is nonsense (*see* Staff IB at 85). The Commission was clear in *NYSEG* that its findings were based on "[t]he record in this case" and nothing in that order implies that NYSEG's rates *must* be based on a consolidated capital structure in perpetuity.

73 *See*, *e.g.*, Case 07-G-0141 - *National Fuel Gas Distribution Corp.*, *Order Establishing Rates for Gas Service* (Dec. 21, 2007) (establishing equity ratio based on risk profile of distribution business in New York); Case 06-W-0131, 06-W-0244 - *UWR, Order Approving Merger and Adopting Three-Year Rate Plan* (Dec. 14, 2006) (approving a Joint Proposal in which UWR would use United Water New Jersey's capital structure, and not that of its ultimate parent Lyonnaise des Eaux); Case 99-G-1188 *et al.* - *St. Lawrence Gas Company, Staff Recommendation (Approved as Recommended and so Ordered by the Commission)* (Mar. 27, 2000) (requiring use of utility operating company's actual capital structure instead of consolidated capital structure because the utility issued its own debt and the holding company's debt ratio was out of line with

Second, Staff's proposed adjustments have not been supported by the record. Staff's first adjustment, the removal of over $55 billion of "pre-existing business operations" of Iberdrola is supported only by Staff's bare assertions in testimony, with no workpapers or other data to support backing out such a substantial amount. While Staff cites the Commission's statement in the 2007 *National Fuel Gas Distribution* order that the Commission was "removing competitive operations at ratios that would support the parent's rating at the level it currently has," there is no record support to show that Staff's use of dated S&P guidelines for U.S. utilities is a valid basis to remove $55 billion from capital structure (*see* Tr. 1087-88).[74] The second adjustment to "remove" Goodwill is similarly unsupported as was made clear at the hearing when Staff witness Barry conceded that "I came up with it myself" (Tr. 1569) and that he is unaware of any precedent for the proposal in any jurisdiction (Tr. 1568-69), including his statement that removing Goodwill had not "to [his] knowledge" ever been required in the State of New York (*Id.*) (same, with respect to FERC). In its Initial Brief, Staff tries to salvage the wholly arbitrary removal of Goodwill by claiming it is a "logical extension" of the Commission's practice of "not allowing goodwill to impact the rates" of customers (Staff IB at 79); however, as demonstrated above, this justification fails completely here because Goodwill

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industry average). Staff's position is also contrary to the stand-alone capital structure approved in the Grid/KeySpan proceeding. *NG/KS Order, supra* note 10.

[74] Staff asserts that Dr. Makholm's criticisms of this adjustment for unregulated operations are "without merit" because the 50/50 equity/debt ratio applied is consistent with the ratio for an "A" rated "international utility holding" [sic] (Staff IB at 84). Dr. Makholm, however, was not focusing on the reasonableness of the *ratio* applied, but rather on the threshold decision by Staff to (a) use Iberdrola's consolidated capital structure in the first place and then (b) arbitrarily remove $55 billion from Iberdrola's books. Dr. Makholm rightly explains that there is no support for this "adjustment" and that developing capital structure from an appropriate proxy group of utility companies would be more reasonable (Tr. 1089).

will be booked at the Iberdrola holding company level, and therefore will have *no impact on the rates* of jurisdictional customers whatsoever.[75]

After making these arbitrary and unnecessary "adjustments" to capital structure, Staff concludes that the resulting capital structure—as artificially re-engineered by Staff—is now "untenable" (Staff IB at 80). Staff then concludes, for the first time in this proceeding and with no record support, that because the resulting capital structure is inappropriate, the ratemaking capital structure would need to be "a hypothetical capitalization" (*Id.* at 81). Indeed, Staff's new reference to a hypothetical capitalization is actually closer to an option first described by Dr. Makholm, who explains that in some instances a more reliable method of establishing regulated capital structure may be to use a proxy group of independent gas and electric utilities and then develop a reasonable capital structure (Tr. 1089). Staff, however, does not attempt to do that here, and provides no indication of what should be used for such a hypothetical capital structure if the existing capital structure were to be found to be inappropriate (with which the Joint Petitioners and their expert witnesses disagree).

75 Staff attacks Dr. Makholm's criticisms of Staff's purely subjective decisions to remove over $65 billion from Iberdrola's capital structure (*i.e.*, the sum of the unregulated operations and Goodwill adjustments), but in doing so, Staff merely repeats the same flawed arguments it made previously, as explained in the Joint Petitioners' Initial Brief (*see* Joint Petitioners IB at 91-94). Staff's criticisms of Mr. Fetter's testimony (Staff IB at 86-88) as it purportedly relates to capital structure are similarly without merit. Mr. Fetter makes two undisputed points in his testimony: (i) that no credit agency has raised Goodwill as a negative factor in its analysis of Iberdrola (Tr. 775-76), and (ii) Staff's focus on capital structure as a risk is misplaced because NYSEG and RG&E will maintain a capital structure regulated by the Commission and nothing in credit ratings agencies' reports indicates concern that Iberdrola's existing capital structure will adversely impact ratings (Tr. 776-77). Thus, while Staff speculates that "financial stress" due to Goodwill will inevitably "lead to service quality problems" (Staff IB at 87), Mr. Fetter appropriately emphasizes that S&P and Moody's have already indicated their comfort with Iberdrola's existing capital structure (Tr. 777-78) (noting Moody's statement that the company should stay '"within its leverage target of 50%'"). Staff also makes the untenable claim that "the *fact* that Goodwill is removed by credit agencies from a consolidated capital structure as 100% equity *clearly shows* that Staff's approach (*i.e.*, removing Goodwill at a ratio of 75% equity/25% debt) *is more conservative*" (Staff IB at 86) (emphasis added). Staff has no such "fact" in the record as it pertains to Iberdrola—none of the credit agencies has suggested that Iberdrola's Goodwill must be "removed."

Instead, Staff concludes that the so-called “risk” stemming from Staff’s own self-concocted “untenable” capital structure can be remedied only by: (1) outright rejection of the Proposed Transaction or (2) approving “ring-fencing conditions” that protect NYSEG and RG&E (Staff IB at 88). Staff does not disclose, however, what new “ring-fencing” conditions it seeks to address capital structure issues.[76]

There is a far more sensible solution to this purported problem. In the absence of any Staff proposal on capital structure and because Staff’s testimony on capital structure for ratemaking purposes is beyond the scope of this Section 70 proceeding, the Commission should make no determinations with respect to ratemaking capital structure as part of its Section 70 review.[77] To the extent that the appropriate capital structure for NYSEG and RG&E ratemaking purposes should be revisited following consummation of the Proposed Transaction, a rate proceeding can be instituted to fully address these issues, with the attendant procedural and due process rights provided NYSEG and RG&E under PSL § 66 and Part 61 of the Commission’s regulations.

F. The Commission Should Reject Staff’s Proposed “Golden Share”

Staff contends that its recommended financial conditions alone would not sufficiently protect the credit quality of NYSEG and RG&E in the event that Iberdrola or one of its affiliates encounters bankruptcy (Staff IB at 148). Although MI and CPB generally state that the Commission should condition its Section 70 approval upon Iberdrola’s acceptance of

76 Presumably, Staff refers to the same ring-fencing conditions Staff cites elsewhere in its Initial Brief, which are addressed in Section III.H above.

77 Staff also adds further empty rhetoric regarding Iberdrola’s purported need to “squeeze excess profits” from an inadequately financed capital structure and suggests that this justifies rejecting the Proposed Transaction (Staff IB at 81). As discussed above, even if Iberdrola were to attempt to “squeeze” an unreasonable level of profit from Energy East’s operating subsidiaries, the regulatory checks in place in New York would prevent it from doing so.

financial protections for customers (MI IB at 35-36; CPB IB at 16-17), MI acknowledges that "[t]o their credit, Petitioners have indicated a willingness to accept many – but not all – of the financial protections proposed by Staff" (MI IB at 43). In fact, MI lists in detail the numerous financial protections that the Joint Petitioners have agreed to accept (MI IB at 44-45).

The only two financial protections still at issue in this case are Staff's recommendations to impose a limited purpose entity ("LPE") and dividend restrictions (*see* MI IB at 45). Staff argues that "ring-fencing" measures need to be imposed as conditions of any approval of the Proposed Transaction (Staff IB at 39; *see also* MI IB at 43; CPB IB at 16-17). In doing so, Staff criticizes Dr. Makholm's testimony that ring-fencing generally pertains to traditional regulatory and accounting mechanisms that have been developed by regulators in the U.S. over several decades (Tr. 1111). As discussed below, Staff's reflexive attempt to cite the Grid/KeySpan merger order as proof that there is a one-size-fits-all, black-letter standard for ring fencing in this country, and in New York (Staff IB at 37), is not fatally flawed and should be rejected. There were critical distinctions between that case—which involved a financially weak acquirer—and this one, in which the acquiring company is an "A" category global, diversified utility.

Staff further asserts that the Commission should require the formation of an LPE and appoint an independent director to protect NYSEG and RG&E from voluntarily declaring bankruptcy at the behest of Iberdrola (*see* Staff IB at 151-152; *see also* MI IB at 43). As the holder of special voting rights granted under a class of preferred stock consisting of one share (a "golden share"), the director purportedly would vote based on the public interest and thus limit the ability of NYSEG and RG&E to commence any voluntary bankruptcy, liquidation, receivership, or similar proceeding (Staff IB at 151-52).

These proposals are counterproductive and unduly severe. Contrary to Staff's contentions, a golden share is an extraordinary and rarely used measure in the regulation of U.S. utilities. Only once, in Grid/KeySpan, has a U.S. utility merger been conditioned on creating a golden share controlled by a regulatory commission appointee (Joint Petitioners IB at 75). In that case, the Commission had concerns about National Grid's financial status and took what former Chair and current Commissioner Acampora referred to as an "unusual step" by requiring the target utilities to issue a golden share to a third-party selected by the Commission (*Id.*). Staff suggests, however, that failing to adopt the Grid/KeySpan prescriptions in the case at hand would contradict the Commission's "view of ring-fencing" (Staff IB at 38). Such an argument overlooks the fact that the Commission's conditions in the Grid/KeySpan case resulted from concerns specific to National Grid (Joint Petitioners IB at 75) which included: (1) "KeySpan's standalone 'A' rating fell to National Grid's lower 'A-' rating" as a result of the merger with National Grid (Tr. 553), whereas here, the new affiliation of Energy East, NYSEG and RG&E with the superior "A" category rating of Iberdrola might help those companies escape their negative outlooks and potentially improve ratings (Tr. 767-68) and/or reduce their cost of debt (Tr. 508); and (2) the Grid/KeySpan transaction was financed entirely with debt, while Iberdrola has financed the Proposed Transaction entirely with equity (Tr. 507).[78]

Staff also refers to a "form of golden share" that was put in place to protect Portland General Electric Company ("PGE") from its parent Enron Corporation ("Enron") (Staff IB at 38-39). Staff cites this case as an example of successful ring-fencing but, contrary to Staff

[78] *See* Case 07-M-0906 - *Staff Transcript Requests and Corrections* (Apr. 3, 2008) (stating that Staff has determined that the acquisition price in the Grid/KeySpan transaction was funded entirely with debt and without any equity). *See also* Tr. 1506.

assertions, the golden share was *not* a condition of the 1997 Enron/PGE merger transaction[79] and in fact, PGE did not create this golden share mechanism until *after Enron declared bankruptcy*. Once Enron declared bankruptcy in 2001, PGE worked with S&P to develop a structure to avoid future downgrades of PGE's bond ratings. PGE opted to issue one share with special voting rights with respect to any voluntary action by PGE regarding bankruptcy. PGE chose the holder of the share; neither the Oregon Public Utility Commission ("OPUC") nor its staff directly selected the shareholder. In 2002, OPUC approved PGE's application seeking authority to issue the single share of $1.00 par value Junior Preferred Stock in order to further insulate PGE from the effects of the Enron bankruptcy.[80]

Thus, CPB is mistaken when it claims: "In fact . . . as the DPS Staff's Policy Panel testified on cross-examination by the CPB, it was the existence of a golden share provision that was the entire reason why Portland was not dragged into the Enron bankruptcy" (CPB IB at 17). This misses the key point: because the so-called "golden share" provision in Oregon was not implemented until after Enron filed for bankruptcy protection, what the case actually shows is that state regulators have the means and ability, *even after a holding company bankruptcy*, to work cooperatively with a utility to protect itself from the effects of a parent's bankruptcy.

Staff's third and final example claims that an LPE mechanism was required as a condition of the Mid-American Holding Company ("Mid-American") and PacifiCorp merger

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79 In the merger order, PGE was directed to maintain its own long-term debt ratings and preferred stock ratings for as long as it had preferred stock outstanding; to maintain the common equity portion of its capital structure at 48 % or higher unless a different level was approved; and to file information and disclosure notices for affiliated interest transactions. The Joint Petitioners are committing to many similar conditions here (Joint Petitioners IB at 5; 73; 78). PGE was *not*, however, required to create a golden share mechanism. *In the Matter of the Application of Enron Corp for an Order Authorizing the Exercise of Influence Over Portland General Electric Company*, OPUC Order No. 97-196 (June 4, 1997).

80 *Portland General Electric*, OPUC Order No. 02-674 (Sept. 30, 2002).

(Staff IB at 38). Staff's discussion overlooks key distinctions between that proceeding and the present case. In the Mid-American/PacifiCorp case, the special purpose entity was created to include standard provisions for separating corporate entities, including provisions for separate books and records, financial statements, and arm's-length relationships with affiliates (Joint Petitioners IB at 75-76). The special purpose entity was not controlled by a third-party appointed by a regulatory commission or its staff.

Notwithstanding the significant distinctions between the present case and Staff's few examples, discussed above, Staff engages in classic hyperbole when it asserts (without record citation) that a "golden share" is "now standard in the utility industry" (Staff IB at 38). Far from being standard, the golden share as proposed here has been implemented only in Grid/KeySpan. That golden share requirement was imposed not as a general protective measure, but due to specific concerns about the financial condition of National Grid. Staff acknowledges that Iberdrola is investment grade today, but it contends that this status "is no guarantee of future performance" and advocates imposing a golden share measure in case "the financial health of Iberdrola were to deteriorate" (*Id.* at 150-51). This reasoning incorrectly implies that a golden share is an appropriate general merger condition. In truth, imposing such an intrusion into utilities' governance is the exception, not the rule, and the Commission never has indicated that the "unusual" conditions in the Grid/KeySpan case generally apply to all mergers. As Staff itself states, the conditions required for merger approval "vary depending upon the nature of the entity that is being transferred" (*Id.* at 31, n.21).

In the present case, an LPE or golden share measure serves no purpose and may create unanticipated problems and costs for Iberdrola and ratepayers. Staff has not provided support for its position that an independent director or shareholder would not create legal or financial burdens or hinder the ability of the utility to conduct business. In fact, Staff inexplicably recommends further allocating matters of corporate governance to a third-party to oversee compliance with dividend and money pool restrictions (*Id.* at 152). MI suggests that it agrees with this approach (MI IB at 43). Neither party has offered legitimate support for such intrusions, and the Commission should reject Staff's golden share proposal. Moreover, the Joint Petitioners have already committed to sufficient protections and measures on the issues of dividend restrictions and money pool arrangements *(see* discussion *infra* below).

G. Dividend Restrictions Proposed By Staff Are Excessive

1. The Risks Staff Identifies To Validate Its Proposed Conditions Are Exaggerated

Staff asserts that its recommended dividend restrictions are required for approval of the merger to prevent Iberdrola from draining the capital of NYSEG and RG&E in the event of unforeseen circumstances that create financial difficulty at Iberdrola, or if Iberdrola simply decides to enhance its dividends to its shareholders (Staff IB at 145). MI also insists that NYSEG and RG&E should be prohibited from issuing dividends unless they meet or exceed a threshold credit rating (MI IB at 44). As is the case with the other financial protections Staff proposes, Staff lifts its "[m]ore rigorous" dividend restrictions directly from the Commission's order approving the Grid/KeySpan merger (*id.* at 145-46) without justification.[81] These arguments present another instance in which Staff concocts a speculative parade of horribles and ignores fundamental differences between the Proposed Transaction and Grid/KeySpan.

There is no need for Staff's additional restrictions beyond those to which the Joint Petitioners have committed. It is unfair for Staff to demand the same invasive protections that the Commission ordered in that case because the Proposed Transaction simply does not carry the

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[81] *See also NG/KS Order*, *supra* note 10, at 124-25.

same financial risks as the Grid/KeySpan merger (Joint Petitioners IB at 57-59). That Staff would have the Commission shoehorn its approval of the Proposed Transaction into conditions designed for other parties in an unrelated proceeding is fundamentally unreasonable and once again contradicts its own acknowledgment that the conditions required for approval "vary depending upon the nature of the entity that is being transferred" (Staff IB at 31, n.21).

Staff contends that the Joint Petitioners misunderstand that the purpose of dividend restrictions is to ensure that cash is conserved during difficult times (*Id.* at 145). It is actually Staff who misunderstands the Joint Petitioners' point, which is simply that Iberdrola's current dividend policy helps the company avoid difficult times in the first place.[82] As the Joint Petitioners have emphasized, Iberdrola's dividend policy is an integral part of its Strategic Plan that the credit agencies have assessed as part of their analyses that led to Iberdrola's "A" category credit ratings (*see, e.g.*, Tr. 555). Iberdrola's dividend policy therefore does protect the financial health of the company by contributing to its continued growth. If Iberdrola decides to enhance its dividends to shareholders, it will and must do so prudently. Staff's speculation that Iberdrola will drain the capital of NYSEG and RG&E is unwarranted, and disregards not only Iberdrola's intentions, integrity and historical practice globally, but also the Commission's ongoing ability to utilize its regulatory powers to ensure that the operating companies provide safe and reliable service.[83]

[82] MI also expresses speculative concern that those policies could be changed in the future (MI IB at 44).

[83] Cases 92-W-0583, 26569 and 28476 - *Jamaica Water Supply Company, Order Amending Orders Dated February 27 and 28, 1974 in Cases 26569 and 28476, To Modify the Company's Common Stock Dividend Restrictions* (Sept. 18, 1994) (restricting dividends up to the parent because of concerns about safe and adequate service).

2. The Joint Petitioners Already Make Adequate Commitments To Mitigate Staff's Concerns

Staff proposes five conditions related to dividend restrictions for NYSEG and RG&E (Staff IB at 143-44). These conditions are unnecessary because the Joint Petitioners have committed to the following dividend restrictions: (1) NYSEG and RG&E will maintain their respective dividend policies with due regard for the financial performance and needs of NYSEG and RG&E, irrespective of the financial performance and needs of Iberdrola; and (2) Iberdrola will report to the Commission in the event that the dividend payout for any year is more than 100% of income available for dividends calculated on a two-year rolling (eight calendar quarter) average basis (Tr. 556-57). These restrictions fully mitigate Staff's unjustified concerns.

Staff also insists that its proposed conditions remain in place as long as Iberdrola or any successor holding company is the ultimate parent of NYSEG and RG&E (Staff IB at 145). Whatever conditions the Commission ultimately requires, the Commission should retain the flexibility to revisit these conditions or grant an exception. Staff's proposed perpetual restrictions are unwarranted.

H. Joint Petitioners Have Committed To Conditions That Meet Staff's Money Pool Concerns

Staff proposes several rules for money pool transactions (Staff IB at 146-47). This issue is not contested because, as even Staff acknowledges (*id.* at 147), the Joint Petitioners have already generally accepted Staff's proposed conditions. No money pool currently exists for Energy East, NYSEG and RG&E; thus, there is no real debate on this issue with respect to Iberdrola.

Nonetheless, two minor differences remain between the Joint Petitioners' offered commitments and Staff's proposed conditions. First, Staff insists that indirect loans from NYSEG and RG&E to any affiliate should be prohibited (*Id.* at 147; Tr. 1409). As an initial matter, it is not clear what Staff means by “indirect loans.” Staff claims that the intent of its specific condition is to close any circumvention of the money pool rules by ensuring that monies lent to other utilities stay within the utility family (Staff IB at 147). The Joint Petitioners are confident that their commitment that Iberdrola shall not borrow from money pools in which NYSEG and RG&E are participants (Tr. 556-57) already mitigates Staff’s concern.

Second, Staff insists that there should be no cross-default provisions for any affiliate of Iberdrola that would affect NYSEG and RG&E and that there should be a promise that Iberdrola and its affiliates will not enter into such arrangements in the future under any circumstances (Staff IB at 146-47; Tr. 1410). The only change the Joint Petitioners have proposed to this condition merely gives the Commission flexibility to approve such provisions in the future if necessary. Should the Commission decide that any money pool or cross-default provisions are necessary for its approval of the Proposed Transaction, it can and should simply accept the Joint Petitioners’ offered conditions without hesitation or additional measures.

I. Joint Petitioners’ Commitments Will Ensure Financial Transparency And Adequate And Timely Reporting

Staff expresses concern that there will be a significant reduction in the Commission’s ability to acquire a complete picture of Iberdrola’s operations because of the company’s status as a foreign holding company operating under International Financial Reporting Standards (“IFRS”) rules, and because of the repeal of the Public Utility Holding Company Act of 1935 (“PUHCA”) (Staff IB at 160). MI echoes these concerns (MI IB at 45-47). These concerns are unwarranted, because the Joint Petitioners have already made commitments to address them (Tr. 549-50). MI in fact acknowledges that “Petitioners agreed to accept all or part of several of the reporting requirements proposed by Staff” and notes the additional commitments that the Joint Petitioners have offered (MI IB at 49-50).

Nonetheless, some minor differences remain between the Joint Petitioners' offered commitments and Staff's proposed conditions. First, Staff states that it should have access to the books and records of Iberdrola and its majority-owned affiliates in English and these books and records should be made available in New York State (Staff IB at 160). The Joint Petitioners have already agreed to provide this information substantially as Staff requests (Tr. 549). Staff unnecessarily quibbles that this commitment is too narrow, because it is limited to Iberdrola affiliates that are related to NYSEG or RG&E (Staff IB at 164-65). It would be unduly burdensome for Iberdrola to provide such information about all its affiliates. Likewise, it would be unnecessary and unhelpful to the Commission, in its ongoing regulation of NYSEG and RG&E to receive such information. For example, providing the Commission with financial information relating to an Iberdrola wind project in Brazil serves no useful purpose, and involves aspects of Iberdrola's business that are totally unrelated to NYSEG and RG&E.

Second, Staff and MI demand that NYSEG and RG&E should continue to meet their current reporting requirements (Staff IB at 160; MI IB at 50). The Joint Petitioners have already volunteered that Energy East will continue to use U.S. GAAP for all financial reporting (Tr. 548-49). Staff illogically complains that this commitment omits what it refers to as "necessary reports" (Staff IB at 164), even though Staff acknowledges that such reports are no longer required under PUHCA, as amended by Congress in 2005 (*Id.* at 154; Tr. 1240).

Third, Staff and MI insist that Energy East should continue to be subject to the legal requirements of the Sarbanes-Oxley Act ("SOX") (Staff IB at 160-61; MI IB at 50). Although the requirements of SOX will not apply to Energy East after the Proposed Transaction is consummated since Energy East will no longer be an SEC registrant, the Joint Petitioners commit that Energy East will continue to assess and monitor controls and provide the attestation of management concerning the adequacy of controls (Joint Petitioners IB at 72; Exh. 19, IBER-0293). The Joint Petitioners' commitment to go beyond what is required under existing law is extremely accommodating and should be more than adequate to address any legitimate concerns Staff and MI may have.

Finally, Staff recommends that the Commission require Iberdrola to provide annual public financial information, including consolidated balance sheets, income statements, and cash flow statements, a comprehensive management discussion of results consistent with Energy East's current 10-K concerning Iberdrola, and financial information about each of Iberdrola's regulated and unregulated energy companies operating in the U.S. Staff insists that such filings should reflect audited U.S. GAAP financial statements in U.S. dollars (Staff IB at 161). Staff also recommends that, as a condition to any approval of the Proposed Transaction, Iberdrola be required to file consolidated balance sheets, income statements and cash flow statements for Energy East and its direct subsidiaries in English, using U.S. GAAP, in all future rate cases (*Id.* at 162).

The Joint Petitioners have already committed that Iberdrola's consolidated balance sheets, income statements and cash flow statements will be made available to the Commission, in English and in New York, on an annual basis and in a format that is mutually agreeable to Iberdrola and Staff. These audited financial statements will be in accordance with IFRS, as issued by the International Accounting Standards Board, consistent with SEC requirements. Additionally, Iberdrola will provide specific answers to particular questions raised by the Commission and Staff with respect to IFRS (Tr. 550).

Staff and MI take issue with certain aspects of this commitment, particularly Iberdrola's use of IFRS (*e.g.,* MI IB at 51). Initially, Staff complains that this commitment to provide information—which Iberdrola has agreed to provide in a format that will be mutually agreeable between Iberdrola and Staff—is "unduly vague" (Staff IB at 165). There is nothing unclear about Iberdrola's commitment. Moreover, based on a handful of select quotations from a PricewaterhouseCoopers publication and a couple of Moody's reports, Staff concludes that significant differences remain between IFRS and U.S. GAAP (*Id.* at 158). Staff claims that such differences in reporting standards create the potential for the misinterpretation of Iberdrola's financial statements (*Id.*). For this reason, Staff insists that only compliance by Iberdrola and its affiliates with U.S. GAAP would resolve this issue (*Id.*).

The SEC, however, has already found that differences between U.S. GAAP and IFRS are no longer so pronounced (*see* Exh. 48). The SEC has adopted a Final Rule, which became effective on March 4, 2008, to accept financial statements from foreign private issuers prepared in accordance with IFRS without reconciliation to U.S. GAAP (Exh. 48). As observed by the SEC, "IFRS as issued by the IASB and U.S. GAAP are both sets of high-quality accounting standards that are similar to one another in many respects, and the convergence efforts to date have progressed in eliminating many differences" (Exh. 48 at 20).[84] In this instance, the Commission should respect the expert judgment of the SEC and summarily reject Staff's needless demand that Iberdrola use U.S. GAAP. The Commission can safely accept the Joint Petitioners' offered commitments without hesitation or additional measures.

J. Hostile Takeover Risks Are Speculative, And Any Future Upstream Change In Ownership Will Be Reviewed As Applicable Under New York Law

[84] The SEC also has made clear that, while there are still differences between IFRS and U.S. GAAP, the ongoing convergence efforts for these standards are "to remove the remaining differences and to avoid creating significant new differences as standard setters continue to address existing and emerging accounting issues" (Exh. 48, at 20).

In response to the ALJ's questions about whether there is any risk of diminution of regulatory authority over Energy East, NYSEG and RG&E, no party identified any risk that the Commission would have its authority reduced as a result of a potential takeover (Staff IB at 31; MI IB at 68-69). In particular, Staff stated that "there can be no doubt that PSL [Section] 70 adheres to Iberdrola's proposed acquisition of Energy East . . .[and that] the same rule would apply to any entity, whether organized in Europe or otherwise, attempting to acquire Iberdrola" (Staff IB at 31). MI states that "the Commission would possess jurisdiction to review a post-merger attempt to acquire Iberdrola" (MI IB at 68). Therefore, as a practical matter, Staff, MI and the Joint Petitioners agree that the Commission retains the same the authority to review fully any potential acquisition upstream from Energy East, if one were to occur. Therefore, there is no risk that any diminution of Commission authority could occur as a result of any potential transfer upstream from Energy East.

Still, Staff and MI suggest that some risk continues to exist relating to a potential upstream acquisition above Energy East (Staff IB at 49-51; MI IB at 66-70). In order for Staff and MI to attach any risk to ratepayers from such an acquisition, Staff and MI engage in three different levels of speculation (Staff IB at 49-51; MI IB at 67). First, Staff and MI rely upon unsubstantiated press reports about potential takeovers upstream from Energy East, without pointing to any offers, bids, contracts or even statements confirming the existence of any takeover attempt (none of which exists) (Staff IB at 49-51; MI IB at 67). Second, Staff and MI speculate that a takeover attempt would ultimately be successful, and that any opposition that Iberdrola may assert would be unsuccessful (Staff IB at 49-51; MI IB at 67). Third, Staff and MI speculate that Energy East's assets would be spun off or sold shortly after the closing of such an upstream transfer (Staff IB at 51; MI IB at 67). Speculation should not be given credibility due to mere repetition. None of Staff's or MI's assumptions is based on facts and the Commission should not give them any weight.

MI insists that additional conditions be imposed in the event that a potential future acquirer of interests upstream from Energy East flouts the Commission's requirements and New York State law and does not seek any required Commission review or approval under Section 70 before undertaking an acquisition (MI IB at 69-71). These proposed conditions are unnecessary as the same compliance concerns exist with every utility and its upstream owners. Requirements already exist under this Commission's regulations, New York law, and many other federal and state laws and regulations with respect to any potential acquisition of an entity upstream from a New York utility. In fact, all of the regulatory approvals that have been required for this transaction would be required for any acquisition of an entity upstream of Energy East, including approvals from the Maine Public Utilities Commission, the Connecticut Department of Public Utility Control, the New Hampshire Public Utilities Commission, the FERC, the Federal Communications Commission, as well as approval by this Commission under Section 70 of the PSL (among others). Failure to obtain any or all of these approvals would present a potential acquirer of an entity upstream from Energy East with a wide variety of possible compliance issues and potential violations of state and federal law that could impair its indirect economic interest in Energy East. In fact, failure to comply with state and federal laws could expose a potential acquirer to civil and criminal liability and other enforcement actions.[85] Although MI provides specific conditions that it seeks relating to dividend freezes and rate reductions (MI IB

85 As merger and acquisition lawyers and businesspersons well understand, representations, covenants and opinions become problematic with entities that have serious regulatory compliance concerns. Thus, compliance with laws and regulations in New York is critical to any merger acquisition or sale transaction.

at 70-71), the Commission should refrain from taking such drastic actions, which are both premature and unnecessary.

IV. BENEFITS OF THE PROPOSED TRANSACTION

A. The Partial Acceptance Offers Additional Tangible and Quantifiable Benefits to Ratepayers and New York State

As part of the Partial Acceptance, the Joint Petitioners commit to provide ratepayers and the State of New York with numerous tangible benefits including: (i) acceptance of over $201 million in one-time PBAs that will result in an immediate $54.8 million annual delivery rate reduction that will be flowed through to ratepayers immediately following closing; (ii) divestiture of all of Energy East's fossil generation in New York;[86] (iii) a commitment to invest a minimum of $100 million in the development of renewable generation in New York State; (iv) enhanced reliability benefits and a resolution of outstanding issues with electric cooperatives;[87] and (v) a resolution of various City of Rochester concerns regarding properties and practices (Exh. 50, at 3-4). As part of the Partial Acceptance, the Joint Petitioners stated that above-book proceeds from the generation sale would be shared with ratepayers in a manner and allocation to be determined by the Commission (*Id.*). In response to requests by MI and CPB (MI IB at 53-55; CPB IB at 7-8), the Joint Petitioners would agree to the retention of as low as 10% of net auction proceeds as a sales incentive, with the remaining proceeds being returned to customers. The Joint Petitioners would also commit to participate in a post-auction collaborative process to determine how and when the net proceeds will be returned to customers. These

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[86] The Joint Petitioners are responding to all arguments regarding the generation divestiture commitment in the Partial Acceptance in connection with other vertical market power issues in Section III.A above.

[87] As a result of the Joint Petitioners' Partial Acceptance, the electric cooperatives state in their Initial Brief that they "no longer oppose the proposed acquisition." *See* Case 07-M-0906 - In*itial Post-Hearing Brief of The New York Association of Public Power and The New York State Rural Electric Cooperative Association*, at 2 (Apr. 11, 2008).

additional commitments further ensure that ratepayers will receive significant tangible benefits as a result of the commitments offered in the Partial Acceptance.

Yet, Staff still entirely dismisses the tangible benefits offered in the Partial Acceptance as “trivial” (Staff IB at 19). Staff argues that the $201 million in write-offs, write-downs and reserve increases offered to ratepayers as part of the Partial Acceptance is “mis-calculated and is entirely inadequate to compensate for the costs and risks associated with the transaction” (Staff IB at 131). CPB and MI similarly assert that the Joint Petitioner’s PBA offer is insufficient given the potential risks of the Proposed Transaction (CPB IB at 32; MI IB at 15). GRE, on the other hand, concludes that the “public interest is served by the $50 million of immediate rate reductions…” and other tangible benefits offered in the Partial Acceptance (GRE Letter at 2).

It is important to remember that the commitments by the Joint Petitioners in the Partial Acceptance to provide tangible monetary benefits to ratepayers and the State of New York are being made in addition to the other substantial benefits of the Proposed Transaction described below. While tangible monetary benefits are not required to demonstrate that the Proposed Transaction satisfies the public interest standard under Section 70, and are unrelated to the Proposed Transaction, the Joint Petitioners have nonetheless offered them in the Partial Acceptance in order to resolve any remaining doubt that the Proposed Transaction satisfies the Commission’s public interest standard.

Moreover, the Joint Petitioners already have committed in this proceeding to various conditions related to vertical market power, reliability, transparency and reporting, credit quality, capital structure, affiliate transactions, and data security, in order to mitigate the alleged risks raised by Staff and other parties in this proceeding. These commitments should fully resolve these potential (and in some instances purely hypothetical) risks. Thus, arguments by Staff and certain Intervenors that the Joint Petitioners' acceptance of $201 million of the PBAs proposed by Staff is inadequate are without merit. This tangible monetary benefit is a "net positive" benefit of the Proposed Transaction, in addition to the other substantial tangible benefits of the Proposed Transaction. To be clear, while Staff and certain intervenors would prefer greater economic concessions, the level in the Partial Acceptance is the only level that the Commission and ratepayers can be assured of here.[88] In other words, in the absence of the Proposed Transaction actually closing, ratepayers and other stakeholders will receive nothing.

Staff also argues that the Joint Petitioners' PBA offer of over $201 million is "substantially overstated" because the Joint Petitioners assume an effective date of July 1, 2008 for their PBAs (Staff IB at 131). Staff further asserts that July 1, 2008 is not the appropriate effective date for these PBAs since the underlying costs "would still be recovered in rates from ratepayers under the current rate plans" until rates are reset (*Id.*). In this regard, Staff appears to misunderstand *completely* the Joint Petitioners' $201 million PBA offer, which includes a commitment to flow through to customers the rate impact of those write-offs, write-downs and reserve increases *immediately* following the closing of the Proposed Transaction (Tr. 614; Exh. 50). The immediate implementation of this flow-through would result in an approximately $54.8 million immediate annual delivery rate reduction for customers (Tr. 614).[89] It is clear that July 1,

88 SPM identifies a real risk associated with the imposition of unreasonable PBAs and other rate concessions in this proceeding (SPM IB at 25). As SPM explains in its Initial Brief: "…Your Honor has to decide if $50 million of immediate rate relief is sufficient. Pushing much past this level of rate relief adds to the risk that Iberdrola will deem the transaction to be uneconomic." (*Id.*). Clearly, the Joint Petitioners' proposal to provide over $201 million in PBAs and over $54 million in immediate rate reductions (plus other benefits in the Partial Acceptance) would not exist in the absence of closing the Proposed Transaction.

89 This commitment means that ratepayers will *never* have that $201.642 million included on the utility's books, and ratepayers will never have to pay rates that would permit the recovery of these amounts (Joint Petitioners IB at 21).

2008 is the appropriate date for the PBAs to be calculated, as this date will allow NYSEG and RG&E customers to benefit immediately from the Joint Petitioners' $201 million PBA offer through immediate delivery rate reductions.

Flowing the PBAs into rates would not be required to obtain regulatory approval under Section 70 of the PSL. The Commission has approved many mergers in which accounting and book adjustments would not be reflected in rates until the next rate case.[90] In those merger cases, ratepayers did not receive *any* immediate benefits in connection with those rate adjustments. Here, however, the Joint Petitioners are nonetheless committing to significant delivery rate reductions (*i.e.*, $54.8 million) that would flow through to ratepayers immediately following the closing of the Proposed Transaction, which is on average a 4.4% reduction for Energy East's New York customers (Joint Petitioners IB at 21; Exh. 50).

B. New York State Will Benefit from Iberdrola's Commitment to Renewable Development, Energy Efficiency and the Environment

Staff has already acknowledged the importance of renewable development to New York State (thus putting to rest any remaining question that renewable benefits should be considered in a public interest analysis) (Tr. 1166-67).[91] Staff conveniently alleges, however, that the State "can reach those goals without Iberdrola's assistance" (Staff IB at 23) to diminish the obvious benefit of Iberdrola's renewable expertise. Additionally, Staff argues that renewable

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90 For example, in the Aqua New York/New York Water Service case, the Commission approved a merger in which there were conditions that required the merging parties to record regulatory assets and liabilities and establish internal reserves related to pension and OPEB expenses, which would not be immediately reflected in rates until new rates were established four years later. Case 06-W-0700 - *Aqua New York, Inc., f/k/a, Kingsvale Water Company, Inc., and New York Water Service Corporation, Order Rescinding Order Issued December 15, 2006 and Approving Stock Sale and Accounting Treatment*, at 8-10 (Dec. 20, 2006).

91 As Chairman Garry Brown stated this week with respect to renewable energy initiatives: "It is critically important to strengthen and promote renewable energy and other types of earth-friendly initiatives in New York. These are fundamental initiatives that will benefit us all in the future." *See* Press Release, State of New York Department of Public Service, *Renewable Energy Initiatives Gain Momentum* (Apr. 23, 2008).

development expertise and commitment should not be considered a benefit of the Proposed Transaction because Iberdrola does not need to acquire T&D companies in order to participate in the development of renewable generation in New York (*Id.* at 21-22).[92] Finally, CPB asserts that Iberdrola's commitment in the Partial Acceptance to support investments in excess of $100 million by Iberdrola Renewables in renewable generation in New York in the next three years is merely a "symbolic" commitment that "might never be fulfilled" (CPB IB at 29-30). Staff similarly asserts that this commitment is "illusory" (Staff IB at 133).

Importantly, Iberdrola is not just another player in the wind industry. Iberdrola is the world's leading producer of electricity from wind generation, with over 7,000 MW of wind capacity installed (Tr. 514) and unparalleled expertise, capacity and resources at its disposal. Iberdrola is uniquely positioned to help New York State meet its renewable goals (Tr. 514-15).[93] Many other parties have acknowledged Iberdrola's extensive experience, expertise and proven success in the development of wind generation (CPB IB at 14; SPM IB at 9; Tr. 1030 (NRDC); Tr. 108 (DEC); Tr. 1764 (City of Rochester)). Moreover, although Staff points to the approximately 7,000 MW of wind projects in the NYISO generation queue, Dr. Hieronymus' testimony emphasizes that many of these projects will never be constructed (Tr. 816).[94] On the other hand, as Mr. Azagra testified at the hearing, "Iberdrola brings reality to [wind

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92 Staff also claims that the ownership and development of wind generation by Iberdrola should be treated as a detriment, rather than a benefit, because Iberdrola's alleged ability to exercise vertical market power after the closing of the Proposed Transaction would discourage competing wind developers from entering New York (Staff IB at 24). This argument is fully addressed in the discussion of alleged vertical market power issues in Section III.A above.

93 Moreover, Iberdrola has a strong history of utilizing energy efficient and environmentally friendly technologies, and Iberdrola is committed to encouraging Energy East's efforts to implement energy efficient initiatives and environmental technologies (Tr. 486; 505).

94 In fact, Dr. Hieronymus notes that, according to the NYISO interconnection queue documents, of the more than 250 interconnection requests since 1999, few projects actually have been placed into service, and more than 100 projects have been withdrawn (Tr. 816).

development] projects" (Tr. 665) and has "an impressive track record with respect to the completion of such projects" (Tr. 520). As other parties have stated, the Commission would be remiss if it prevented the world's largest wind energy producer from bringing its expertise, capacity and resources to New York State.[95]

Iberdrola has never suggested that it needs to acquire T&D companies to participate in the development of renewable generation in New York. Instead, Iberdrola has consistently emphasized that it will target its renewable investment in those states where it is familiar with market opportunities and regulatory frameworks, and where the regulators are receptive to its renewable development (Tr. 519-20). Iberdrola has a solid track record of making significant investments in specific regions following major acquisitions (Tr. 641-42). For example, following the closing of the ScottishPower transaction, Iberdrola announced planned investments of 3 billion Euros in the U.K. as part of its Strategic Plan 2008-2010 (Exh. 52). Iberdrola has similarly announced planned investments of 8.6 billion euros in renewable development as part of its Strategic Plan 2008-2010 (*id.*), but has not yet determined the specific regions in which those investments will be made. It is consistent with Iberdrola's past practice that a more substantial portion of these renewable development investments would be focused in New York State after the closing of the Proposed Transaction.

In response to claims that Iberdrola's renewable commitment is merely "illusory" or "symbolic," Iberdrola has offered a binding merger commitment that it would support investments in excess of $100 million by Iberdrola Renewables in the development of renewable

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95 As SPM asserts in its Initial Brief, "New York needs all the help it can get to achieve a 15% reduction in gas and electric consumption by 2015 ('15 x 15'). Iberdrola must be part of that process. … How does it look to the world if we shut out the leading company in wind development while at the same time professing to be serious about achieving the 15 x 15 goal?" (SPM IB at 9); s*ee also* CPB IB at 14; Tr. 1030 (NRDC); Tr. 108 (DEC), Tr. 1764 (City of Rochester).

generation in New York over the next three years (*see* Exh. 50, at 2). Of course, while Iberdrola has announced goals to make renewable investments substantially in excess of this $100 million commitment after the closing of the Proposed Transaction (Tr. 681), the minimum $100 million commitment is unprecedented—no other renewable developer has ever provided this level of binding commitment to the State of New York.

Furthermore, Staff's claim that Iberdrola's renewable commitment is "illusory" is ironic, in light of the fact that Staff itself is recommending a total prohibition on the development of renewable generation by Iberdrola in New York State that would make it impossible for Iberdrola to fulfill this commitment. The majority of the parties in this proceeding (including ratepayer advocacy groups such as CPB and MI) have urged the Commission to resolve Staff's alleged vertical market power concerns in a manner that does not impose any restrictions on Iberdrola's ability to develop wind generation in the State, thereby allowing Iberdrola to satisfy its renewable commitment and broader investment goals for New York. Accordingly, the Commission should resist any invitation to restrict Iberdrola's ability to bring its expertise and investment in renewable generation to New York and should recognize the substantial renewable benefits offered by the Proposed Transaction, consistent with the policies of New York State (*see, e.g.*, Tr. 515-16; 1166-67).

C. The Proposed Transaction Will Benefit New York State Through Economic Development and Job Retention

Staff alleges that the economic development and job retention benefits offered by the Proposed Transaction are "ephemeral" (Staff IB at 27). In particular, Staff would discount Iberdrola's "snapshot" commitment regarding job retention because it does not "extend beyond the date the transaction closes" (Staff IB at 27). MI similarly requests that the Proposed Transaction be conditioned upon maintaining existing manpower levels for a reasonable period.

Concerns raised by Staff and other parties regarding the effect of the Proposed Transaction on job levels are without merit and unsupported by the record.[96] Iberdrola has repeatedly stated that there will be no job reductions as a result of the Proposed Transaction (Tr. 524; 638; 665-66). The absence of any job reductions is a logical byproduct of the Proposed Transaction, which is a non-synergy, first-mover merger. As explained in the Joint Petitioners' testimony, there is no reason to believe that the Proposed Transaction, which does not involve the combination or elimination of corporate or utility operating functions, would result in any job reductions, either at the time of closing or in the future (Tr. 524). To the contrary, there is evidence suggesting that job levels would be much more likely to increase after the closing of the Proposed Transaction.[97] Thus, concerns regarding the temporal nature of Iberdrola's job retention commitment are misplaced since there is no evidence to suggest that any job reductions would be likely to occur as a result of the Proposed Transaction.

Staff's absurd assertion that Iberdrola's job retention commitment could be a detriment to economic development is equally unfounded (Staff IB at 27). Staff makes the convoluted argument that the Proposed Transaction could somehow impair economic development because the retention of unnecessary employees at NYSEG and RG&E could result in rates that are unreasonably high, which could then cause employers to leave the NYSEG and RG&E service territories "for locations where utility prices are lower" (*Id.*). As demonstrated above, however, there is simply no evidence in the record or any other basis for Staff's concern

96 GRE, an economic development organization in the Greater Rochester region, does not question Iberdrola's commitment to job retention, and cites the "retention of jobs in the local community" as a benefit supporting Commission approval of the Proposed Transaction (GRE Letter at 2).

97 As Mr. Rude testified in response to potential concerns about job reductions, NYSEG and RG&E have likely reached the point where job levels have "got to head in the other direction … particularly to meet the capital program needs that we have and … to maintain service quality in the territory" (Tr. 667-68).

that existing job levels at NYSEG and RG&E would be affected by a non-synergy, first mover merger such as the Proposed Transaction. Accordingly, Staff's argument should be rejected.

Moreover, it is undisputed that Iberdrola's commitment to invest in renewable generation in New York will bring new jobs and related investment in the renewable generation industry in the State. As Mr. Azagra testified, Iberdrola sees the Proposed Transaction as "the platform in which we want to do much more business in the [S]tate" (Tr. 642). Moreover, as discussed in Section IV.B above, Iberdrola has a strong history of regional investment in those areas where it has completed major acquisitions. In fact, there is absolutely no evidence in the record that disputes the substantial economic development opportunities offered by the Proposed Transaction.

In response to Nucor's request that the Commission require specific commitments to economic development as a condition to approval of the Proposed Transaction (Nucor IB at 9), the Joint Petitioners would commit to the continued use of economic development incentives, including the use of Flex Rate contracts, to retain and attract industry and large customers to upstate New York. Additionally, Iberdrola would commit to directing NYSEG and RG&E to continue and, if possible, enhance these programs as part of the subsequent rate proceedings.

The economic development opportunities offered by the Proposed Transaction are even more significant in light of the fact that upstate New York, and particularly the areas served by NYSEG and RG&E, are struggling to attract and retain quality jobs (Nucor IB at 7). In fact, Governor Paterson recently called on New York's business and government leaders to develop a stronger alliance to ensure expanded job growth in the State, noting in particular that the government should "strengthen green business through the State."[98] The Commission has

[98] *See* Press Release, David A Paterson, Governor of the State of New York, *Governor Paterson Calls for Improved Public-Private Partnership to Stem State's Job Losses* (Apr. 22, 2008).

recognized economic development as a benefit when evaluating previous utility merger transactions,[99] as well as the fact that the revitalization of upstate New York is a top priority (Tr. 1599-1600). Accordingly, consistent with its own precedent and with New York State policy, the Commission should recognize and encourage the important economic development and job retention benefits offered by the Proposed Transaction.

D. Ratepayers Will Benefit from Iberdrola's Financial Strength and Stability

Staff asserts that Iberdrola's financial strength and stability are "ephemeral," since Iberdrola's financial health could "fall just as rapidly" as it has risen (Staff IB at 20). In particular, Staff argues that Iberdrola's strong "A" category credit ratings, which are currently one to three notches higher than those of Energy East, are an existing "snapshot of comparative credit ratings that could change rapidly" (*Id.* at 21). Staff also notes that the Joint Petitioners are not currently able to quantify the direct benefit to NYSEG and RG&E resulting from Iberdrola's financial strength and stronger credit rating (*Id.*). Therefore, Staff argues that Iberdrola's financial strength and stability should be considered a risk of the Proposed Transaction, rather than a benefit (*Id.*). CPB asserts that Iberdrola's financial strength, while positive, is highly speculative and entitled to little weight (CPB IB at 27-28).

Staff's and CPB's arguments in this regard are unsupported. Iberdrola's financial strength and stability are well-established in this proceeding and recognized by the market, as evidenced by Iberdrola's market capitalization of approximately $67 billion and its successful issuance of $4.5 billion of equity to fund the Proposed Transaction (Tr. 504; 507). Iberdrola's

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[99] *See* Case 97-M-0567 - *Long Island Lighting Co. and The Brooklyn Union Gas Co., Opinion and Order Adopting Terms of Settlement Subject to Conditions and Changes*, at 8 (Apr. 14, 1998) (hereinafter "*LILCO/BUG Order*") (recognizing settlement's stimulation of economic development as a benefit); *see also* Case 96-C-0603, *et al.* - *New York Telephone Co., et al., Order Approving Proposed Merger Subject to Conditions*, at 28 (May 30, 1997) (holding maintenance of the corporate headquarters in New York as one of the benefits that caused the NYNEX/Bell Atlantic merger to be in the public interest).

strong "A" category credit ratings (currently one to three notches higher than those of Energy East) cannot be described as mere "snapshots," but instead incorporate "an assessment of all future events to the extent they are known or can be anticipated," as Mr. Fetter explains (Tr. 750-51) (citation omitted).[100]

Moreover, the fact that the direct benefits resulting from Iberdrola's financial strength and stability are not currently quantifiable does not mean that these benefits are purely speculative. As Mr. Azagra testified, the interest rate spread on the debt of an "A" category company as compared to a "BBB" category company "changes every minute" (Tr. 630). Thus, although it is clearly anticipated that Iberdrola's financial strength will in the future provide NYSEG and RG&E with greater access to capital at lower cost, it is simply impossible to calculate the precise level of those benefits at this time. Importantly, Mr. Azagra has noted that the interest rate spread between an "A" category company and a "BBB" category company "has widened a lot" as a result of the current volatility of capital markets (Tr. 630).[101] Thus, these

[100] Contrary to Staff's position in this case, but consistent with Mr. Fetter's view, Staff assumed in the recent Con Ed rate case that Con Ed's then-current rating, as well as the then-current ratings of a proxy group of utility companies, should be used in setting Con Ed's forward-looking rates. *See* Case 07-E-0523 - *Consolidated Edison Co. of New York, Prepared Testimony of Staff Finance Panel*, at 23-29, 41-44, 56-58 (Sept. 2007). In particular, Staff asserted that Con Ed's then-current higher rating relative to the then-current lower ratings of the companies in the proxy group justified an upward credit quality adjustment to Con Ed (thereby resulting in a lower return on equity for forward-looking ratemaking purposes) because "[r]ating agencies have reviewed the risk of the companies in the proxy group and they are all riskier than Con Edison." *Id.* at 43. Similarly, Staff relied in part on "S&P predicting the Company will be at the top of the recommended A-range" to argue that it "fail[ed] to see how the Company's financial ratios would be considered weak by the investment community." *Id.* at 59.

[101] As explained in the rebuttal testimony of the Joint Petitioners' Policy Panel, the average basis point spreads on bonds for "BBB" rated utility companies has increased to approximately 205 basis points from 103 basis points one year ago (Tr. 509). The spread for "A" rated utilities has widened to a much lesser extent (*Id.*). Additionally, the difference in spreads between "A" and "BBB" rated companies has increased from 17 basis points to 35 basis points for the same period (*Id*.).

uncertain market conditions create an even greater opportunity for NYSEG and RG&E to benefit from Iberdrola's stronger "A" category credit ratings.

As described in the Joint Petitioners' Initial Brief, the Commission has consistently recognized such improvements in financial strength and stability when evaluating whether a potential utility merger is in the public interest under the PSL,[102] and the Commission should not ignore the substantial financial benefits offered by Iberdrola in this proceeding.[103]

E. Ratepayers Will Benefit From Iberdrola's Global Utility Expertise And Sharing Of Best Practices

Staff and CPB allege that benefits from Iberdrola's global utility expertise are speculative and unverifiable (Staff IB at 25; CPB IB at 26). In particular, Staff notes that Iberdrola has not yet identified which best practices it intends to implement at NYSEG and RG&E (Staff IB at 25). Staff further argues that Iberdrola's reliance on local management and its geographic distance from NYSEG and RG&E will prelude the sharing of information regarding best practices (Staff IB at 25-26). Finally, CPB argues that Iberdrola's global utility expertise, while important, should not be considered a benefit in the absence of evidence that its expertise will fill a need that is currently going unmet by NYSEG and RG&E, which already excel in and exceed a variety of service quality performance measures (CPB IB at 26). These arguments have no merit.

As described in the Joint Petitioners' Policy Panel, Iberdrola's commitment to local management does not mean that Iberdrola will not be able to help improve the operations of

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102 *See LILCO/BUG Order*, *supra* note 99, at 8, 37 (finding that the settlement improves the merged companies' financial integrity and access to capital); *Long Island Water/Thames Order*, *supra* note 12, at 6 (providing the utility with better access to capital markets was one of the benefits contributing to the satisfaction of the public interest standard).

103 CPB's position that Iberdrola's financial strength should be given "little weight" (CPB IB at 28) is ironic in light of the fact that CPB has identified reduced financing costs as a potential source of synergy benefits associated with the Proposed Transaction (*Id.* at 22).

NYSEG and RG&E for the benefit of their customers (Tr. 514).[104] While Iberdrola has traditionally relied on local management for the operation of other, non-Spanish entities that it acquired, local management at utility subsidiaries in Brazil and Guatemala have instituted various programs and upgrades as a result of Iberdrola's practice of sharing information about best practices among its operating subsidiaries (Tr. 514). Iberdrola has been able to have a measurable and positive influence on the operations of its utility subsidiaries in Brazil and Guatemala despite their geographical distance from Iberdrola's headquarters in Spain.

Furthermore, the fact that Iberdrola has not yet been able to identify which specific best practices may be appropriate to implement at NYSEG and RG&E does not mean that the benefits from Iberdrola's global utility expertise are purely speculative. Iberdrola will not have the opportunity fully to assess existing needs and evaluate which specific best practices may be appropriate to implement at NYSEG and RG&E until after the closing of the Proposed Transaction. Finally, as the Joint Petitioners' Gas Safety and Reliability Panel testifies, the existing excellence of NYSEG's and RG&E's operations does not preclude "opportunities for continued improvements in the future" resulting from Iberdrola's global experience and best practices (Tr. 253).

The Commission regularly treats demonstrated global utility expertise of an acquiring entity as a benefit when evaluating a potential utility merger under the PSL.[105]

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[104] Staff's assertion that Iberdrola's commitment to local management constitutes a disavowal by Iberdrola of "any intent to supervise the management of its new NYSEG and RG&E subsidiaries" (Staff IB at 16-17) is nothing but unsupported hyperbole. Iberdrola's demonstrated history of working with local management to improve the operations of its utility subsidiaries in Brazil and Guatemala is clear evidence that Iberdrola works collaboratively with local management (Tr. 514). Iberdrola's ongoing efforts to enhance the T&D standards at its utility subsidiaries in Spain and the U.K. are further evidence that Iberdrola is committed to working with local management to improve the operations of its utility subsidiaries (Exh. 42, IBER-0030, slides 8-9).

[105] *See Long Island Water/Thames Order*, *supra* note 12, at 6 (holding that the fact that Thames was an international firm with vast holdings in 44 countries would provide "American affiliates and

Moreover, Staff itself has acknowledged the benefit of parent companies' "transmitting the value of their extensive expertise and greater knowledge to [their] subsidiaries" (Staff IB at 16). Accordingly, it would be inappropriate for the Commission to discount the benefits offered by Iberdrola's global utility expertise and the sharing of information regarding best practices that would result from the Proposed Transaction.

F. Comparison to RGS/Energy East Commitments

Staff raises various unfounded criticisms of Energy East's compliance with the Energy East/RGS merger commitments made six years ago (Staff IB at 28). CPB makes similar arguments (CPB IB at 19). Staff alleges that NYSEG and RG&E did not meet in a "meaningful" way the merger commitments that were included as part of the Energy East/RGS merger (Staff IB at 28). This allegation by Staff is neither new nor correct and its repetition here does not give it any additional validity (Tr. 568). Staff has sought historically to expand the scope of the Energy East/RGS merger commitments and has claimed that the commitments expressly identified in the Joint Proposal pertaining to the merger were not reasonably met by Energy East. These commitments were set forth in full in the Joint Proposal and the 2002 Merger Order adopting that Joint Proposal[106] (Tr. 568). To the extent Staff alleges that the Energy East/RGS merger commitments were not met, the record in this proceeding demonstrates otherwise. The

subsidiaries the benefits of the knowledge, research and development it acquires elsewhere"); Case 99-W-1128 - *Kelda Group plc and Aquarion Company, Order Approving Stock Acquisition and Merger*, at 7 (Dec. 20, 1999) (hereinafter "*Kelda/Aquarion Order*") (recognizing the potential for sharing of best practices among U.S. and U.K water utilities as a significant benefit, as well as the fact that the utility would obtain access to Kelda's ongoing research and development efforts).

[106] Cases 01-E-0359 and 01-M-0404 - *Energy East Corp., RGS Energy Group Inc., et al., Order Adopting Provisions of Joint Proposal with Modifications* (Feb. 27, 2002).

Joint Petitioners' Policy Panel testified that Energy East did, in fact, comply with the conditions (Tr. 568-69) and Staff's and CPB's criticisms are without any basis.[107]

First, Energy East has disputed in the past and continues to vigorously disagree with Staff's view of the RGS commitments. Rather than being unenforceable, as Staff claims, the actual commitments were expressly set forth in the Joint Proposal and therefore were subject to the Commission's authority. As far back as 2003, Energy East responded in detail to an investigation by Staff regarding the scope of and compliance with the commitments made as part of the Energy East/RGS merger.[108] Staff's position that these commitments have not been met, therefore, has been consistently disputed by Energy East.[109] Second, there has been no finding by the Commission of non-compliance by Energy East with the 2002 RGS Merger Order. Third, Staff complains about a provision in the Energy East/RGS merger agreement about staffing levels (Staff IB at 29). That merger condition terminated as of the closing of that transaction, which is typical of conditions of this nature.[110] Staff conveniently overlooks that it was also

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107 Indeed, Mr. Rude testified that, "Energy East met its RGS merger commitments to the Commission, even though changed circumstances required some modification in how they were met" (Tr. 568).

108 *See* Letter from Seth A. Kaplan to Dawn Jablonski Ryman, Commission General Counsel (July 17, 2003). Energy East also responded to various interrogatories from Staff on this topic. *See* Letter from Eric Nelson to Peter Catalano, Staff Counsel (May 9, 2003) (enclosing detailed response to information requests dated April 4, 2003).

109 *See* Cases 03-E-0765, 02-E-0198, 03-G-0766 - Rebuttal Testimony of the Overview/Policy Panel, at 12-13.

110 Staff's suggestion that it was in some way hoodwinked by the parties to the merger, inasmuch as this provision was "[b]uried in the Agreement, pages after the promises were made" (Staff IB at 29) is not believable. Staff, of course, had a copy of the Agreement and Plan of Merger, attached to the March 23, 2001 Joint Petition in Case 01-M-0404 as Appendix A, from the moment it was filed. Moreover, the provision in question, Section 10.1, appears as the very first item under "General Provisions" (Article X), and bears the underscored title, "Non-Survival; Effect of Representations and Warranties." If that constitutes "burying" a provision in a document, it is a shallow grave indeed.

seeking extensive synergy savings in that transaction, which made workforce reductions ultimately necessary (Tr. 569).

Fourth, the entire employment issue Staff raises is irrelevant to this Proposed Transaction. What the Joint Petitioners have clearly stated about staffing is that the nature and logic of this Proposed Transaction make staffing reductions unlikely. Iberdrola has no regulated operations in the United States. How would job reductions be accomplished in such a first-mover non-synergy transaction? In a non-synergy merger, there is no "pool" of potentially redundant positions that could be eliminated. Job reductions are merely another Staff manufactured risk to try to justify higher PBAs and rate concessions.

To the extent Staff alleges that the Energy East/RGS merger commitments were not met by Energy East, the record in this proceeding demonstrates otherwise and Staff's use of the these commitments to attack the validity of the intangible benefits of the Proposed Transaction should be rejected as without merit.

V. STAFF'S PBA LEVELS ARE UNJUSTIFIED AND UNREASONABLY HIGH

A. Proxy Benefits

Based on the erroneous belief that mergers must demonstrate immediately quantifiable monetary benefits for ratepayers in order to be approved under Section 70 of the PSL, Staff proposes $644 million of PBAs which it asserts "are a reasonable substitute for the synergy savings that have been required in other energy utility mergers" (Staff IB at 116). As explained in Section II above, the Commission has previously approved non-synergy mergers without artificially manufacturing savings for ratepayers (*see also* Joint Petitioners IB at 16-18). Moreover, through the Partial Acceptance, Joint Petitioners have already agreed to provide substantial monetary benefits to ratepayers, which are more than sufficient to demonstrate that the Proposed Transaction is in the public interest pursuant to Section 70.

Despite the substantial concessions already offered by the Joint Petitioners, Staff asserts that additional concessions—in the form of Staff's proposed $644 million of PBAs—are "a reasonable sum to require as a condition of approval" (Staff IB at 114). Critically, rate concessions must be based on actual synergies and efficiencies that would result from a merger (Tr. 942-43) and there are no such synergies here. Consequently, Staff's requested PBAs are nothing more than an attempt to levy an "entrance fee" or "toll" on Joint Petitioners by requiring them to bear additional costs to consummate the Proposed Transaction. As Joint Petitioners have demonstrated, this approach, if accepted, would deter future mergers to the detriment of New York (Tr. 958; 1000-01; *see also* Joint Petitioners IB at 34-35).

Staff nonetheless asserts that it has shown its proposed PBAs to be "reasonable" based on three invalid comparisons (Staff IB at 115). First, Staff creates a list of purported "benefits" of the Proposed Transaction which amount to $1.6 billion and argues that these benefits should be shared with ratepayers (*Id.*). These purported "benefits" lack any legal basis, or factual basis in the record, and suffer from errors. Indeed, more than $1 billion of the "benefits" identified by Staff are in fact costs that must be borne by Iberdrola itself in order to consummate the Proposed Transaction, while the remaining amounts are purely speculative. The Commission has never relied on non-existent synergy benefits to create rate concessions (*see* Joint Petitioners IB at 34, n.31). Second, Staff attempts to compare the Proposed Transaction—a stock purchase of an upstream holding company—to an asset sale (Staff IB at 115). This approach has previously been rejected by the Commission—and by Staff itself—each with a detailed principled explanation (Joint Petitioners IB at 35-37). Third, Staff attempts to compare its proposed PBAs to the ratepayer concessions provided previously in energy utility mergers in New York as well as to monetary benefits provided by Joint Petitioners in Maine (Staff IB at

115-116). In attempting to compare the Proposed Transaction to the Grid/KeySpan and Energy East/RGS mergers, both of which were synergy mergers, Staff ignores the basic fact that the Proposed Transaction is not a synergy merger and that the Commission has not conditioned its approval of non-synergy utility mergers on upfront rate concessions. Even assuming, *arguendo*, that there is any valid basis for comparing the Proposed Transaction to synergy mergers, Staff's comparison suffers from severe computational errors, and Staff's comparison of the proposed PBAs to the stipulation entered into by the Joint Petitioners suffers from critical flaws.

Like the mythical three-headed Hydra, each of Staff's so-called "comparisons," has no basis in reality. Comparisons, proxies or claimed justifications of whatever name that are neither independently justified nor justifiable, must be rejected.

1. Staff Improperly Attempts To Rely On Unjustifiable "Benefits" To Justify Its Proposed PBAs

In attempting to justify its proposed PBAs, Staff has created a list of purported "benefits" of the Proposed Transaction to the Joint Petitioners totaling $1.6 billion (Tr. 1210-21; Exh. 106; *see also* CPB IB at 23). However, Staff's so-called "benefits" "have a number of problems, not the least of which is the fact that these benefits have nothing to do with the realization of operating efficiencies achievable by the regulated utility operations of NYSEG or RG&E as a result of the Proposed Transaction," as Mr. Meehan testifies (Tr. 949). Staff is forced to concede that these are in fact "benefits *other* parties receive" (Staff IB at 116) (emphasis added). There is no principled basis for attempting to craft rate concessions from non-existent synergy benefits (Tr. 942-43), and Staff acknowledges that it adopted this approach only because "there really isn't any guidance in the precedents we looked at as to how to develop positive benefits to ratepayers" (Tr. 1510). Staff's proxy "benefits" suffer from other fundamental flaws, as discussed below, and they each fail to support the level of PBAs Staff requests.

a. Payments To Energy East Shareholders, Executives And Third Parties

Staff's calculation of proxy "benefits" from the Proposed Transaction includes $930 million in the form of an acquisition premium to be paid to Energy East shareholders, $78 million to be paid to Energy East executives, and $46 million to be paid to investment bankers, attorneys and advisors (Exh. 106; *see also* Staff IB at 117, 120).

These *payments*—totaling over $1 billion of Staff's $1.6 billion total—are not "benefits" but are instead costs that Iberdrola will incur to consummate the Proposed Transaction (Joint Petitioners IB at 35-38).[111] Staff does not seriously attempt to rebut the fact that it has improperly attempted to characterize costs as benefits. For example, Staff labels payments to executives and third parties as "transaction costs" (Staff IB at 120). While CPB attempts to argue that the payments to shareholders, executives and third parties are "a measure of the expected benefit of the transaction *to the company*" (CPB IB at 23 (citing Tr. 1611-12)) (emphasis added), this is plainly incorrect. Iberdrola, Energy East, NYSEG and RG&E will in no way benefit from or retain these payments (*see* Tr. 949; 1507-08; 1554-56).

Staff's attempt to justify ratepayer concessions using costs to Iberdrola from the Proposed Transaction is unprecedented. As even Staff acknowledges, "the Commission decided

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[111] The Joint Petitioners further explained that Staff's calculations are artificially inflated because they attribute the entirety of the payments to the acquisition of NYSEG and RG&E and also fail to take taxes into account (Joint Petitioners IB at 37, n.36, n.37). Staff fails to address this point, stating only that conducting a proper calculation that excludes taxes "is not feasible or particularly relevant" (Staff IB at 118).

in the [*ConEd/O&R Order*][112] […] [that] the premium paid shareholders at an arms-length transaction belongs to them" (Staff IB at 117; *see also* Tr. 1509-10 (conceding that Staff is not aware of any instance where the Commission has required acquisition premiums to be shared with ratepayers)).[113] Similarly, Staff acknowledges that it only points to payments to third parties because "[w]e don't have any other way of evaluating the benefits that Mr. Benedict and Mr. Haslinger presented" (Tr. 1511).

Staff nevertheless asserts that it "is not attempting to divert from shareholders the $930 million in gain they will receive as a premium for the sale of their stock" (Staff IB at 117 (citation omitted); *see also* MI IB at 23).[114] The fact remains, however, that "only benefits in excess of costs are realizable benefits" (Tr. 953). The Commission should reject Staff's proposal to use these Iberdrola payments to justify rate concessions because, as the evidence shows, the "attempt to reach beyond traditional benefits raises the cost of the transaction" and could chill future investment in New York (Tr. 957-58; *see also* Tr. 953-54).

b. Production Tax Credits Cannot Be Used to Justify Staff's Unreasonable PBA Levels

Staff argues that production tax credits, or "PTCs," that it believes may be available in connection with Iberdrola Renewables' affiliated wind generation in the U.S., can be used to justify Staff's proposed PBAs (Staff IB at 119). Staff values these tax credits as high as

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112 Case 98-M-0961 - *Consolidated Edison, Inc., Consolidated Edison Co. of New York, Inc. and Orange and Rockland Utilities, Inc., Order Authorizing Merger* (Apr. 2, 1999) (hereinafter "*ConEd/O&R Order*").

113 Staff nonetheless argues that the ConEd-O&R merger resulted in $468 million in benefits that were shared with ratepayers (Staff IB at 117). Those amounts, however, resulted from synergy savings, *ConEd/O&R Order, supra* note 112, at 4, and therefore cannot be used to justify rate concessions in this non-synergy merger.

114 Staff further puts forward the claim that "many of [the investment bankers and advisors] will be paid a flat fee for their services, regardless of the level of time and effort put forward" (Staff IB at 120), which is both irrelevant and unproven.

$150 million (Exh. 106). Two other parties make similar claims (MI IB at 17-18; CPB IB at 22). These arguments are unsupported by the record, based on inherently flawed calculations and are contrary to the public policy behind tax incentives.

The availability of PTCs from Iberdrola Renewables' wind projects is completely unrelated to the Proposed Transaction. [115] These PTCs will exist regardless of whether the Proposed Transaction is consummated and regardless of Energy East's tax liability (Joint Petitioners IB at 41; Tr. 528).[116] Moreover, as CPB acknowledges in its Initial Brief, Iberdrola Renewables' wind projects regularly "take on tax equity partners who invest in the facilities in return for the right to use the PTCs" (CPB IB at 22). Additionally, as the Joint Petitioners' witnesses explain, these PTCs have absolutely nothing to do with NYSEG's and RG&E's operations, customers or regulated rates (Tr. 951; 1081; 1083). Since the Proposed Transaction is wholly unrelated to whether or not Iberdrola will be able to realize benefits in connection with PTCs from Iberdrola Renewables' wind projects, it would be inappropriate for the Commission to treat these PTCs as synergy savings in this proceeding.

MI's claim that the Moody's February 2008 publication supports the argument that Iberdrola Renewables' PTCs should be treated as potential synergy savings is similarly unfounded (MI IB at 18). The mere fact that Moody's included language regarding the potential

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115 Contrary to suggestions by Staff and MI (Staff IB at 119; MI IB at 18), certain early statements by Iberdrola related to the potential utilization of PTCs from Iberdrola Renewables' wind projects are of no consequence to the issues raised in this proceeding. These early statements were made when Iberdrola had not fully evaluated these PTC issues. Since then, the Joint Petitioners have explained, including through the testimony of Mr. Azagra, that Iberdrola did not include any potential PTC benefits in its valuation of the Proposed Transaction (Joint Petitioners IB at 32; Tr. 652-53). No PTC benefits were quantified and relied upon in the decision of the Iberdrola Board of Directors to move forward with the Proposed Transaction.

116 CPB argues that Iberdrola may be able to obtain "greater value" for its PTCs by utilizing them to offset its own tax liability (CPB IB at 22). There is absolutely no evidence in the record to support a conclusion that utilizing Energy East's tax liability would provide any "greater value" than other sources of tax liability, much less any evidence to quantify any such "greater value."

utilization of taxable income from Energy East in connection with renewable tax incentives as part of a recent publication on Iberdrola does not change the fact that Iberdrola does not need Energy East's tax liability to utilize the PTCs from Iberdrola Renewables' wind projects. Moreover, the Moody's February 2008 publication does not necessarily reflect the views and opinions of Iberdrola.[117] Accordingly, MI's reliance on statements in the Moody's February 2008 publication as support for its argument that PTCs in connection with Iberdrola Renewables' U.S. wind projects should be treated as potential synergy savings is clearly unfounded.

More importantly, even if one were to assume that PTCs in connection with Iberdrola Renewables' wind projects were somehow related to the Proposed Transaction (which they are not), the Joint Petitioners demonstrate that Staff's calculation of PTC benefits is fundamentally flawed (Joint Petitioners IB at 40-41). In particular, Staff's calculation of PTC benefits ignores the existing third-party equity structures that are already in place to allow third parties to utilize the PTCs from Iberdrola Renewables' operational wind projects (Tr. 529-30; Exh. 19, IBER-288),[118] and includes projects that are still under development, which may never be completed and for which PTCs may no longer be available (Tr. 528; 530-31). Thus, Staff's valuation of PTC benefits attributable to the Proposed Transaction should not be given any weight.

Finally, by attempting to use potential PTC benefits as a justification for its PBAs, Staff and certain other parties ignore the public policy and economic purpose of the PTC mechanism, which is to provide incentives for the development of renewable generation and

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117 Although Iberdrola sometimes reviews certain objective data in rating agency reports prior to their public release (*e.g*,. numbers, ratios, etc.), Iberdrola does not have the opportunity to review the subjective opinions expressed by the ratings agencies in such reports.

118 For example, the PTCs from Iberdrola Renewables' only two operational projects within New York State are already being utilized by third-party tax equity investors (Joint Petitioners IB at 40).

promote competition between renewable energy sources and conventional energy sources (Joint Petitioners IB at 39; Tr. 527-28). If regulatory authorities were to make a practice of obstructing the flow of these federal tax incentives to their intended recipients, the likely result would be that investments in renewable generation simply would not happen (Tr. 527-28; 651-52).[119] Accordingly, it would be entirely improper for the Commission to rely on PTC benefits that may be available to Iberdrola's affiliated wind projects in the U.S. as a justification for any portion of the PBAs proposed by Staff in this proceeding.

c. Spanish Tax "Benefits" Cannot Be Used to Justify Staff's Unreasonable PBA Levels

Staff and certain other parties continue to argue that certain tax deferrals/amortizations that may potentially accrue to Iberdrola can be used to justify Staff's unreasonable proposed PBAs (Staff IB at 118-19; MI IB at 18). Staff asserts that the value of this potential tax deferral is $476 million (Exh. 106).[120] As the Joint Petitioners demonstrate, Iberdrola is highly unlikely ever to realize this "tax benefit"[121] because of certain restrictions under Spanish law (Joint Petitioners IB at 42-44; Tr. 536; 657). Neither Staff nor MI challenges, much less rebuts, the highly speculative nature of this supposed tax "benefit" under Spanish law. Instead, they argue that the mere fact that Iberdrola may pursue such tax deferral/amortization

119 In fact, the Commission has acknowledged that "renewable resources are generally more expensive than non-renewable resources, such as fossil fuels. Therefore, without access to financial incentives to cover all or some of these above-market costs, renewable resources struggle to compete with resources using fossil fuels." Case 03-E-0188 - *Proceeding on Motion of the Commission Regarding a Retail Renewable Portfolio Standard, Order Regarding Retail Renewable Portfolio Standard*, at 2-3 (Sep. 24, 2004).

120 As described in the Joint Petitioners' Initial Brief, Staff reaches this calculation through a manipulation of information provided by Iberdrola in response to a Staff data request in order to further inflate its artificial calculation of proxy benefits (Joint Petitioners IB at 42).

121 Iberdrola has repeatedly objected to the classification of this item as a "benefit" since Spanish law provides to Spanish entities that acquire companies outside of Spain only a limited tax deferral that would be recaptured in the taxable base of the seller if and when an acquired company is sold (Joint Petitioners IB at 43-44; Tr. 655; 658).

after the closing of the Proposed Transaction somehow makes it less speculative. This argument is absurd on its face. It would be imprudent for Iberdrola not to pursue favorable tax treatment, even though such pursuit will not make favorable tax treatment any less speculative.[122]

Moreover, even if this tax "benefit" were to be realized, using it to justify Staff's proposed PBAs is contrary to the policy underlying its design (Joint Petitioners IB at 42-44; Tr. 949-50). This highly speculative Spanish tax "benefit" associated with Goodwill is entirely unrelated to rates that would be paid by customers of NYSEG and RG&E that will not bear any of the costs of that Goodwill (Tr. 949-50), and is instead intended by the Spanish government to create a tax incentive for foreign investment by companies based in Spain (Tr. 657; 950). Accordingly, it would be completely inappropriate for the Commission to rely on this supposed tax "benefit" as a justification for any portion of the PBAs proposed by Staff in this proceeding.

2. Synergy Savings Do Not Exist

MI alleges that the Joint Petitioners purposely did not identify synergy savings or other financial benefits flowing from the Proposed Transaction (MI IB at 15-16). Staff and CPB also question the validity of the Joint Petitioners' determination that the Proposed Transaction will not result in any synergy savings (Staff IB at 112; CPB IB at 23). These arguments, which are based upon assumptions of bad faith and false dealing, without any supporting record evidence, are without merit. Indeed, as Mr. Meehan explains, given that all synergy savings ultimately will flow to ratepayers, not investors, in the normal course of ratemaking, the very premise of these arguments is absurd. If there were any synergies resulting from the Proposed Transaction, it would be in Iberdrola's economic interest to identify and quantify these savings (net of the costs that must be incurred to produce them) so that it could obtain a share (Tr. 934;

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[122] Furthermore, Staff offers no justification for its use of the high end of the range of this potential tax deferral.

956-57; 983; 1001; 1004; 1007-10; 1013-15). Nonetheless, the Joint Petitioners have demonstrated that there are no potential synergies resulting from this type of first-mover transaction, in which Iberdrola's only current assets in the United States are unregulated affiliates that have a different business focus than Energy East, and that would continue to be separately managed after the closing of the Proposed Transaction (Joint Petitioners IB at 44-46; Tr. 526; 935-36). The mere fact that Iberdrola describes Energy East as a "synergic business" in one of its recent presentations (MI IB at 17) does not alter the fundamental nature of the Proposed Transaction (a first-mover transaction) or the reality that it does not create any synergy opportunities.

Moreover, although Staff and MI point out that Iberdrola was able to find synergies in its acquisition of ScottishPower, which also could be described as a first-mover transaction, the vast majority of the synergy savings in that transaction were driven by IT consolidation and implementation opportunities that do not exist for the Proposed Transaction (Tr. 540; 644). Only 3 million euros of the synergies in the ScottishPower transaction are related to ScottishPower's regulated T&D operations in that transaction (Tr. 541; 644).[123] No party has disputed this number. Accordingly, it was perfectly logical for Iberdrola, based on its 100 years of experience in the utility business and its recent experience in the ScottishPower acquisition, to determine that no synergy studies were needed in connection with the Proposed Transaction.[124] Any argument that Iberdrola purposely did not identify, or otherwise hid, synergies resulting from the Proposed Transaction is without merit.

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[123] It is also important to note that the ScottishPower acquisition was much larger than the Proposed Transaction, with a total transaction value of over $30 billion.

[124] In fact, Mr. Azagra testified that Iberdrola certainly would have put synergy savings "on the table" if Iberdrola thought that such savings would be possible in connection with the Proposed Transaction (Tr. 645-46).

MI and CPB also assert that refinancing is a source of savings as a result of the lower cost of credit associated with Iberdrola's higher credit rating (MI IB at 19; CPB IB at 22). The Joint Petitioners agree that this is a benefit of the Proposed Transaction, as discussed previously, and the Joint Petitioners commit that these savings will accrue to the benefit of ratepayers over time. However, these savings cannot be quantified or front-loaded without knowing the conditions of the financial markets when debt is needed at RG&E and NYSEG, as well as the precise financial status of NYSEG, RG&E and Iberdrola at that time (Tr. 630; 632). As Mr. Azagra testified, the precise benefit that NYSEG and RG&E ratepayers will receive from Iberdrola's superior credit rating and financial strength cannot be quantified at this time (*Id*.). Even MI acknowledges that "not all potential benefits … can be quantified" (MI IB at 6).

To the extent that the Proposed Transaction results in future savings over the long term, the Commission will have the opportunity to review any such savings in the context of a future rate proceeding (Tr. 526; 982-83). Although MI argues that ratepayers will not benefit from these synergy savings until rates are reset (MI IB at 21), MI points to no precedent in which the Commission has attempted to forecast currently unknown future synergy savings and costs to provide current rate reductions as a form of merger-related benefits. This is not surprising because such an approach would not be workable. As Mr. Meehan explains, the timing issue raised by MI is the result of regulatory lag in the normal ratemaking process that applies equally to savings and costs, absent some sort of forward rate case projection (Tr. 998-99). Of course, such a forward projection would have to include the costs that would need to be incurred to generate the savings. Otherwise any imputed future savings provided to customers in the form of a current rate reduction would not be a real merger-related benefit; instead, it would be nothing more than "taking money away from the shareholder and giving it to the customer without a cost reduction. You're not compensating the shareholder in that case for providing the service" (Tr. 1000-01; *see also* Tr. 996). Accordingly, MI's argument is without merit.

Staff's attack on the validity of the Joint Petitioners' determination that the Proposed Transaction will not result in any synergy savings is particularly disingenuous in light of the fact that Staff's own proposal regarding affiliate transactions would preclude any opportunity to achieve traditional synergy savings. Staff's affiliate transaction rules would, themselves, prevent Iberdrola from achieving any synergies via the combination of its U.S. business by prohibiting Iberdrola or any of its affiliates from providing goods or services to NYSEG or RG&E (Joint Petitioners IB at 46-47; Exh. 111 at 13). Staff does not dispute this fact, and has readily acknowledged that this prohibition would extend to *any* goods or services, including, IT services,[125] O&M services, back office services and accounting services (Tr. 1498-99). Accordingly, the Commission should not give any weight to Staff's unsupported conclusion that the "synergy savings exist, but are hidden…" (Staff IB at 113).

3. The Proposed Transaction Cannot Be Compared To An Asset Sale

Staff also attempts to justify its proposed PBAs by claiming that "[t]he gain on an asset sale is generally directed primarily to ratepayers," and by comparing RG&E's recent sale of its Ginna nuclear facility to the Proposed Transaction (Staff IB at 115). This attempt to compare the sale of a regulated asset out of rate base to the Proposed Transaction—which involves the sale of holding company stock—is untenable. Indeed, in the *ConEd/O&R Order*, the Commission reviewed and rejected precisely the types of arguments advanced by Staff here. In

[125] Even assuming that Iberdrola and its affiliates were allowed to provide IT services to NYSEG and RG&E, the Joint Petitioners have clearly demonstrated that the Proposed Transaction does not offer any opportunities for IT synergies, since all ascertainable IT savings associated with Energy East were already realized in connection with the Energy East/RGS merger (Tr. 536-37). Arguments to the contrary by Staff and MI lack merit (Staff IB at 112-13; MI IB at 19). MI's argument that there may be synergy savings in connection with the elimination of certain Energy East holding companies is not supported by any evidence in the record (MI IB at 19).

that case, an intervenor argued that any premiums paid to shareholders "should inure to ratepayers as they would obtain the gain on any sale of O&R's assets to another company".[126] The Commission found, however, that "[w]ith respect to … claims that the CEI acquisition of O&R's common stock is the same as a transfer of the company's assets and its franchise rights, neither the facts here nor the applicable legal requirements provide any reason to recast the proposed merger."[127]

Staff in the ConEd/O&R proceeding also firmly rejected the notion that "ratepayers have a claim on a portion of the stock premium," recognizing that there is "no precedent for such a proposal and … no regulatory principle that would justify such a proposal as a ratepayer interest in the assets remains unaffected by the merger and stock transfer."[128] Staff fails to provide any principled basis for its about-face here.

In its Initial Brief, Staff now attempts to downplay the Commission's holding in the *ConEd/O&R Order*, as well as Staff's own statements in that proceeding, arguing that the comparison of the Proposed Transaction to an asset sale "is sustainable, to the extent that both transactions fall within the ambit of [Section] 70 and both require that benefits be directed to ratepayers in order to justify approval" (Staff IB at 120). Staff ignores the fact, however, that the Commission's statements in the *ConEd/O&R Order* were also made in the context of a Section 70 proceeding, and that the Commission nevertheless concluded an asset sale comparison to be inapt. The same is true here.

126 *ConEd/O&R Order, supra* note 112, at 16.

127 *Id.* at 21.

128 Exh. 113, at 9-10 (Staff's Reply Statement, Case 98-M-0961); *see also ConEd/O&R Order, supra* note 112, at 16 ("Staff also distinguishes asset transfer cases from those involving stock acquisitions and mergers.").

4. Staff's Comparison Of The Proposed Transaction To Other Mergers And The Maine PUC Proceeding Regarding The Proposed Transaction Is Flawed

In a final attempt to justify its proposed PBAs, Staff compares its proposal to the ratepayer benefits provided in two previous synergy mergers—the Grid/KeySpan merger and the Energy East/RGS merger—as well as to the monetary benefits agreed to by the Joint Petitioners in Maine. As the Joint Petitioners have explained in Section II above, there is no legal or factual basis to compare a non-synergy merger like the Proposed Transaction to synergy mergers, like the Grid/KeySpan and Energy East/RGS mergers. In addition, Staff's comparison to what the Joint Petitioners agreed to in the Maine Merger Stipulation submitted on January 9, 2008 in Docket No. 2007-355 - *Central Maine Power Company and Maine Natural Gas Corporation Reorganization/Acquisition of Energy East Corporation and Iberdrola, S.A.* (Exh. 51) suffers from fundamental computational and other errors. Accordingly, Staff's utility merger comparisons, like its proxy benefit and asset sales comparisons, should be rejected.

a. Comparison to Grid/KeySpan

Staff improperly asserts that the Grid/KeySpan merger resulted in $602.8 million in ratepayer benefits. The Commission's order in Grid/KeySpan shows that this $602.8 million figure is overstated—after subtracting amounts "that are of no real benefit to customers over the long run" [129] the Commission "conclude[d] that the partial revenue requirement savings that would be achieved are approximately $407.877 million …, including KEDNY's and KEDLI's shares of synergy savings during that time."[130] Staff's suggestion that the Commission "relied" on the full $602.8 million in approving the Grid/KeySpan merger (Staff IB at 122-23) has no basis in the Commission's order itself, and should be disregarded.

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129 *NG/KS Order*, *supra* note 10, at 117.

130 *Id.* at 118.

Staff also suggests that Mr. Meehan improperly excludes $45 million in synergy savings that were passed on to shareholders, claiming that this amount was not included in the $602.8 million (Staff IB at 122). Staff misunderstands the purpose of Mr. Meehan's analysis. As Mr. Meehan explains, Staff's PBAs are not based on synergy savings that would ordinarily result in delivery rate reductions (Tr. 961). Even assuming there were any valid basis for comparing the rate reductions in Grid/KeySpan to the PBAs recommended by Staff, it is necessary first to remove from the comparison any rate concessions in that case that were based on synergy savings (Tr. 989; 991). Moreover, as Mr. Meehan explains, investors are permitted to retain a share of synergy savings in order to defray transaction costs and to incentivize mergers (Tr. 962). Thus, to obtain a true comparison between a non-synergy merger and Grid/KeySpan, Mr. Meehan properly excludes the $45 million of synergy savings assigned to shareholders because those savings would have been used to fund rate concessions (Tr. 962-63).

Staff further argues that Mr. Meehan errs in dividing the Grid/KeySpan unfunded rate concessions by the delivery revenues for KEDNY, KEDLI, LIPA and Niagara Mohawk, rather than KEDNY and KEDLI alone (Staff IB at 122-23). Again, Staff misunderstands the import of Mr. Meehan's analysis. As explained above, Mr. Meehan's analysis is intended to arrive at a calculation of unfunded rate mitigations in the Grid/KeySpan merger that can be properly compared with Staff's proposed PBAs in this case. Such rate mitigations did not result from synergy savings or other cost reductions at KEDNY or KEDLI; rather, these costs would have to be absorbed by the entirety of the merging companies' utility operations—*i.e.*, from LIPA and Niagara Mohawk, as well as KEDNY and KEDLI. Consequently, that the unfunded rate mitigations only benefited KEDNY and KEDLI is irrelevant.

Mr. Meehan has properly shown that the unfunded rate concessions in the Grid/KeySpan merger do not exceed $317.6 million (Exh. 79),[131] and that, at most, the nominal non-synergy rate mitigation level for the Proposed Transaction should be no more than $87 million (Tr. 964). Notably, the Joint Petitioners have already offered one-time PBAs of over $201 million that far exceed that figure. Thus, to the extent that a comparison to Grid/KeySpan has any value whatsoever in assessing this non-synergy merger, the comparison in fact shows the Proposed Transaction to be in the public interest.[132]

b. Staff's Comparison to The Maine Stipulation

In its Initial Brief, Staff attempts to justify its extraordinary request that Joint Petitioners pay a toll for merger approval in New York, using for comparison its interpretation of the monetary benefits provided to ratepayers in the Maine Stipulation (Exh. 51). Specifically, Staff claims its proposed PBAs are justified since the Proposed Transaction, according to Staff, is going to result in monetary benefits of almost $400 million to CMP ratepayers (Staff IB at 124). Staff arrives at this figure by adding (i) the $306 million Staff claims Energy East is

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[131] In fact, this $317.6 million figure is inflated because it includes amounts that were offered to resolve litigation disputes not necessarily related to the Grid/KeySpan merger (Tr. 964).

[132] Staff also asserts that there were "$496 million in benefits to Niagara Mohawk and LIPA ratepayers … unrelated to the directly-affected KeySpan delivery subsidiaries" which were considered by the Commission in approving the Grid/KeySpan merger (Staff IB at 123). These benefits are simply not comparable to the "unfunded" benefits analyzed by Mr. Meehan. In addition, Staff is simply incorrect in attributing these benefits to Niagara Mohawk and LIPA alone. In fact, approximately $127 million of these benefits were based on synergy and efficiency savings for KEDNY and KEDLI. *NG/KS Order, supra* note 10, at 119. Another $171 million was attributable to synergy savings at Niagara Mohawk. *Id*. at 119. As discussed previously, synergy savings cannot validly be used as a basis for assessing the Proposed Transaction, which is a non-synergy merger. Moreover, the Commission found that the KEDNY/KEDLI efficiency savings, as well as asserted gas savings of $93 million, should not be considered benefits of the merger. *Id.* at 119-120. Finally, even excluding such amounts, the Commission pointed out that the asserted benefits were likely overstated. *Id.* at 120. As a result, these additional benefits—which are not comparable to the "unfunded" benefits discussed by Mr. Meehan—fail to demonstrate that monetary benefits are required in the context of this non-synergy merger, much less show that the rate benefits offered by the Joint Petitioners are inadequate.

forgoing in the recovery of the acquisition premium paid by Energy East to acquire CMP, and (ii) the $86 million that Staff alleges CMP is forgoing as a result of CMP's agreement to levelize the revenue requirements associated with its proposed advanced metering infrastructure (“AMI”) investment (*Id.*). Staff is just plain wrong. The amounts of these alleged monetary benefits to ratepayers are unsubstantiated and erroneous and the Commission should not afford them any weight.

First, although Staff estimates the value of the “forgone” acquisition premium as $306 million, this amount was not what CMP was requesting in Docket 2007-215. In fact, CMP was only attempting to recover $9 million (or 50%) of the merger savings attributable to Energy East’s acquisition of CMP. Staff agreed with this amount on cross-examination (Tr. 1485). Moreover, it was far from certain that CMP would actually prevail on this issue had it been litigated in Docket 2007-215; thus this benefit is not worth a full $9 million.

Second, there is no logic to Staff’s position that, on the one hand, characterizes a forgone acquisition premium in Maine as a ratepayer “benefit” that could somehow justify extraordinary PBAs, one-time adjustments and other rate concessions in New York, and on the other hand, claims that the forgone acquisition premium in New York is not a ratepayer benefit. To the Joint Petitioners’ knowledge, in both New York and Maine, utilities have not been permitted to recover acquisition premia in rates. Staff’s reliance upon the forgone acquisition premium in Maine is ironic in light of Staff’s position here that a commitment not to recover an acquisition premium is not a benefit of the Proposed Transaction.

Third, the $86 million allegedly attributable to forgone AMI carrying charges must be rejected as unsupported and exaggerated. Quite simply, that number is factually wrong; the actual annual amount of forgone AMI carrying charges in Maine is only $1.6 million. Staff’s sole basis for its figure is an alleged quote from the Office of Public Advocate in the State of Maine contained in the January 12, 2008 edition of the Bangor Daily News[133] (Tr. 1486). Staff's use of and reliance on a newspaper article quote as the basis of its $86 million valuation provides no valid record support for Staff's position. When pressed on this issue during cross-examination, Staff admitted that, for comparison purposes, it does not have any idea whether the $86 million would translate on a proportional basis to NYSEG and RG&E (Tr. 1487). Moreover, the information Staff relies on can best be characterized as "hearsay within hearsay" since it is a quote of a newspaper article quoting an individual. This "double hearsay" is patently unreliable. Staff's unfounded allegation based on a quote in a newspaper that is located in another utility's service territory is without basis and should be dismissed outright.

Moreover, the Maine Stipulation is a public record from another jurisdiction and represents an integrated agreement authorizing the merger. The Maine Stipulation was executed by ten different parties and approved by the Maine Public Utilities Commission in its Order Approving Stipulation on February 7, 2008. Procedurally, after the Maine Stipulation was filed on January 9, 2008, there were no briefs or further filings by the parties describing the Stipulation. The Maine Stipulation's provisions are relevant to Maine, but not to New York. Additionally, as became apparent during cross-examination, Staff does not know or understand the provisions of the Maine Stipulation or know how rates are set in Maine for CMP (Tr. 1484-1491; 1562-1566). In particular, Staff revealed that it did not know the difference between CMP's distribution rates and CMP's transmission rates (Tr. 1488-91). Since Staff decided to

133 In fact, neither Energy East nor the Maine Commission placed a monetary value on this alleged benefit. The $86 million figure cited by Staff is not in the record in the Maine proceeding (s*ee* Exhs. 51-54). Staff, when queried, neither was able to locate in the Maine record any reference to the $86 million value its ascribes to this "benefit" nor knew the value Energy East assigned to the forgone AMI carrying costs (Tr. 592). This is not surprising since the monetary value of the AMI levelization will be determined at a later time as part of a separate Maine proceeding (Tr. 593).

brief the Maine Stipulation, the Joint Petitioners are again compelled to respond to the errors contained in Staff's Initial Brief, even though the Joint Petitioners do not believe that they are instructive to the ALJ or the Commission in this proceeding.

The Maine Stipulation contains sixty-six integrated provisions. Section C of the Maine Stipulation deals with additional ratepayer benefits such as the forgone acquisition premium (equal to $8.8 million annually) and forgone AMI charges (equal to $1.6 million annually). Staff erroneously alleges, without knowledge of the actual record and facts and Maine regulation, that these benefits equal 34% of CMP's annual delivery revenues. Staff is wrong. These benefits total $10.4 million per year. CMP's annual delivery revenue (distribution, transmission and DSM) is approximately $311 million[134] per year. Thus, these benefits equal only 3.3% of CMP's annual delivery revenues.

The Maine Commission specifically found that there were net benefits to Maine, many of which were unquantifiable. If the Commission wants to look to Maine as a model, the Commission should not adopt Staff's cherry-picking approach. The Maine Commission found that the benefits of the Stipulation met the requirement of a showing that benefits offset the potential risk and it granted approval of the merger. The New York Commission should do the same.

c. Comparison to RGS/Energy East Merger

Staff also seeks to justify its excessive conditions by comparing benefit levels in the non-synergy first-mover Proposed Transaction to the benefit levels in the synergy-driven Energy East/RGS merger, which, of course, provides no function or purpose. Additionally,

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134 Comprised of annual distribution revenue of $223 million from Maine PUC Docket No. 2007-215, annual transmission revenue of $77 million from FERC Dockets ER07-1107 & ER07-1225, and DSM revenue of $11 million from Maine PUC Docket No. 2007-475.

Staff's numerous calculation errors have significantly overstated the level of customer benefits from the Energy East/RGS merger (Tr. 571). Accordingly, Staff's flawed comparison of the customer benefits of the Energy East/RGS merger with the Proposed Transaction must be rejected.

Both Staff's initial and revised calculations of benefits from the Energy East/RGS merger suffer from serious errors. Staff initially alleged that customers of NYSEG and RG&E received almost $822 million in cumulative reductions over five years or approximately 12.6% of five-year delivery revenues (Tr. 570). These figures have been fully discredited on the record. The correct five year total net benefit figure is approximately $165 million (Tr. 571), and this amount was allocated and shared evenly between customers and shareholders.

In calculating its figures, Staff seems to have utilized the "NYSEG/RG&E Synergy Estimate, Synergy Allocation Appendix A" which was a table of projected annual merger benefits filed with the Joint Proposal in Case 01-M-0404 – Energy East /RGS Merger. The Synergy Appendix A showed a five-year total net benefit figure of $164.3 million for the four Companies (NYSEG and RG&E electric and gas). Staff appears to have incorrectly multiplied total five-year net synergy benefit by another 5 years ($164.3 x 5) to arrive at its original, significantly inflated comparison amount of approximately $822 million (*Id*.).

Staff then sought to revise its calculations and reduced the so-called synergy savings down from $822 to a total $383.4 million over five years, but those revised calculations suffer from other fatal errors (Tr. 571). Staff's recalculation utilizes only the "year 5" benefit amount of $76.67 million and then multiplies that year's benefits by five years, which is exaggerated and inconsistent with the five-year amount from Synergy Appendix A that was used by the Commission in approving the Energy East/RGS merger.[135]

Because Staff's ratepayer benefit calculation did not utilize the five-year synergy amount relied upon by the Commission in Synergy Appendix A of approximately $165 million, Staff's proposal should be given no weight. Moreover, that lower figure should be multiplied by 50% to reflect the 50/50 sharing between customers and shareholders. Furthermore, the comparison is of no consequence (and should be rejected), because the values from the Energy East/RGS merger are based upon synergies, and the Proposed Transaction is a non-synergy merger.

VI. INTRODUCTION TO STAFF'S RATE ISSUES

Staff raises a multitude of rate issues that generally fall into three categories: (1) PBAs; (2) rate changes ("One-time Adjustments"); and (3) modifications to NYSEG and RG&E's existing rate plans and orders ("Rate Plan Issues") (Staff IB at 170-223). Some of these rate issues have been raised previously, while others are now being raised for the first time. Staff's rate issues are beyond the scope of, and in no way necessary to, the Commission's determination in this proceeding. Moreover, as detailed in the Rebuttal Testimony of the Joint Petitioners' Rate Adjustment Panel ("RAP"), Staff's rate issues are both procedurally flawed and substantively incorrect (Tr. 320-411).

As shown on Table 1, Staff's proposed rate issues would result in a negative financial impact on the Joint Petitioners totaling $1.7 billion over five years, including $646 million of PBAs, $209 million of One-time Adjustments and $855 million of Rate Plan Modifications. The impact of Staff's proposals would be to reduce the delivery revenues of

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135 Staff may be understandably reluctant to use the actual $165 million number, which is less than the over $201 million in PBAs that the Joint Petitioners are offering in the Partial Acceptance.

NYSEG and RG&E by over 26%, which exceeds any level recently approved by the Commission.

Table 1 – Totality of the Staff's Proposals

Million

Description	**Staff Proposal** NYSEG	RG&E	Total	% of Delivery
PBA's	$ 308	$ 338	$ 646	9.9%
Additional One-Time Adjustments	$ 137	$ 71	$ 208	3.2%
Rate Order and Rate Plan Modifications	$ 307	$ 547	$ 855	13.1%
Total - PBAs, One-Time Adjustments and Rate Plan Modifications	**$ 753**	**$ 957**	**$ 1,710**	**26.3%**

As explained herein, in the event that the ALJ or the Commission determines that any of Staff's rate issues need to be addressed, such consideration should be deferred to a subsequent proceeding, following the closing of the Proposed Transaction.

VII. JOINT PETITIONERS' PROPOSED PBAS BRING IMMEDIATE RATEPAYER BENEFITS, AND THE COMMISSION SHOULD GO NO FURTHER ON RATE ISSUES THAN TO APPROVE THESE PBAS

A. The PBAs Proposed In The Partial Acceptance Will Provide Immediate Benefits To Customers Without The Need To Impose New Rate Plans

The Commission should approve the level of PBAs proposed by the Joint Petitioners. Although the level of PBAs proposed by Staff is unsupported and unreasonable, the Joint Petitioners and most other parties agree that the PBAs are an appropriate mechanism for providing customers with immediate benefits (*see, e.g.*, MI IB at 25-26).

Staff, however, further insists that its PBAs be coupled with One-time Adjustments and a multitude of Rate Plan Modifications based on an erroneous assertion that new rate plans are required in order to flow the benefits of the PBAs to the customers of NYSEG and RG&E (Staff IB at 170). Contrary to Staff's claim, there is no need to modify the existing rate plans or orders (particularly at this time) to ensure that the PBAs are translated into lower rates for the customers of NYSEG and RG&E (*compare* Staff IB at 170 *with* Joint Petitioners IB at 3). As explained in the Partial Acceptance Document and the Joint Petitioners' Initial Brief, the proposed PBAs can be monetized and immediately passed back to ratepayers through credits or other forms of rate reductions without disrupting the terms of the continuing rate plans (Exh. 50; Joint Petitioners IB at 3). Thus, it is not necessary for the Commission to make determinations with respect to Staff's proposed One-time Adjustments and Rate Plan Modifications at this time. Rather, to the extent the Commission deems it appropriate, those matters should be decided on the merits in a subsequent proceeding after the merger is approved and closed.

In the testimony of the RAP, the Joint Petitioners provide an extensive rebuttal of all of Staff's 21 PBAs totaling $646 million (Tr. 331-339). In order to expedite resolution of this issue, however, the Joint Petitioners have agreed to provide for five PBAs totaling over $201 million. As shown on Table 2, the Joint Petitioners have offered an appropriate and sufficient level of PBAs to ensure immediate net benefits to the customers of NYSEG and RG&E effective on or about July 1, 2008 (Exh. 50; Tr. 614).

Table 2 – PBA Comparison

Million

Description	**NYSEG**	**RG&E**	**Total**
Petitioners PBAs			
Regulatory Asset Write-Offs	$ 31	$ 120	$ 152
Reserve Increases	$ 50		$ 50
Supply Cost Absorption	$ -	$ -	$ -
Total Company PBAs	**$ 81**	**$ 120**	**$ 202**
Staff PBAs			
Regulatory Asset Write-Offs	$ 65	$ 221	$ 286
Reserve Increases	$ 194	$ 117	$ 311
Supply Cost Absorption	$ 49	$ -	$ 49
Total Staff PBAs	**$ 308**	**$ 338**	**$ 646**

Notwithstanding that the Joint Petitioners do not believe that the commitments in the Partial Acceptance Document are necessary for approval of the Proposed Transaction under Section 70, these concessions provide $201.642 million of one-time permanent PBAs (Exh. 50), which will translate into an immediate $54.8 million annual delivery rate reduction that will be flowed through to ratepayers immediately following the closing of the Proposed Transaction on or about July 1, 2008. What this means is that the $201.642 million will be removed permanently from the utilities' books and monetized into an average rate reduction of 4.4% for the customers of NYSEG and RG&E. The Joint Petitioners have agreed to make these annual rate reductions of $54.8 million effective upon closing in a manner to be determined by the Commission (*Id.*).

The Joint Petitioners' proposal for an average annual decrease in rates of 4.4%, combined with the other benefits and concessions offered by the Joint Petitioners, are more than adequate to off-set any real or perceived risk resulting from the Proposed Transaction. This rate reduction is far from "paltry" (Staff IB at 9).[136] In fact, Staff's proposal to require $646 million of PBAs, $209 million of One-time Adjustments and $855 million of Rate Plan Modifications, would decrease the distribution revenues of NYSEG and RG&E by over 26% (Tr. 330) which is excessive even in the context of a synergy merger, which this is not. Staff's PBAs represent an excessive and unnecessary level of benefits to address a fictionalized level of risk and that level of concessions should be rejected.

B. The Rate Base Effect

As explained above, the Joint Petitioners have proposed to monetize the PBAs and immediately provide rate reductions to customers, including the rate base effect of the PBAs. Staff mischaracterizes the Joint Petitioners' position by claiming that the RAP argued against reducing rate base by the amount of any *regulatory assets* that are removed from the books of NYSEG or RG&E as a result of the PBAs (Staff IB at 175). In fact, the rebuttal testimony of the RAP objects to Staff's proposal to reduce rate base by the amount of company-contributed capital to *reserves*.

Specifically, the Joint Petitioners object to Staff's inequitable proposal to require NYSEG and RG&E to use company-contributed capital that is used to increase reserve balances as an additional rate base reduction or to require that interest be accrued on those company-contributed amounts (Tr. 351-52). Such an adjustment might be appropriate if money used to

136 Staff's characterization of the proposed level of the Joint Petitioners' PBAs as "utterly inadequate," "paltry" and "trivial" begs the question of whether Staff would find a request for a 4.4% rate increase to be inadequate, paltry or trivial.

increase the reserves came from customer rates, so that customers receive the time value of their contributions until the reserves are used to fund the costs for which they were intended. However, when a utility is contributing the capital, there is no logical reason for reducing rate base by that contribution or requiring that interest be accrued on those amounts. Staff's proposed adjustment is inequitable because it would effectively require shareholders to pay a return on their own contributions (Tr. 352).

VIII. THE ONE-TIME ADJUSTMENTS

As discussed above, Staff has inappropriately introduced several one-time rate adjustments in the context of this Section 70 proceeding that are unrelated to, beyond the scope of, and in no way necessary to, the Commission's determination in this proceeding. These items should, if at all, be raised and addressed in separate and subsequent rate proceedings, rather than in this merger case. Nevertheless, in the event the Commission determines to address any of these issues, the Joint Petitioners respond to Staff's claims below.

A. Treatment of Software Costs

Staff continues to argue that depreciation and related rate base for capitalized software should be eliminated from rates (*Id.* at 178). Staff proposes adjustments that exclude 100 percent of capitalized software, including software for the Integrated Back Office project ("IBO"), the Work Management System ("WMS") and the Customer Care System ("CCS"), from RG&E's and NYSEG's rate base and reduces RG&E's and NYSEG's depreciation expense by the annual amount of depreciation that is accrued on capitalized software (Tr. 374-75). According to Staff, the "effect of capitalizing software costs, where a utility was allowed to recover the same software expense in rates already, causes ratepayers to pay twice…" (Staff IB at 178). These issues were previously litigated and resolved and should not be collaterally attacked here. The calculations underlying Staff's adjustments are also incorrect and overstated, and the rationale Staff offers for eliminating capitalized software from rates is erroneous.

Staff claims that "NYSEG has insisted upon recognizing in rate base capitalized computer software costs even though it has recovered software expenses in rates" (*Id.*). Staff is inappropriately attempting to relitigate issues surrounding NYSEG's capitalization of software costs that were resolved by the Commission in Case 05-E-1222. The August 23, 2006 Order[137] in that proceeding clearly states, on page 73, "We adopt the judges' recommendation to allow the Customer Care System to enter rate base given the evidence that the system has been placed into service…." The Order goes on to state "…the total cost of this system compares favorably with the amounts that other firms have incurred for comparable systems." All of the points raised by Staff (Staff IB at 178) in this proceeding mirror those argued and lost by Staff during the Case 05-E-1222 proceeding.

For the first time in its brief (*id.* at 180), Staff challenges NYSEG's capitalization of software costs from a new angle, arguing that "[w]hile NYSEG there was allowed to replace CCS costs in rate base, the accounting there amounted to deferral accounting." Staff's new line of attack is simply incorrect. As is clear from the Commission's decision in Case 05-E-1222, the CCS costs represented a new investment in an asset that was capitalized and that was "placed into service"—a traditionally accepted term referring to the capitalization of plant. Indeed, the titles of the basic capital investment accounts in the Commission's own Uniform System of Accounts for Account 101 are "Electric Plant in Service" and "Gas Plant in Service." Staff's unnecessary expenditure of time and resources in its campaign to relitigate this issue should end.

[137] Case 05-E-1222 - *Proceeding on Motion of the Commission as to the Rates, Charges, Rules and Regulations of New York State Electric & Gas Corp. for Electric Service, Order Adopting Recommended Decision with Modifications*, at 73 (Aug. 23, 2006).

Staff inaccurately states (*see* Staff IB at 179) that "[t]he petitioners assert their interpretation of the NYSEG Electric Order also applies to the capitalization of software at RG&E." The Petitioners have made no such assertion. In fact, as the records in numerous other RG&E proceedings reflect, RG&E has been capitalizing software investments since the mid-1990s, during the period in which the Commission issued Orders and approved several rate plans.[138] Staff's continuing efforts to eliminate capitalized software costs from rates should be rejected and not be relitigated.

If the Commission determines that it is appropriate to reopen this issue, Staff's proposed adjustments should be revised to correct for certain errors. Correcting Mr. Haslinger's adjustment to include recovery of 100 percent of CCS software would result in a total decrease in RG&E's depreciation ($1.4 million electric and $749,000 gas) of approximately $2.1 million and a total decrease in RG&E's net plant ($11.6 million electric and $6.3 million gas) of approximately $17.9 million (Tr. 376).

Staff's proposed capitalized software adjustment is also overstated (*Id.* at 377). While the Joint Petitioners have been prevented from fully reconciling Staff's calculations because Staff did not provide any supporting documentation or workpapers, Staff's adjustments exceed all of the RG&E Capitalized Software (*Id.*). In light of the fact that (a) CCS is a legitimate capital cost to be included in rates; (b) RG&E's CCS went into service in October of 2006; and (c) Staff was using calendar year 2006 data upon which it projected its forward-looking revenue requirements for RG&E, Staff should have made an adjustment to annualize CCS (*Id.* at 378). Depreciation expense should have been increased by $1.523 million (electric)

138 *See e.g.*, Cases 95-E-0673, 95-G-0764, 96-E-0898, 02-E-0198, 02-G-0199, 03-E-0765, and 03-G-0766.

and $820,000 (gas), and rate base should have been increased by $9.623 million (electric) and $5.181 million (gas).

Therefore, if the Commission determines that it is appropriate to address capitalized software costs in this proceeding, the Joint Petitioners request that: (i) all of the Staff adjustments be reversed; (ii) the depreciation and rate base be increased to annualize the CCS costs; and (iii) if the Commission deems it necessary to exclude IBO and WMS, depreciation expense and rate base be reduced to exclude the cost of these items (*Id.*).

B. Annual Compliance Filing Issues

In its Initial Brief, Staff (for the first time and contrary to its pre-filed testimony) proposes that the Commission rule on the one-time adjustments related to the Annual Compliance Filings ("ACFs") of NYSEG and RG&E (Staff IB at 181). In its initial filings and discovery, Staff disclosed that it had failed to conduct a timely review of the ACFs submitted by NYSEG and RG&E (Tr. 1694-95). For example, Mr. Haslinger stated that Staff had not completed its audits of the RG&E ACFs, which he described as "on-going" (Tr. 1655). When asked about the relevancy of the ACF issues to this proceeding, Mr. Haslinger states "[w]e are putting Iberdrola on notice that we intend to pursue these adjustments in the near future" (*Id.*). Similarly, Mr. Benedict testified that Staff had not finished its audit of NYSEG's 2002-2006 ACFs but intended to provide its response to NYSEG no later than NYSEG's next rate case (Tr. 1756). Staff expects to issue its audit reports on the ACFs *six to seven years* after NYSEG and RG&E began to submit the ACFs in 2002. Despite the fact that Staff has been dilatory in providing responses to the ACFs and has provided *none* to date, Staff now asks the Commission to institute multiple rate adjustments based upon its previously undisclosed critique of the ACFs and without support of any workpapers, calculations or detail describing the adjustments. Staff's assertion regarding the ACFs is procedurally and substantively defective, as the Joint Petitioners have addressed (Tr. 360-64). Staff's litany of excuses for failing to submit routine audit reports for seven years neither justifies Staff's inaction nor lends support to its flawed analysis (Staff IB at 181-82). Moreover, Staff's claims that "[c]orrections" associated with ACF issues "should be recognized in any rate plans developed here" (Staff IB at 186) should be rejected. Rate plans should not be developed in the context of this proceeding and Staff's allegations regarding ACF filings under existing rate plans are beyond the scope of this proceeding (Joint Petitioners IB at 96-97). In the event the Commission determines to address any of these issues, however, specific responses to Staff's contentions are set forth below.

1. NYSEG's ACF Standby Deferral Calculation Is Proper

The only ACF issue that Staff has brought to NYSEG's attention is the standby deferral calculation. There is no dispute that NYSEG is allowed to recover the difference between the revenues received under its standby rates and the revenues it would have otherwise received from the customer had the standby rates not been introduced (Staff IB at 184; Tr. 184). Staff takes exception to NYSEG's calculation of the amount of lost revenues associated with a single standby customer, Cornell University (Tr. 1625-26), alleging that NYSEG inappropriately utilized the S.C. 7 Transmission non-Industrial High Load Factor ("IHLF") rate as the "otherwise applicable rate" when the lower S.C. 7 Transmission High Load Factor ("HLF") rate should have been utilized (Staff IB at 184).

Staff's position, that standby lost revenues calculations should be based on a rate at a single point in time and not reflect any changes in rates associated with a customer's declining load factor (*id.*), is illogical (Tr. 184). The Commission should reject Staff's attempt to utilize a lower rate that might have applied at one point in time, but no longer does. NYSEG utilized the historical rate that was consistent with the actual load factor of the customer (*Id.* at 184-85). Staff asserts, with no record support, that "[h]ad there been no standby rate Cornell could have continued to meet the 68% load factor test and could continue to have qualified for the [lower] HLF rate" (Staff IB 185). This claim is directly rebutted by the fact that the actual historical load factor of Cornell did not meet the applicable threshold for the relevant period (Tr. 184-85). Moreover, NYSEG reviews all of its standby accounts annually to verify continued qualification for a particular rate based on that customer's usage during the prior year (*Id.* at 184) and did not single out Cornell. Thus, there can be a reduction or increase in lost revenues depending upon whether each particular customer meets the IHLF criteria for that year and, accordingly, NYSEG did not improperly increase the amount of lost revenues it claimed.[139]

Staff pointedly ignores the fact that it has been long aware of NYSEG's calculation methodology. At Staff's request, NYSEG has provided detailed work papers supporting the lost revenues calculation for Cornell and other customers as far back as October 3, 2005 (*Id.* at 185). Staff's concerns on this ACF issue are not appropriate for consideration in this proceeding and, to the extent they are addressed in a subsequent proceeding, they should be rejected.

2. RG&E's Accounting For Major Storms is Proper

It is undisputed that under its rate plan, RG&E is allowed to recover Storm Costs that exceed a $250,000 threshold (Staff IB at 187). Staff contends, however, that RG&E has in some fashion double counted recovery of Storm Costs by including capital costs in the calculation (*Id.*). The RAP fully rebutted the testimony of Staff witness Mr. Haslinger and demonstrated why Staff's claim of double recovery is incorrect (Tr. 386-89). Staff's allegations fail because the record demonstrates that capital costs were not included by RG&E in the amount sought for deferral (*Id.* at 389). Any capital costs were capitalized and only non-capital

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139 Even assuming, *arguendo*, that Staff's methodology is correct (which it is not), Staff acknowledges that its calculations were in error and must be corrected (Staff IB at 186).

incremental expenditures incurred to restore service during or after a major storm were treated as eligible for deferral (*Id.* at 434).

Having failed to refute RG&E's calculation of storm cost deferral based on capital costs, Staff next alleges that RG&E has deferred non-incremental costs associated with a major storm (Staff IB at 187; Tr. 1663). Staff's allegations in this regard are without merit and are fully rebutted by the RAP (Tr. 388). The record is clear that RG&E only sought to defer incremental O&M costs incurred to restore service during and as a result of the event (*Id.*).[140]

Staff next attempts to minimize the extreme nature of the heat wave weather event, perhaps in an effort to avoid having the event meet the definition of a "Major Storm." (Staff IB at 188). Contrary to everything in the record, Staff inexplicably describes the heat wave as an "expected weather event" and a mere common summer occurrence of hot and humid weather (*Id.*). The record, however, demonstrates that the "unprecedented heat wave" was anything but "predictable" as it caused numerous outages affecting 39,156 customers from July 11, 2005, to July 15, 2005 (Tr. 387). The heat wave fits squarely within the definition of a Major Storm as set forth in the Joint Proposal and Order in Case 03-E-0756 (*Id.* at 386), which is: a "period of *adverse weather* during which service interruptions affect at least 10% of RG&E's customers within an operating area and/or result in customers being without electric service for a duration of at least 24 hours unless RG&E receives a determination from the Commission that such event does not constitute a Major Storm" (*Id.* at 387) (emphasis in original). This event was self-evidently a period of "adverse weather" and the unprecedented heat wave caused outages affecting "about 11% of RG&E customers over a period of 4 days" (*Id.*). Thus, both the

[140] Over the last four years there has been only one event that accumulated over $250,000 in total costs and at the same time less than $250,000 in incremental costs.

10% threshold and the twenty-four hour threshold were exceeded and the event clearly meets the definition of a major storm.[141]

The record demonstrates that RG&E follows an appropriate methodology for its storm related accounting (*Id.* at 389) and Staff's proposed adjustments should be rejected.

C. The Security Cost Deferral

Staff opposes RG&E's deferral of certain security costs (Tr. 1666) on grounds that "such deferrals are limited to incremental costs" (Staff IB at 188). Staff's argument that the Joint Proposal ("JP") in Case 03-E-0765 only set targets for the costs of obtaining security services from outside vendors (Tr. 1666) is not supported by the language of the relevant JP, which states that "Security Costs are reconciled in total" (*Id.* at 391).[142] The need for increased security in a post-9/11 world, including costs related to a 2004 increase in security at the Ginna nuclear plant, is self-evident. The Commission should encourage utilities, rather than hinder them, in their efforts to protect utility assets. In fact, the Staff Policy Panel recognizes the importance of maintaining the security of utility T&D assets and data systems (*Id.* at 1423-24), despite Mr. Haslinger's inexplicable proposal to prohibit recovery of the costs of implementing such security measures. Staff's proposal should be rejected and RG&E should be allowed to defer and recover security costs that it incurs to protect its assets (*Id.* at 392).

[141] Staff witness Mr. Haslinger also suggests that increased consumption and any "extra" revenue should offset the costs of the event (Tr. 387). While some customers may have increased their usage during this period, it certainly is not true for interrupted customers and there is no record basis to determine how usage balanced out (*Id.* at 388). Moreover, if Staff's position were to be adopted, it would logically follow that storm-related incremental costs would have to include all lost revenues that RG&E has not taken in the past (*Id.*).

[142] Cases 02-E-0198 and 03-E-0765 - *Proceeding on Motion of the Commission as to the Rates, Charges, Rules and Regulations of Rochester Gas and Electric Corporation for Electric Service,* and Case 03-G-0766 - *Proceeding on Motion of the Commission as to the Rates, Charges, Rules and Regulations of Rochester Gas and Electric Corporation for Gas Service, Order Adopting Provisions of Joint Proposals With Conditions* (May 20, 2004)

D. The Voice Your Choice Deferral

Staff claims that RG&E's expenditures for *Voice Your Choice* ("VYC") were "excessive" and should not be deferred (Staff IB at 189). These arguments are rebutted in the Joint Petitioners' Initial Brief, which explains that the deferral is fully consistent with the operative rate plan (Joint Petitioners IB at 88). The Joint Petitioners' Initial Brief and the record describe how the VYC program for RG&E was developed in close coordination with Staff, was reviewed by Staff, was publicly lauded by then-Chairman Flynn and undeniably produced the results desired by Staff and the Commission (*Id.*). Staff acknowledges for the first time in its Initial Brief that Staff "might have reviewed" RG&E's outreach and education efforts, belatedly arguing that such review somehow did not demonstrate that Staff reviewed or accepted the costs RG&E incurred or that RG&E could not have produced the same materials at a lower cost (Staff IB at 189-90).

Staff has failed to demonstrate that RG&E's VYC expenditures were excessive and were inappropriately deferred and it cannot reasonably do so since the media utilized and the outreach efforts were reviewed by Staff. Staff could have challenged the use of particular media (in particular television) had Staff felt that such media were too expensive or inappropriate to achieve the Commission's goals. Staff did not do so at the time and Staff today has completely failed to show that it took any such action.[143]

Recognizing this inherent weakness, Staff's Initial Brief claims that "[c]ontrary to the Petitioner's claims, Staff did question the amount of the deferral … and RG&E could have

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143 Staff's comparison of RG&E's VYC costs and NYSEG's costs is irrelevant. The nature of the two service territories and the needs of the individual utilities' VYC programs differ. Thus, comparison of NYSEG's expenses to RG&E's proves little since the media required to inform ratepayers varied. In particular, the television media necessary to reach RG&E's ratepayers effectively is more expensive than print media (Exh. 40). Again, to the best of RG&E's knowledge, the selection of specific media was made known to Staff prior to or around the time of placement with the various media outlets and Staff did not object.

pursued the matter further had it desired. It did not do so" (Staff IB at 190). Like many of Staff's sweeping conclusions in its Initial Brief, there is no record support for Staff's statement, despite an express citation to Tr. 1714-1715. A review of Tr. 1714-1715 proves exactly the opposite of what Staff alleges. Staff's testimony on the referenced pages has nothing to do with RG&E. The testimony refers only to Staff's position in the last *NYSEG* rate case that the "commodity option panel informed the company [NYSEG] about its own E [sic] costs and that they were excessive" (Tr. 1714-15). It is inconceivable how citing to a Staff position involving a 2005 rate case of another company in any way proves that Staff questioned the amount of RG&E's VYC deferral. Thus, Staff's unsupportable claim that it "did question the amount of the deferral" and that RG&E "could have pursued the matter further" (Staff IB at 190) is demonstrably false.[144] Staff's arguments also fail to acknowledge the dissimilarity between the two company service territories and distinctions between the two programs.[145]

In summary, RG&E implemented VYC and did what (the right hand of) Staff wanted, produced the results that Staff and the Commission desired and now, many years later (the left hand of) Staff seeks to reach back and economically punish RG&E for cooperating with

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144 Indeed, to avoid any possibility of confusion, Joint Petitioners' counsel asked Staff the following question: "When you indicated that the commodity panel in the last NYSEG rate case said that Voice Your Choice expenditures were too much, was that referencing Rochester Gas and Electric … or was it addressing NYSEG?" Staff's witness responded, "[t]hat was a NYSEG rate case" (Tr. 1715).

145 *Cf.* Cases 01-E-0359, *Petition of New York State Electric and Gas Corporation for Approval of its Electric Price Protection Plan* and 01-M-0404, *Joint Petition of Energy East Corporation, RGS Energy Group, Inc., New York State Electric & Gas Corporation, Rochester Gas and Electric Corporation and Eagle Merger Corp for Approval of Merger and Stock Acquisition. Compliance filing by New York State Electric & Gas Corporation Pursuant to Commission Orders issued February 27, 2002 and July 29, 2002* (Sept. 26, 2002) (noting biannual program) *with* Cases 03-E-0765,02-E-0198 - *Proceeding on Motion of the Commission as to the Rates, Charges, Rules and Regulations of Rochester Gas and Electric Corporation for Electric Service,* and Case 03-G-0766*, Proceeding on Motion of the Commission as to the Rates, Charges, Rules and Regulations of Rochester Gas and Electric Corporation for Gas Service,* at 27 (May 20, 2004) (noting annual program).

the Commission. As demonstrated above and in the Joint Petitioners' Initial Brief, Staff's challenge to RG&E's VYC deferral lacks any record support and should be denied.

IX. RATE PLAN MODIFICATIONS

A. Staff's Proposed Rate Plan Modifications Are Unnecessary and Inappropriate

As the Joint Petitioners have explained repeatedly, Staff's proposed rate plan modifications and other rate issues are unnecessary and inappropriate for consideration in this Section 70 proceeding. The PBAs and other benefits of the Proposed Transaction demonstrate that the transaction will produce immediate net benefits for New York ratepayers in accordance with even what Staff insists are the requirements of Section 70 (Tr. 611-614; Exh. 50). Staff's ever-changing proposals to impose new rate plans for NYSEG and RG&E on or about January 1, 2009, are inappropriate, inconsistent with the terms of NYSEG's and RG&E's existing rate plans and orders, and would deny NYSEG and RG&E, as well as other interested parties, any semblance of due process.

Furthermore, the Joint Petitioners have seen wildly divergent proposals with respect to rate plans and subsequent rate cases. Staff's proposals (which remain a moving target) would all involve rapid rate plan and rate order modifications. MI's proposal, on the other hand, requests a two-year stay-out for new rate cases for RG&E and NYSEG (MI IB at 26-28).

The Joint Petitioners' approach is that PBAs would be flowed through to ratepayers *immediately* following the closing of the Proposed Transaction for a $54 million rate reduction, and any other modifications to rates would be examined in subsequent rate proceedings after the merger is approved and closed.

B. Staff's Proposals Abrogate the Terms of NYSEG's and RG&E's Existing Rate Plans and Orders

Staff's proposal to establish new rate plans for NYSEG and RG&E ignores the established rate case procedures which require compilation and review of detailed cost of service data and agreement by the utility to adopt a multi-year rate plan (Tr. 354-355). Rather, Staff proposes to modify NYSEG's and RG&E's existing rate plans and orders by imposing a series of one-sided downward adjustments that would benefit customers and penalize shareholders. Staff readily admits that its rate proposals would not be adopted in a litigated rate case, but requests that the Commission impose these same rate reductions as a condition of the proposed merger (Tr. 1704-05). Such conditions would deny the Joint Petitioners due process, are inconsistent with Commission precedent, and constitute poor public policy because they would discourage future investment of capital in New York.

Staff's assertion that the rate plans can be unilaterally modified because they purportedly expire January 1, 2009, is also erroneous. The Commission should not set aside a litigated rate case order (NYSEG Electric) or Commission-approved rate case JPs (NYSEG Gas and RG&E Gas and Electric) that are the result of multi-party litigation or settlement. The NYSEG Electric order and the JPs each represent a carefully determined balance of interests on multiple issues that the Commission should not "modify" based on Staff's unsubstantiated assertions and extreme positions.

Contrary to Staff's claims, by their own provisions, the rate case settlements do not automatically expire January 1, 2009. Under Section VI(2) of the NYSEG Gas JP, the Gas Rate Plan shall continue beyond December 31, 2008, unless or until a new gas rate plan has been approved by the Commission. Similarly, Section III(4) of the RG&E JPs specifically allows RG&E to submit a filing to continue the applicable JP beyond 2008. RG&E, after consultation with the Staff, submitted its request to continue the Gas and Electric JPs on February 1, 2008. Staff's rate proposals seek to modify unilaterally the fundamental terms of the NYSEG Gas and

RG&E Gas and Electric JPs and should be summarily dismissed.

In the case of NYSEG Electric, the Commission set new rates as the result of a litigated proceeding in 2006. It is neither necessary nor appropriate to reset NYSEG Electric's rates now outside the context of a rate case proceeding. The Commission must reject Staff's Rate Plan Modifications and One-time Adjustments because they are inappropriate in a Section 70 proceeding and constitute a collateral attack on the existing rate plans and orders.

C. Staff's Rate Plan Modification Would Deny NYSEG and RG&E Due Process

In its Initial Brief, Staff for the first time proposes three options for implementation of its rate modification proposals. Under Option 1, Staff proposes that new rates and rate plans be put in place effective January 1, 2009 (Staff IB at 172). Under Option 2, Staff recognizes that there may not be sufficient time to develop new rate plans by January 1, 2009, and suggests that new temporary rates (apparently as dictated by Staff rather that as provided in new or revised rate plans) be imposed effective January 1, 2009, subject to refund (*Id.*). Under Option 3, Staff would impose upon NYSEG and RG&E a lower earnings sharing threshold as of January 1, 2009, to be followed by expedited rate proceedings (*Id.*). All of Staff's proposed options are flawed because they would deny NYSEG and RG&E their fundamental due process rights.

Section 66 of the PSL, 16 NYCRR Part 61 of the Commission's regulations, and the Commission's procedures governing rate cases set forth specific ground rules for information to be provided, and considered, in establishing new rates for an electric or gas utility.[146] Such rate determinations must be based upon historical and forecasted cost of service information including a fully adjusted cost of service that is typically considered over an eleven-month

146 *See Statement of Policy on Test Periods in Major Rate Proceedings*, 17 N.Y. PSC 25-R (Nov. 23, 1977) ("Statement of Policy on Test Periods").

period. The Commission has established the periods for which the data must be provided and has developed extensive precedent for determining specific cost of service issues. Based upon the utility's initial filing in conformance with the Commission's requirements, and extensive testimony and discovery on multiple issues, the parties either enter into a JP recommending a proposed rate plan, or the Commission issues a final rate decision based upon extensive cost of service evaluation, hearings and briefing by the parties. Under the settlement process, a utility may agree to, but the Commission may not impose, a multi-year rate plan. In a litigated proceeding, the Commission may only establish rates for a period of one year.

Staff's multiple proposals to establish new "rate plans" for NYSEG and RG&E ignore the due process rights of NYSEG and RG&E reflected in the Commission's rate making procedures, and would exceed the authority of the Commission to the extent they require imposition of multi-year rate plans.

D. Any Subsequent Rate Proceedings, If Required, Must Be Conducted Consistent With Applicable Statutes and Rules

As noted above, the Commission may and should approve the Proposed Transaction without requiring rate plan modifications or subsequent rate proceedings. In the event, however, that the Commission does condition the Proposed Transaction upon the Joint Petitioners' agreement to conduct subsequent rate proceedings, such proceedings must be conducted and scheduled in a manner consistent with NYSEG's and RG&E's due process rights and all applicable statutes and procedures.

Specifically, the Joint Petitioners must be allowed to file their rate cases in accordance with Section 66 of the Public Service Laws, Part 61 of the Commission's regulations, and the Statement of Policy on Test Periods. The Statement of Policy on Test Periods provides that the applicants must use a twelve-month historical test period expiring at the end of a calendar quarter no earlier in time than 150 days before the date of filing. NYSEG and RG&E should be allowed to stagger their rate filings to allow for a thorough compilation and review of the rate case data and the efficient utilization of resources. Filing four rate cases at once would be an administrative burden on all parties and should be avoided. In addition, to the extent the Commission authorizes the divestiture of RG&E's fossil generation, any rate filing for RG&E should occur after such divestiture is complete and the value of proceeds is known.

Accordingly, the Joint Petitioners must first be allowed to close the Proposed Transaction before any subsequent rate filings. The scheduling of deadlines for any rate filings, if deemed necessary, should be staggered to provide sufficient time for preparation and review of rates for the four divisions of NYSEG and RG&E. Staff's requests for immediate rate plan modifications or proceedings are based on the erroneous assumption that these measures are needed to provide immediate rate benefits. Because the Joint Petitioners propose to flow through immediately the benefits of the PBAs in customers' rates, the Commission need not require revised or new rate plans. At least one party has suggested that the implementation of the PBAs be followed by a two-year stay-out provision (MI IB at 26-28). The Joint Petitioners would consider a stay-out provision that accurately reflects the PBAs that Joint Petitioners have agreed to in rates, but that otherwise leaves intact the existing rate orders and JPs for NYSEG and RG&E.

E. Staff's Rate Analysis Is Flawed

The Commission need not and should not determine a new return on equity ("ROE") for NYSEG and RG&E in this proceeding. Any discussion of ROE should wait until the appropriate subsequent rate cases.

Staff's characterization of NYSEG's and RG&E's rates as excessive is based on an erroneous set of assumptions and is unsubstantiated. Staff, in fact, creates the alleged over-earnings by assuming an artificially low ROE of 9.0%, using a 38% equity ratio and slashing the rate base of NYSEG and RG&E through its excessive PBAs, One-time Adjustments and Rate Plan Modifications. Staff also continues to introduce extra-record evidence, unsubstantiated by any sworn testimony, and not subject to cross-examination, to support its claim of excess earnings (Staff IB at 176-77).

Staff bases its over-earning analysis on a 9.0% ROE, but Staff's attempt to develop this ROE was inadequately supported. Staff's proposed 9.0% ROE, however, shows that it is punitive; for example, it is significantly lower than the 9.8% ROE used in the Grid/Key Span proceeding and, as Dr. Makholm explains, is markedly lower than returns approved for utilities in other states (Tr. 1065-66). Similarly, as discussed above, Staff's over-earning analysis is erroneous because it uses a 38% equity ratio.

Staff attempts to buttress its unsubstantiated claims of excess earnings by referencing extra-record evidence and revisions to its analysis that are unsupported by any work papers or detail. The Commission must reject and give no weight to Staff arguments based on analysis not presented to the other parties during the course of the proceeding and not subject to discovery and cross-examination.

It is also instructive that in attempting to demonstrate excessive earnings by NYSEG and RG&E, Staff presents a multi-year analysis (Staff IB at 176-77). At the same time, Staff critiques the Joint Petitioners for using a multi-year analysis to assess Staff's proposed rate adjustments (*Id.* at 128). Staff also summarily concludes that its downward rate plan adjustments are warranted by earnings analysis without any empirical proof to support them.

F. Revised Earnings Sharing Mechanisms

Staff continues its collateral attack on the existing rate plans and orders for NYSEG and RG&E by asserting that the Commission should impose revised earnings sharing mechanisms ("ESMs") (Staff IB at 190-91). As a procedural matter, the Commission cannot require a change to the ESMs that resulted from negotiated JPs outside the context of a fully litigated rate proceeding. Moreover, in the case of NYSEG Electric, which has no rate plan or ESM, the Commission lacks authority to unilaterally impose such a mechanism.

The Commission must also reject Staff's ESM proposals for their substantive flaws, including the fact that they are based upon an artificially low and unjustified ROE of 9.0% (Staff IB at 191). Staff also provides no explanation for why the Commission should impose upon NYSEG and RG&E an ESM that is significantly below the ESM approved in the Grid/KeySpan transaction (*Id.*).

G. RG&E's Commodity Service Option

Staff asserts in its Initial Brief that the conditions of the NYSEG commodity order should be applied to RG&E (Staff IB at 221). The proposed changes include the reduction of the Fixed Price Option ("FPO") conversion factor and a reconstructed earnings sharing mechanism that provides no downside risk to customers and allows customers to share upside potential (Tr. 379). Staff notes that the Joint Petitioners "claim that RG&E's existing FPO mechanism should continue in place" and that "[t]he only reason [the Joint Petitioners] offer justifying retention … is the inclusion of the existing provisions in the existing rate plan" (Staff IB at 221) (citation omitted).

While Staff attempts to diminish the Joint Petitioners' argument, the fact remains that the Joint Petitioners have raised real concerns and issues with Staff's proposals. First, Staff's proposed modifications to the RG&E Commodity Program are inappropriate and should not be considered in this proceeding because they are unrelated to the Proposed Transaction. Second, Staff's proposal raises a host of concerns and issues that have not been addressed fully by the parties in this proceeding and, thus, there is no evidence in the record upon which the

Commission could make sound determinations relative to RG&E's commodity program. Finally, since the commodity program is one of the provisions in the existing RG&E Rate Plan that RG&E proposes to continue,[147] similar to other Staff rate plan modifications, this matter should be addressed in a separate, subsequent proceeding.

H. ASGA Depletion Will Not Result in a "Structural Deficit" in RG&E's Rates

In response to Commission policy, RG&E divested the Ginna nuclear power plant and the net proceeds from the sale of approximately $389 million pretax[148] were required to be placed in the Asset Sale Gain Account ("ASGA") for the benefit of ratepayers (Staff IB at 221-22). While the ratepayers received a gain from the sale, the market price power that replaces the utility-owned generation may ultimately result in ratepayers bearing additional costs. According to the terms of the RG&E Rate Plan, the ASGA balance is being utilized to offset the costs paid for market-priced power and power from the Ginna plant, given the terms of the Ginna Power Purchase Agreement ("PPA") (Tr. 1682). Staff identifies the PPA credit—the difference in the costs of purchasing power under contract from the current owners of Ginna and the cost that was embedded in RG&E's rates prior to the facility's sale—as the most significant factor that is reducing the ASGA. [149] What Staff should have additionally made clear is that the PPA credit is calculated not only for the difference in costs of power under contract versus the costs embedded in rates, but also includes the difference in costs between the replacement market priced power

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147 Cases 03-E-0765, 02-E-0198 and 03-G-0766, *Joint Proposal* (Mar. 9, 2004); Cases 03-E-0765, 02-E-0198 and 03-G-0766, *Rate Plan Continuation Filing* (Feb. 1, 2008).

148 Case 03-E-1231 - *Rochester Gas and Electric Corporation, Constellation Generation Group, LLC and R.E. Ginna Nuclear Power Plan, LLC*, Order Approving Transfer Subject to a Modification (May 19, 2004).

149 Staff cannot have it both ways. On page 130 of its Initial Brief it alleges that RG&E will see earnings erosion as a result of having to expend an additional $60 million for market based power and it faults the Joint Petitioners' RAP for not taking that into account. However on page 222 of its brief Staff correctly notes that ratepayers will have to bear the additional $60 million cost. (*Compare* Staff IB at 130 *with* Staff IB at 222).

for the 10% of Ginna's output that RG&E no longer receives and the cost embedded in RG&E rates. In fact, the reduction of the ASGA driven by the market priced power that RG&E had to purchase on behalf of its customers (the 10% portion) is an equally significant reason for the depletion of the ASGA. In any event, Staff freely acknowledges that the ASGA is being utilized by RG&E to moderate RG&E's electric rates (*id.*), which is exactly what the ASGA was intended to do consistent with the RG&E rate plan.

Staff expresses concern that the funding of the PPA credit will empty the ASGA by the end of 2010. Given that the ASGA is not projected to be depleted until 2010, there is no reason why this issue needs to be addressed in this Section 70 merger proceeding. It is best dealt with in the context of a rate case where the full revenue requirement of RG&E can be analyzed and understood. The policy that the Commission implemented regarding utility generation ownership has simply reached its logical conclusion. Short-term profits to ratepayers from the sale of utility generation must ultimately be balanced against long-term market costs of power which, depending upon the prevailing market price, could result in an increase in the cost of power borne by ratepayers, or as the Commission policy contemplated, lower costs. Thus, Staff's concern about the ASGA may or may not be overstated as it is based on an assumption about electric commodity market prices in the future being similar to those in the recent past (*Id.* at 392).

The Joint Petitioners agree with Staff, however, that once the ASGA is fully depleted, RG&E's rates may need to increase by about $60 million to fund the cost of power. Staff labels this a "looming structural deficit in RG&E's rates" and implies that it is somehow the fault of RG&E (Staff IB at 222). This characterization is wrong. There is no "structural deficit." RG&E's rates in the future will have to reflect true power purchase costs, just as the rates of all other utilities must do. Staff's "structural deficit" argument ignores the reality that the ASGA was not intended, nor could it be expected, to last indefinitely or to offset all future market fluctuations. At some point, the offsetting credit will expire and ratepayers must face the full competitive market cost of replacing the Ginna power (*Id.* at 130). In an effort to support its PBA adjustments, Staff implies that the Joint Petitioners' only response, once the ratepayers' Ginna sale profits are used up from moderating higher power costs, is that rates should be held constant, but the $60 million yearly cost should be deferred, creating a regulatory asset in the amount of that deferral (*Id.*; Tr. 392-93). Staff alleges that this would "destabilize RG&E's rates" (Staff IB at 223) and reflects an attempt by RG&E to "ignore the impending crisis and eventually increase rates" (*Id.*). To the contrary, it would stabilize RG&E's rates until they could be reset (in a future rate proceeding) and would directly address the alleged "impending crisis," which is nothing more than a reflection of the electric supply policies of the Commission.

Staff inexplicably seeks to utilize the inevitable matching of RG&E's cost of power with its rates as a justification for its proposed PBAs (Staff IB at 223). The fact that the AGSA will end at some indeterminate point in the future (2010 or beyond) does not in any way justify the immediate imposition of Staff's unsupported PBAs. Moreover, each of the three scenarios relating to the future of the ASGA and related rate issues is beyond the scope of this proceeding and should be addressed, if at all, in a subsequent rate proceeding.

X. OTHER RATE PLAN ISSUES

A. Gas Pension Expense For NYSEG

Staff's argument for the elimination of the NYSEG gas pension deferral (Staff IB at 215) should be rejected because this issue is outside of the scope of a Section 70 proceeding.

Staff's proposal in its testimony to eliminate the NYSEG gas pension deferral is reiterated in its Initial Brief. However, the supposed justification for this proposal has changed since Staff witness Mr. Benedict filed his testimony on this issue. In Mr. Benedict's testimony, he states that the reasons for eliminating the gas pension deferral are to eliminate the complexity of the computations and general administrative burdens associated with these mechanisms (Tr. 1731). The new justifications, appearing for the first time in Staff's Initial Brief, are that "the true-up that is performed uses outdated financial metrics and is not consistent with the approach to pension deferrals taken in the Commission's Policy Statement on Pensions and OPEB" (Staff IB at 215).

The fact is that none of these justifications are appropriate. As the RAP noted in its rebuttal testimony, the deferral for gas pension costs is based on incremental or decremental changes from the assumed 9% return on assets and 6.75% discount rate. These two financial metrics—return on assets and discount rate—can hardly be considered "outdated." These measures are intrinsic to actuarial calculations made by every actuary for every company with a pension plan. The calculations to support the deferral are completed annually by NYSEG's actuaries and provided to Staff, and are not difficult to understand. The fact that this approach is not consistent with the Commission's Policy Statement on Pensions and OPEB is not a surprise—the very reason this deferral methodology needed to be agreed to in a rate plan was because it differed from the Pension Policy Statement, [150] and that rate plan was approved by the Commission in Case 01-G-1668.[151] There are many utility companies in New York that have some sort of variance or inconsistency from the Pension Policy Statement included in their approved rate plans. Therefore, none of Staff's supposed justifications are appropriate.

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150 Case 91-M-0890 - *Accounting for Pensions Statement of Policy and Order Concerning the Accounting and Ratemaking Treatment for Pensions and Post-Retirement Benefits Other Than Pensions* (Sept. 7, 1993) (hereinafter "Pension Policy Statement").

151 Case 01-G-1668 - *Proceeding on Motion of the Commission as to the Rates, Charges, Rules and Regulations of New York State Electric and Gas Corporation for Gas Service, Joint Proposal dated September 12, 2002*, *Order Establishing Rates* (Nov. 20, 2002).

Also in this section of its Initial Brief, Staff states that "once NYSEG's gas rate plan expires, the partial true-up provision should disappear with it" (Staff IB at 215). While NYSEG agrees that the appropriate time to address this issue is a separate proceeding that would establish prospective gas rates, one clarification is needed. Staff's statement implies that Staff believes that NYSEG's Gas Rate Plan will expire simply as a result of the passage of time. This is certainly not the case. As noted in section VI(2) of the Joint Proposal approved in Cases 01-G-1668 and 01-G-1683, "all Gas Rate Plan provisions shall continue beyond December 31, 2008 unless or until a new gas rate plan has been approved by the Commission".

Further, the financial data upon which the true-up is based is not outdated, but is provided annually as part of the ACF submitted for Staff's review. Beginning in 2003 and every year thereafter, NYSEG's actuaries calculate the gas pension deferral. NYSEG submits its gas pension deferral calculations and work papers to Staff in its annual compliance filing (Tr. 369). The NYSEG gas pension deferral in 2006 was $6.5 million. Thus, gas customer rates reflect pension income that is $6.5 million higher than actual pension income (*Id.*). This amount is significant for NYSEG's gas business, equaling 14 percent of gas earnings or 139 basis points on equity using the NYSEG's 2006 annual compliance filing rate base and equity (*Id.* at 369-70).

In its rate adjustments, Staff also fails to reflect the removal of the gas pension deferral in its gas revenue requirement. The impact of the pension deferral increase amounts to 208 basis points using Staff's lower rate base and equity (Tr. 370; Exh. 125). Staff has overstated the NYSEG Gas ROE by 208 basis points because it failed to adjust operating expenses to reflect its recommendation to eliminate deferred accounting for gas pension costs (Tr. 370). Accordingly, Staff's ROE schedules are erroneous and should not be relied upon in this proceeding.

B. AMI

The Joint Petitioners agree with Staff that the issues surrounding AMI require additional review and should be addressed in other proceedings (Staff IB at 216). As explained in their Initial Brief, the Joint Petitioners encourage the Commission to adopt cost recovery policies for AMI consistent with recent NARUC resolutions which provide for timely recovery of all costs associated with this important initiative. The AMI investments are key steps in achieving New York's "15 x 15" renewable energy strategy, and these important issues should not be pre-determined in this Section 70 proceeding.

C. Staff's Gas Cost Incentive Mechanism Should Be Rejected

Staff argues that the GCIM 2 sharing mechanism should be eliminated because, unlike GCIM 1, it "is specific to Energy East and provides for a sharing of savings attained through specific joint Energy East affiliate optimization of gas supply portfolios…" (Staff IB at 217-18). Staff also claims the GCIM 2 "unnecessarily over-compensate[s] the companies" for procuring and managing their gas supply which they are already required to do (*Id.)*.

In Case 01-G-1668 and Case 04-G-1278, the Commission adopted the new NYSEG GCIM 2 sharing methodology which increased the benefit to customers by allocating 56.25% to customers and 43.75% to shareholders (Tr. 384).[152] The new allocations and methodology for GCIM sharing were the result of numerous meetings during 2005 between NYSEG and Staff to resolve concerns related to GCIM classifications (*Id.* at 384-85). In supporting NYSEG's and RG&E's rate plans and participating in the discussions that led to adoption of the new GCIM 2 sharing methodology, Staff recognized that it is appropriate to

[152] Case 01-G-1668 and Case 04-G-1278 - *Proceeding on Motion of the Commission as to the Rates, Charges, Rules and Regulations of the New York State Electric & Gas Corporation for Gas Service and In the Matter of the Filing of Annual Reconciliations of Gas Expense and Gas Cost Recoveries, Order Approving Gas Cost Incentive Mechanism Methodology* (Oct. 7, 2005).

provide an incentive to NYSEG and RG&E to create gas supply savings based upon the joint optimization of Energy East LDC gas assets.

Staff rests its argument for the elimination of the GCIM 2 on the erroneous assumption that the rate plans in which the GCIM 2 was established will expire as of December 31, 2008.[153] In fact, the rate plans will not expire, and the Commission should not, based upon Staff's unsupported recommendation in this proceeding, discontinue the sharing mechanism which Staff aided in developing and agreed to less than three years ago.

Staff also fails to take into account the benefits that the GCIM has created for customers since its adoption, and ignores the fact that the savings were brought about because of the joint optimization of the combined Energy East LDC gas supply assets. Although NYSEG and RG&E agree that they have an obligation to obtain gas supplies at the least cost, the Commission has recognized the importance of having an incentive mechanism so that NYSEG and RG&E will employ creative methods to pursue optimum levels of efficiencies for these assets (*Id.* at 455). The GCIM 2 is part of the gas rate plans of both NYSEG and RG&E (*Id.* at 382-83), and Staff has provided no rational argument for eliminating it in this Section 70 merger proceeding.

D. Existing Funding Levels For The Low-Income Programs Are Adequate

Staff argues for the continuation of NYSEG's and RG&E's existing low-income programs at increased funding levels and establishing a low-income electric program for RG&E modeled on NYSEG's Power Partner Program (Staff IB at 219). As Staff correctly notes, the Joint Petitioners support continuation of NYSEG's existing Power Partner and Affordable

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153 *See* discussion *supra*, Section IX.B.

Energy Programs at current funding levels and continuation of RG&E's Non-Heating Gas Low-Income Program in the same manner (Tr. 135).

Strikingly absent from the record is support for Staff's proposed increase in funding levels, such as the proposed doubling of the number of Residential Energy Customer Assistance Program ("RECAP") participants for RG&E. To the contrary, the record reflects that such a doubling should not occur as the needs of RG&E's customers are being met through existing programs (Tr. 136).

It is reasonable for NYSEG and RG&E to oppose the creation of an entirely new low-income program at RG&E without removing redundancies in programs (Tr. 136) and providing for funding in rates (Staff IB at 219). Staff freely acknowledges that low- income programs necessarily incur costs (Staff IB at 220). Staff makes various assertions that its proposed levels of funding are "generally commensurate with those at other utilities" (Staff IB at 220), but fails to cite to any record support. In fact, there is no record support sufficient to justify modifying the existing low-income programs outside the context of subsequent rate proceedings. Staff appears to recognize this basic fact when it notes that "[a]s with all other rate issues related to this proceeding, the costs of these programs should be addressed when a rate plan is developed for these utilities …" (Staff IB at 220). The Joint Petitioners agree with Staff that low-income programs are properly dealt with in the context of electric and gas rate plans. Accordingly, the existing low-income programs should be continued and Staff's additional low-income rate proposals should be raised, if at all, in subsequent rate proceedings where the Joint Petitioners and all parties will be afforded due process.

E. Outreach And Education ("O&E") Plan Filings

In its Initial Brief, Staff states that it proposes "to continue existing O&E plan filing requirements for NYSEG's and RG&E's customer information efforts, bolstered by more detailed budget reporting" (Staff IB at 220). Staff also states that "NYSEG and RG&E oppose additional reporting" (*Id.*). Staff then flatly states that NYSEG and RG&E, "[a]s regulated utilities … are required to provide the information necessary for Staff to perform its oversight function" (*Id.*). Staff provides no support for its position and fails to rebut the Joint Petitioners' valid reasons why such additional reporting should not be required.

The Joint Petitioners' Rate Design and Retail Access Panel testified that the content of the NYSEG and RG&E current overall outreach and education plan filings, which includes budgets for certain initiatives such as *Voice Your Choice*, is sufficient (Tr. 137-38). In addition, the Joint Petitioners noted that NYSEG and RG&E provide overall budget figures and detailed budgets for specific programs and file plans and results upon request, such as winter heating outreach (*Id.*). Staff apparently agrees that the information provided in NYSEG's and RG&E's current overall outreach and education plan filings is sufficient. When asked in an interrogatory (IBER/EE IR (DPS-116)) about Staff's proposed plan, Staff simply referred NYSEG and RG&E to their prior filings (Tr. 138; Exh. 8 at 48). There is no basis in the record to the contrary that would support adoption of Staff's recommendations.

F. Capital Expenditures

Staff has proposed a reconciliation of capital expenditures for both gas and electric businesses at RG&E and NYSEG based on average planned capital spending (after adjusting for certain projects). This reconciliation is another rate plan issue that is appropriate for consideration in a subsequent proceeding. However, if addressed here at all, at a minimum, there must be symmetrical reconciliation such that any overspending would be subject to a carrying charge as would any under-spending (*see* Tr. 385-86). The exact spending levels and the reconciliation methodology would be determined in the subsequent proceeding through collaborative discussions among NYSEG, RG&E, Staff and other parties.

Staff further proposes that NYSEG be required to submit to Staff its management-approved annual electric budget, detailed by project, for each of the next three years, within two months of the date of this proceeding, with a filing detailing actual expenditures and any variances from forecast within two months of the end of each calendar year thereafter (Staff IB at 195). While the Joint Petitioners do not see the need for such additional reporting requirements, the Joint Petitioners do not oppose providing additional capital expenditure information so long as such reports are granted appropriate trade secret status.

Staff states that "RG&E's capital expenditures substantially exceed the $280 million target, because the company has exceeded forecast costs for the [RTP] by approximately 60%" and goes on to state that "the company may have improperly included software costs in its capital expenditures" (Staff IB at 196). Both of these statements are false. The current RG&E electric rate plan provisions were established to assure that neither RG&E nor the ratepayers would be inappropriately harmed by, respectively, a material excess of capital spending or a material shortfall in capital spending during the 2004 through 2008 period. Through the end of 2007, RG&E had expended approximately $310 million of qualified capital expenditures (qualified capital expenditures exclude certain generation spending), which is in excess of the $280 million target.[154] This spending level is about 10% above the $280 million–hardly a substantial excess at this point, as Staff claims.

Further, whether or not the RTP exceeded forecast costs is irrelevant despite Staff's insinuations. Since the RTP is an approved and valid capital expenditure, and any given capital project may come in under budget or over budget, the costs of the RTP are appropriately

[154] Staff has been kept informed of the progress of the RTP throughout the history of the project dating back to 2005.

included in the comparison to the $280 million target.[155] As discussed in Section VIII.A above, software costs are properly included in capital expenditures and Staff's suggestion that they be excluded from the amount to be compared to the $280 million target is simply a misguided attempt to financially harm the utility.

G. The Commission Should Ignore Staff's New Arguments Based On Extra-Record Evidence

On brief Staff submits, for the first time, revised arguments and exhibits which reflect extra-record "evidence" in the guise of updates and revisions (Staff IB at 171-74, 176-77, 181-83; Revised Exhs. 119-21; 123-24). Staff's primary witnesses on rate issues, Mr. Benedict and Mr. Haslinger, revised many of the calculations and schedules contained in their proposed exhibits at the hearings on March 20, 2008, ostensibly in response to the Joint Petitioners' rebuttal testimony (Exhs. RPH-1 though RPH-4 (Revised) and Exhs. JB-2 through JB-6 (Revised)). In its Initial Brief, filed three weeks later, Staff again revised certain calculations and schedules of witnesses Benedict and Haslinger, ostensibly to reflect extra-record updates of the ACFs filed by NYSEG and RG&E (Staff IB at 174). Staff's attempt to insert new facts and testimony through brief, when it could have and should have presented such updates during the hearing process, is inequitable and must be summarily rejected. By inserting these new facts in its brief, rather than in pre-filed testimony or at the hearings, Staff has effectively prevented cross-examination by the other parties on Staff's revised exhibits and assertions. Accordingly, the portions of Staff's Initial Brief reflecting arguments based on new facts, along with its revised exhibits, should be ignored (*Id.*).[156] The Commission should accord no evidentiary

155 Staff has been kept informed of the progress of the RTP throughout the history of the project dating back to 2005.

156 *See* Staff IB at 174 and revised Exh. 121; Staff IB at 177 and Exhs. 119-120 (Revised), and Exhs. 123-124 (Revised).

weight to the post-hearing facts and related arguments submitted by Staff for the first time in brief.

XI. REVENUE DECOUPLING MECHANISMS

A. Revenue Decoupling Mechanisms

As the Joint Petitioners' RDM Panel testified, approval of a revenue decoupling mechanism ("RDM"), or a specific decoupling methodology, is not relevant to the Commission's determination as to whether the Proposed Transaction is in the public interest (Tr. 258). The recommendation by the Staff Gas Rates Panel that approval of the Proposed Transactions should be conditioned on implementation of gas RDMs for NYSEG and RG&E, a position also advocated by MI (MI IB at 59-60), is inappropriate and unnecessary (Tr. 258). On cross-examination, Staff witness Mr. Dickens conceded that RDMs have no bearing on whether the Proposed Transaction is in the public interest (Tr. 1637).

Despite the above, the Joint Petitioners agreed to file more detailed RDM proposals in light of the Commission's consolidation of Case 07-M-0996[157] with this proceeding. NYSEG and RG&E originally proposed to make an RDM filing by the second quarter of 2008 (Tr. 257-58; Joint Petitioners IB at 112). However, given the timing of this proceeding and the fact that this issue remains pending before the Commission, Joint Petitioners, in their Initial Brief, requested that NYSEG and RG&E be allowed to file the RDM proposals later this year after Commission approval of the Proposed Transaction (Joint Petitioners IB at 112). The consideration of the RDM proposals as part of a subsequent proceeding would allow parties to examine fully the issues on a more developed record. It would, however, still meet the Commission's initial goal of consolidating Case 07-M-0996 with this proceeding because the

[157] Case 07-M-0996 - *Proceeding on Motion of the Commission to Consider a Revenue Decoupling Mechanism for New York State Electric & Gas Corporation*

relevant portions of the record from this proceeding would serve as the basis for a future determination on the RDM issues and the Commission could outline the procedural steps for the subsequent process.

In its Initial Brief, Staff agrees that review of NYSEG's and RG&E's RDM proposals "may be conducted in the second half of this year" (Staff IB at 193-94). Staff requests that the Commission establish procedures for conducting the RDM review when this proceeding is decided (*Id.* at 194). Nucor and the Natural Resources Defense Council support a subsequent proceeding (Nucor IB at 11-13; NRDC IB at 2).

The RDMs should be addressed in a separate proceeding, subsequent to the Commission's consideration of and action on the Proposed Transaction. However, any decision on procedures for the subsequent proceeding should not have any statements prejudging substantive positions, including but not limited to whether the same reconciliation mechanism should be used for gas and electric, whether annual indexing of RDM targets should be utilized and the service classifications to be included in the RDM (Tr. 257-81; Joint Petitioners IB at 112-113).

XII. SERVICE QUALITY

A. Service Quality Measures

1. Staff's Gas Safety And Reliability Proposals Should Be Rejected

Staff continues to model its proposed "enhanced" gas safety and reliability metrics on the Grid/KeySpan merger, and argues that the higher metrics are needed because Iberdrola's acquisition of Energy East "creates incentives for the parent to squeeze capital out of the New York subsidiaries by cutting operational costs…" (Staff IB at 201). There is no evidence to substantiate the charge that Iberdrola will cut operational costs. In fact, the Joint Petitioners have repeatedly assured the Commission and the parties that no change in NYSEG's and RG&E's operations is anticipated as a result of the Proposed Transaction (Tr. 202). And, because there is the potential for sharing of best practices, the affiliation with Iberdrola will assist NYSEG and RG&E to maintain their commitment to high performance levels in the areas of system safety and reliability (Tr. 204-05). Staff's specific concerns on service quality issues, discussed below, have no merit.

Staff fixates on a minor discrepancy between the number of gas services indicated on Exhibit 18 and in NYSEG's and RG&E's testimony (Staff IB at 203). As explained at hearing, the 2,196 figure for gas services on Exhibit 22 was a transposition error, and the correct number of gas services replaced in 2005 was 2,169 (Tr. 242). The error has no significance because NYSEG's goal is to accomplish 2,000 gas service replacements each year for five years, and never to replace fewer than 1,900 in a given year.[158] NYSEG and RG&E have consistently exceeded their goals, and Staff's complaint about minor arithmetic errors is irrelevant.

Regarding service replacements, the Joint Petitioners demonstrated that Staff's estimate of a $1.6 million per year increase in capital spending for service replacements fails to take into account the costs of replacing pipe for highway projects (Tr. 212-13; 231-39). Any confusion on this issue (*see* Staff IB at 203) is of Staff's own creation. Each company is required to replace a certain number of miles of bare steel mains, ineffectively coated steel mains, and cast-iron mains.[159] As NYSEG's cast iron pipe was completely replaced in 2005, the

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[158] Case 01-G-1668 - *Proceeding on Motion of the Commission as to the Rates, Charges, Rules and Regulations of New York State Electric and Gas Corporation for Gas Service*, Joint Proposal dated September 12, 2002, *Order Establishing Rates (*Nov. 20, 2002) ("*2002 NYSEG Order and JP*"), p. 5, Item 2. (a) and (b).

[159] Case 01-G-1668 - *Order Establishing Steel Mains Replacement Program* (Nov. 7, 2005) ("2005 NYSEG Order and JP"), Appendix A, p.3, §B.1 (a); Case 03-G-0766 - *Joint Proposal dated March 9, 2004* (May 20, 2004) ("*2004 RG&E Order and JP*"), p. 21, §XVII 4 (c) 1.

Gas Rate Plan JP was renegotiated for the remaining rate period ending December, 2008.[160] Under the 2005 Order and JP, NYSEG is required to replace a minimum of 15 miles of bare steel and ineffectively coated gas mains each year.[161] RG&E must also replace a minimum of 15 miles of bare steel, ineffectively coated gas mains and cast iron mains each year; but if any of the pipe is replaced in conjunction with a highway project, RG&E is not permitted to count the highway mileage toward the 15 mile mandate (Tr. 231). Staff's calculation of $1.6 million per year in Exhibit 18 is underestimated because it is based upon *total* mileage of mains replaced at RG&E for both categories (highway and non-highway projects), but is divided by the funds expended on non-highway projects, which results in a lower average cost of replacement (*Id.* at 213).

Staff's assertion that construction in 2007 declined compared to 2006 is erroneous (Staff IB at 204). The one-call ticket data do not, as Staff claims, refute the fact that construction projects were lower in 2006 than 2007 because of the flooding in 2006 which caused certain projects to be deferred until 2007 (Tr. 218). Because the number of one-calls in 2006 (117,890) was approximately the same as, or slightly higher than, 2007 (116,483), does not mean that the level of construction that occurred in 2007 was the same as or lower than in 2006 (Staff IB at 204). The point is that much of the construction related to the one-calls that were received in 2006 did not take place in 2006 and was deferred until 2007 (Tr. 218). The difference between the Companies' performance in 2006 and 2007 was a negligible decrease and was still well within their current targets.

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160 Case 01-G-1668 - *Proceeding on Motion of the Commission as to the Rates, Charges, Rules and Regulations of New York State Electric and Gas Corporation for Gas Service, Order Establishing Steel Mains Replacement Program* (Nov. 7, 2005) ("*2005 NYSEG Order and JP*").

161 *Id.* at 3, §III B 1 (a).

2. There Is No Basis To Impose Additional Customer Service Performance Metrics On NYSEG And RG&E

Staff proposes that the service quality metrics at NYSEG and RG&E be made consistent with one another, that the revenue adjustments associated with such targets be increased significantly, and that the Commission adopt a new measure, the Escalated Complaint Response Time, for NYSEG and RG&E. The Joint Petitioners have shown that Staff's proposals are unsupported and arbitrary (Tr. 122-29; Joint Petitioners IB at 106-10). Once again, Staff turns to the Grid/KeySpan merger order in an attempt to rebut the Joint Petitioners' arguments and justify Staff's recommendation (Staff IB at 206). Staff further asserts that the Joint Petitioners have not submitted anything that warrants reaching a conclusion that is contrary to that order. Staff is incorrect on both counts.

First, Staff ignores the fact that the Joint Petitioners have readily shown, through testimony, their Initial Brief, and the discussion above, that the circumstances involved in and the risks presented by the Grid/KeySpan merger are vastly different from those of the Proposed Transaction.

Second, Staff continues to ignore the differences between Niagara Mohawk/National Grid's and NYSEG's and RG&E's service quality. Niagara Mohawk/National Grid's service quality issues were central to the Commission's determinations in the Grid/KeySpan merger proceeding. As the Commission acknowledged in that case, National Grid's poor service quality performance was the basis, at least in part, for increased revenue adjustments. The Commission specifically stated that "[b]ecause National Grid's performance did not meet established reliability standards for three of the past five years…, we are requiring enhancements to the existing Service Quality Assurance Mechanism."[162] In sharp contrast to National Grid's, NYSEG and RG&E have generally provided excellent service quality (Tr. 126-27; Joint Petitioners IB at 106-10). Thus, in light of the performance distinctions and the differences between the Grid/KeySpan merger and the Proposed Transaction, there is no basis for Staff's proposed metrics and increase to the revenue adjustments.

Third, while Staff argues that its proposal to implement an Escalated Complaint Response Time metric "was fully justified by Staff's testimony" (Staff IB at 207), a review of the testimony easily disproves this statement. Staff merely explained how the metric would work and provided absolutely no reason for its proposed implementation (Tr. 1879-80). NYSEG and RG&E, to the contrary, explained that there is no issue at either company to warrant implementation of the metric, which would not lead to enhanced service quality and has not been imposed on any other utility (Tr. 129; Exh. 9; Exh. 8 at 47; Joint Petitioners IB at 107-08).

Fourth, there is no merit to Staff's assertion that NYSEG and RG&E have not justified separate metrics. Staff inappropriately switches the burden on this issue—it is Staff that had proposed different metrics for the two companies and thus Staff that needs to provide justification for its new proposal here. The Commission establishes metrics on a company-by-company basis, which is obvious from the fact that not all of the electric and gas utilities in New York have the same metrics (*see* Exh. 8). That is exactly how NYSEG and RG&E ended up with differing metrics. Staff does not explain why, at this point in time, the metrics must be conformed, particularly in light of the fact that Staff made no attempt to do so during the last

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162 Case 06-M-0878 - *Joint Petition of National Grid plc and KeySpan Corp. for Approval of Stock Acquisition and Other Regulatory Authorizations, Abbreviated Order Authorizing Acquisition Subject to conditions and Making Some Revenue Requirement Determinations for KeySpan Energy Delivery New York and KeySpan Energy Delivery Long Island*, at 26 (Aug. 23, 2007) (hereinafter "*Abbreviated NG/KS Order*").

NYSEG electric rate case or in the RGS/Energy East merger proceeding (Tr. 134). Unlike Staff, NYSEG and RG&E provided a rational basis for keeping different metrics at each utility (*i.e.*, the composition of each company's service area, the type of complaints, the methodology of tracking complaints, and how and when the metrics were set for each company) (*Id.* at 128). As the Commission recently found, "different standards can be justified for utilities with different past performances and current circumstances."[163] That is the case here, and the Commission should reject Staff's proposals.

Finally, Staff insists that it has justified its additional reporting requirements for NYSEG because Staff needs to be alerted to any "degradation of customer service" (Staff IB at 208). Staff misses the point. As the Joint Petitioners testified, NYSEG already reports on these measures on a monthly basis to Staff and the additional requirements Staff seeks are unnecessary and will not lead to customer benefits (Tr. 126). Based on the Joint Petitioners' testimony, there is no record evidence to support the adoption of Staff's additional reporting requirements.

3. The Record Contains No Support for Staff's Electric Reliability Proposals

In its Initial Brief, Staff sets forth only one reason for its dramatic increases to the revenue adjustments associated with NYSEG's and RG&E's electric reliability targets - similar conditions adopted in Grid/KeySpan (Staff IB at 208-09). Staff then flatly claims that "the characteristics of Iberdrola's proposed acquisition strongly resemble the circumstances at issue in the KeySpan/Grid Order" (*Id.* at 209). As the Joint Petitioners have explained at length with respect to other issues - equally applicable to reliability - Staff wrongly invokes Grid/KeySpan

163 Case 07-G-0141 - *Proceeding on Motion of the Commission as to the Rates, Charges, Rules and Regulations of National Fuel Gas Distribution Corporation for Gas Service, Order Establishing Rates for Gas Service,* at 45 (Dec. 21, 2007).

when distinct shortcomings were being addressed by the conditions attached to the merger approval.

Specifically in this context, Staff refuses to recognize (as does MI) that National Grid's declining service quality and declining performance were a key reason (if not *the* reason) why the Commission took action relative to electric revenue adjustments in the Grid/KeySpan merger proceeding (Tr. 147-49; Joint Petitioners IB at 100). In approving the merger, the Commission specifically found that "given National Grid's history in New York," the amounts proposed to be put at risk for missing targets that were contained in the JP were "too small."[164] In fact, Staff was the party that raised the reliability concerns as support for increased revenue adjustments in that case and the Commission specifically noted that Staff was "relying on developments in the Niagara Mohawk rate plan docket where they [understood] that a different DPS Staff team [was] seeking the imposition of increased … revenue adjustments due to Niagara Mohawk's 'chronic deteriorating performance.'"[165] Clearly, the Commission was concerned about National Grid's performance and increased the revenue adjustments accordingly.

Similar concerns do not exist in this proceeding. The record demonstrates that NYSEG and RG&E have a history of exceeding their electric reliability targets (Tr. 146). That point is undisputed (*Id.* 1857-59). Thus, in light of the fact that the Proposed Transaction does not present the same risks as the Grid/KeySpan merger and NYSEG's and RG&E's history of reliable service is dramatically different from Niagara Mohawk's, Staff's proposal to increase NYSEG's and RG&E's revenue adjustments is unwarranted and there is no evidence in the record to support its adoption by the Commission.

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164 *Abbreviated NG/KS Order*, *supra* note 162, at 20.

165 *NG/KS Order*, *supra* note 10, at 96-97.

B. Retail Access Issues

1. Bill Issuance and Payment Processing

In its Initial Brief, Staff continues to allege that NYSEG and RG&E apply their billing charges "in a manner that does not conform to Commission policy and orders" (Staff IB at 209). Staff is wrong. As the Joint Petitioners explained, NYSEG's and RG&E's billing issuance and payment processing ("BIPP") charges are in compliance with Commission orders (Tr. 170-75). The Joint Petitioners' Rate Design and Retail Access Panel testimony details how NYSEG and RG&E are in compliance with relevant orders (*Id.*). Staff provides no specific explanation regarding why or how NYSEG and RG&E have not complied with such orders. Whether Staff now interprets the Commission's generic orders on BIPP in a different manner does not make NYSEG and RG&E non-compliant. A closer review of Staff's position shows that Staff provides no meaningful legal support for its position.[166] As the Joint Petitioners mentioned in their Initial Brief, this issue should not be decided outside the context of a rate case (*Id.* 173-75) and Staff's position should be rejected outright by the Commission as inappropriate, unsupported and irrelevant to approval of the Proposed Transaction (Joint Petitioners IB at 110-12).

2. Staff's Proposed Further Unbundling of Utility Rates Is Inappropriate

In its Initial Brief, Staff states that "RG&E in particular should be required to file revised tariffs that convert all existing back-out credits to unbundled charges in a revenue neutral manner, including the merchant function credit and metering back-out credits" (Staff IB at 213). The Joint Petitioners' testimony demonstrates that the Companies have addressed these issues in accordance with Commission orders (Tr. 170-75). Any further unbundling of utility rates is

166 Staff relies on a recent case involving another utility, Con Ed, whose facts have no bearing on NYSEG's and RG&E's compliance with applicable Commission orders.

completely unrelated to the Proposed Transaction and, thus, should not be considered in this proceeding. As the Joint Petitioners testified, these issues are associated with revenue requirement and rate design and should be considered, if at all, during the Companies' next major rate proceeding (*Id.* at 174).

3. There is No Evidence in the Record to Support Staff's Proposed ESCO Referral Program Collaborative

Staff claims in its Initial Brief that "[s]ince the original ESCO Referral Program filings of RG&E and NYSEG are well over a year old, the Commission should impose on NYSEG and RG&E requirements regarding ESCO Referral Programs that are similar to the requirements the Commission imposed on KeySpan and NFG" (Staff IB at 214). In an attempt to support its assertion, Staff states that "[t]here is no basis for the companies' contention that they should be distinguished from KeySpan and NFG" (*Id.*) and, indeed, Staff's *only* rationale for new ESCO referral programs is that the Commission established them in these two other rate proceedings (Tr. 176). The issues Staff raises are unrelated to this proceeding and should be rejected by the Commission for that reason alone. Moreover, Staff ignores the fact that the Joint Petitioners have demonstrated key reasons why such a requirement should not be imposed on NYSEG and RG&E.

Notwithstanding the fact that the issues are unrelated to the Proposed Transaction, the Joint Petitioners have adequately demonstrated that the fact that the Commission has ordered a utility to undertake an ESCO Referral Program in another case does not justify doing so in this case (Tr. 177-79). Nor are there any other reasons to adopt Staff's recommendations. In fact, the Joint Petitioners have shown that there are reasons not to do so for NYSEG and RG&E.

First, any discussion regarding whether utilities should be required to undertake an ESCO Referral Program should be resolved within the context of the Commission's on-going generic retail access proceeding (*Id.* at 178-80). Important issues, such as whether utilities should be undertaking such programs at this time and who should pay the costs of any such programs, are under consideration in that case (*Id.*).

Second, for NYSEG, the signatory parties to NYSEG's Supply Service JP in Case 07-E-0479 agreed that the company should undertake an ESCO Introduction Program, not an ESCO Referral Program (*Id.* at 181). The signatory parties, which included NYSEG, Staff, CPB and a number of ESCOs, agreed that NYSEG would withdraw its pending ESCO Referral Program and file the ESCO Introduction Program in its place (*Id.*; Joint Petitioners IB at 111-12). In other words, the ESCO Introduction Program would supplant, rather than supplement, NYSEG's pending ESCO Referral Program. The adoption of Staff's proposal would undermine the intentions and agreement of the parties who executed the JP in that case, which was approved by the Commission.

Third, Staff fails to acknowledge that one of the two utilities that the Commission ordered to undertake an ESCO Referral Program Collaborative–NFG–concluded that there was "little support for an ESCO Referral Program in [NFG's] service territory" and "the filing [did] not propose the establishment of an ESCO Referral Program."[167] The report also states that CPB and the Public Utility Law Project "oppose an ESCO referral program outright."[168] It is reasonable to believe that the same opposition would be raised in any ESCO Referral Program collaborative for NYSEG and RG&E, and the outcome would likely be the same as in the NFG collaborative. In light of the above, Staff's proposal that NYSEG and RG&E undertake an ESCO Referral Program collaborative should be rejected by the Commission.

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167 Case 07-G-0141 - *Report on Results of Collaborative for ESCO Referral Program*, at 10, 13 (Mar. 19, 2008). The other utility's collaborative–Grid/KeySpan–is ongoing.

168 *Id.* at 10.

XIII. CONCLUSION

For the foregoing reasons, as well as those presented in their Initial Brief, the Joint Petitioners respectfully request that the Commission approve the Proposed Transaction without any conditions in addition to those the Joint Petitioners commit to herein and in their Initial Brief. The record has demonstrated that the Proposed Transaction will bring extensive benefits to NYSEG's and RG&E's ratepayers and to the State of New York. These benefits meet and exceed the "public interest" standard of Section 70.

Respectfully submitted,

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