STATE OF NEW YORK DEPARTMENT OF PUBLIC SERVICE
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April 25, 2008

Hon. Rafael A. Epstein
Administrative Law Judge
Department of Public Service
Three Empire State Plaza
Albany, New York 12223-1350

Case 07-M-0906 - Iberdrola, S.A., Energy East Corporation, RGS Energy Group, Inc., Greene Acquisition Capital, Inc., New York State Electric & Gas Corporation and Rochester Gas and Electric Corporation – Joint Petition For Approval of the Acquisition of Energy East Corporation by Iberdrola, S.A.

Dear Judge Epstein:

Enclosed please find Staff's Reply Brief in the above-captioned proceeding. A copy has been served on all active parties via regular mail and e-mail.

Very truly yours,

Leonard Van Ryn
Sean Mullany
Staff Counsel

Enclosure
cc: All Active Parties

STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

CASE 07-M-0906 - Iberdrola, S.A., Energy East Corporation, RGS Energy Group, Inc., Greene Acquisition Capital, Inc., New York State Electric & Gas Corporation and Rochester Gas and Electric Corporation – Joint Petition For Approval of the Acquisition of Energy East Corporation by Iberdrola, S.A.

STAFF REPLY BRIEF

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STAFF REPLY BRIEF

INTRODUCTION

On April 11, 2008, Staff received Initial Briefs (IB) in this proceeding from the Consumer Protection Board (CPB), the Department of Environmental Conservation (DEC), Empire State Development (ESD), the Independent Power Producers of New York, Inc. (IPPNY), Multiple Intervenors (MI), Natural Resources Defense Council (NRDC), Nucor Steel Auburn, Inc. (Nucor), the Rural Electric Cooperative Association (RECA), Strategic Power Management LLC (SPM) and the petitioners.[1] While Staff believes it anticipated most of the arguments made in the petitioners' Initial Brief (PIB), and the Initial Briefs of the other parties, Staff responds to those arguments that require explication, clarification or updating beyond the content of its Initial Brief (SIB).

[1] The petitioners include Iberdrola, S.A. (Iberdrola), which is seeking approval to acquire Energy East Corporation (Energy East), the holding company owner of the New York State Electric & Gas Corporation (NYSEG) and Rochester Gas and Electric Corporation (RG&E) transmission and distribution (T&D) utilities.

ARGUMENT

I. THE NECESSARY BENEFITS

In its Initial Brief, Staff detailed the benefits that must be provided, in addition to those the petitioners have presented in their testimony and their Partial Acceptance (Exh. 50), before it can be determined that approval of Iberdrola's acquisition of Energy East is in the public interest. Petitioners protest that Staff's additional conditions amount to imposing a "toll" on entry into the utility business in New York (PIB 1). The petitioners' arguments in support of this contention lack merit.

A. Synergy Savings Arguments

In comparing this transaction to prior approvals of utility acquisitions, the petitioners present an analysis of the role of synergy savings that deviates from the Commission's analyses of synergies. At PIB 18, petitioners claim that any monetary benefits sufficient to justify approval of a utility acquisition must be "funded out of actual synergy savings expected to result from [a] merger."

That reasoning is faulty. The monetary value of synergy savings standing alone is not necessarily sufficient to justify approval of an acquisition. Indeed, the petitioners admit that approval of the KeySpan/Grid merger was contingent upon supplementing synergy benefits with non-synergy monetary benefits, albeit petitioners term those additional benefits "unfunded mitigations" (Exh. 79). Moreover, when Niagara Mohawk merged with National Grid, synergy benefits were supplemented with a $850 million write-down of stranded asset costs.[2] The positive benefit adjustment write-downs and write-ups Staff proposes here are analogous to that particular write-down.

Petitioners also contend that the only rate concessions considered in justifying approval of a merger are those that can be derived from synergy savings, after careful study of the synergy amount (PIB 33). But the Commission has decided that rate reductions, approximating those that could be achieved as a litigated result, would be a tangible benefit that assisted in justifying approval of a merger.[3] Moreover, energy company mergers have often been accompanied by rate plans that reset rates to just and reasonable levels, before synergy savings benefits to ratepayers are recognized as an additional rate offset. The petitioners' begrudging concession to embark upon rate proceedings, after undue delay (PIB 84), is bereft of any of the rate concessions, synergy savings, or substitutes for synergy savings needed to justify approval of this transaction.

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[2] Case 01-M-0075, Niagara Mohawk Power Corporation and National Grid Group plc, Opinion No. 01-6 (issued December 3, 2001).

[3] Case 97-M-0567, Long Island Lighting Company and the Brooklyn Union Gas Company, Opinion No. 98-9 (issued April 14, 1998), p. 36.

Because the standards of conduct Staff proposes prevents Iberdrola from providing services to Energy East, the petitioners complain, they cannot actually realize any synergy savings from this transaction (PIB 46). Those standards of conduct, however, do not prohibit Energy East from providing services to Iberdrola and its affiliates, or other avenues to achieving synergy savings.

Petitioners crown their synergy arguments with a claim that no synergy savings will be realized from this transaction, because Iberdrola is a "first mover" entering the U.S. market for the first time (PIB 44-45). Synergies, they imply, cannot be achieved because Iberdrola has no existing T&D utility operations to synergize to the operations of the NYSEG and RG&E affiliates it intends to acquire. But Iberdrola already owns substantial business interests in North America (SM 1188-89), and the upgrades Iberdrola might bring to NYSEG and RG&E operations could also create synergies (SIB 112-14). That these synergies savings are currently obscured and cannot be quantified is not proof they fail to exist (SM 1206-16). Since synergies could be achieved, and savings realized, the Positive Benefit Adjustments (PBAs) Staff proposes are needed to offset petitioners' retention of the potential synergy savings.

The petitioners' mistaken analysis of synergy savings leads them to a distorted interpretation of Commission Orders and the standards that must be met to justify approval of this transaction. As Staff has demonstrated, tangible benefits must be provided, and if those benefits cannot be found in synergy savings, they must be found elsewhere (SIB 13-18, 112-14). Staff's proposals meet that tangible net benefit standard, while petitioners' do not.

B. The Water Company Orders

Rather than comparing their transaction to other energy company mergers, the petitioners focus instead on the water industry. From Commission Orders on water company mergers, they manufacture support for their fictitious "first mover" and "non-synergy" merger categories (PIB 14-16).

A close analysis of the UWR Order, upon which the petitioners primarily rely, demonstrates that the petitioners' arguments are flawed.[4] As discussed in that Order, the acquirer already owned 30% of the water company's equity, and so was not a "first mover" (UWR Order, p. 2). Moreover, tangible benefits for ratepayers were achieved, because an existing rate plan was extended even though the company was not earning its allowed rate of return (UWR Order, p. 9). Continuation of the rate plan also held rate increases below the rate of inflation, resulting in a merger that yielded "terms economically advantageous for

[4] Case 99-W-1542, United Water Resources, Inc. and Lyonnaise American Holding, Inc., Order Approving Stock Acquisition (issued July 27, 2000, errata issued August 1, 2000).

customers" (UWR Order, p. 10). Moreover, petitions for deferral accounting and waivers that would have increased costs to ratepayers were withdrawn. Finally, conditions attached to approval of the merger addressed the potential for impacts adverse to the quality of customer service and the reliability and safety of utility operations; prevented the company from recovering executive severance payments; and, continued the company's existing debt/equity ratio (UWR Order, p. 3).

Petitioners here declined to make any promises concerning future rates. They failed to provide other tangible benefits for ratepayers. They did not adequately protect NYSEG and RG&E from the risks of affiliating with Iberdrola. The minimal and paltry concessions made in their Partial Acceptance do not alter this analysis (SIB 131). As a result, there is no analogy between these circumstances and those present in the UWR Order.

C. The Comparison to Maine

The petitioners misinterpret the Maine Public Utility Commission's (MPUC) approval of Iberdrola's acquisition of Energy East and its Central Maine Power Company (CMP) subsidiary that operates in that state. The petitioners argue that the MPUC treated CMP's agreement to forgo recovery of the acquisition premium paid for Energy East as a benefit of the transaction, even though it was unlikely that the utility could have recovered that premium in rates. The petitioners maintain that their agreement to forgo recovery of the acquisition premium in New York should be treated as a benefit, in the same way as it was in Maine (PIB 32).

The MPUC's Order, however, indicates that the acquisition premium was recoverable to the extent recovery was supported by synergy savings (Exh. 51). The Maine petitioners claim to have demonstrated that synergy savings existed (Exh. 51, pp. 4-5; Exh. 63), and included $9 million of those savings in regulated utility revenue requirements (SM 1485). Since the MPUC clearly viewed forgoing the recovery of the premium as a benefit, logically, it must be presumed that it could have been recovered had it been pursued. In contrast, the petitioners here did not pursue recovery of the acquisition premium, and if they had, recovery would have been denied (SM 1221-25, 1400-02).

D. <u>The PBA Analysis</u>

1. <u>PBAs as Benefits of the Transaction</u>

Staff has demonstrated that petitioners must present tangible benefits to justify approval of the transaction (SIB 9-13). Since petitioners declined to offer those benefits, prior to their belated presentation of their inadequate Partial Acceptance, Staff proposed the PBAs in their stead. Petitioners complain that Staff's PBAs would not be adopted if presented in a rate case (PIB 33). That fact, however, does not undermine

Staff's argument -- instead, it supports it. Since the petitioners could recover these costs the PBAs represent in rates, forgoing their recovery creates a benefit to ratepayers. Conversely, if they are recovered, there is no benefit to ratepayers, and the tangible benefits that are necessary to support approval of the transaction cannot be found.

2. The Partial Acceptance and PBAs

The level of over-earning at NYSEG and RG&E exceeds the amount of the PBAs that petitioners have offered in their Partial Acceptance. Staff estimates annual over-earnings at $72.5 million (SIB, Att. 1), while petitioners value their PBAs at only $54.8 million (Exh. 50). Since the amount of NYSEG and RG&E over-earnings exceeds the amount of the petitioners' PBAs, this analysis demonstrates those PBAs and are not sufficient to justify approval of the transaction. The petitioners' contention -- that their PBA rate reductions are "unchallenged" (PIB 21) -- therefore rings hollow, especially since they never challenge Staff's contention that NYSEG and RG&E are over-earning.

3. SPM's PBAs

SPM both criticizes and lauds Staff's PBAs. In taking both sides of the issue, SPM complains that Staff's proposed PBAs are excessive and are not adequately justified (SPM IB 15-20), but then maintains that the PBAs properly establish the one-time monetary adjustment needed to justify approval of the transaction and are preferable to attempting to forecast uncertain synergy savings (SPM IB 13-14). SPM concludes the remedy to its conundrum is to split the difference between the petitioners and Staff, which it calculates at an additional $216 million in PBA benefits beyond those presented in the Partial Acceptance.

SPM's efforts are unavailing in establishing the level of benefits that petitioners must provide to justify approval of this transaction. SPM's calculation is wrong, because it begins with the assumption that the petitioners have offered $201 million in PBA benefits (SPM IB 28). As Staff has demonstrated, petitioners' offer actually amounts to substantially less than $201 million (SM 1457).

Moreover, SPM proposes to "convert the [PBA] balance into a revenue requirement and then make that amount subject to refund" (SPM IB 2). The process proposed for "converting" the PBAs into a revenue requirement lacks detail and might prevent ratepayers from timely and appropriately realizing the benefits of the PBAs. SPM also has not shown that its PBA amount is adequate compensation for the risks ratepayers will assume if the transaction is approved. As a result, SPM's proposal should be rejected.

E. Comparison of the PBAs to Overall Benefits

The petitioners attack the comparison Staff makes between the $1.6 billion in benefits participants in this transaction receive and the absence of any quantifiable benefits for ratepayers. In attempting to make their point, petitioners maintain that Staff overstates the $1.6 billion figure (PIB 35). The petitioners, however, have failed to demonstrate that comparison of PBA's to the $1.6 billion figure is excessive. Instead, it is conservative, because it excludes nearly $0.5 billion in foreign exchange gains (Exh. 106), and the $626 million tax benefit component has not been grossed up for income taxes (SM 1512).

1. Control of PTCs

The petitioners protest that Iberdrola has no control over the production tax credits (PTCs) for wind generation production that Staff attributes as a benefit to it (PIB 38). Iberdrola, however, admits it maintains sufficient control over its Iberdrola Renewables subsidiary sufficient to ensure that it will make a $100 million investment in the development of wind generation in New York (Exh. 50). It is clear that Iberdrola controls its renewable subsidiary (SM 1176), subject to its obligation to minority shareholders (SM 690). It therefore controls the PTCs the subsidiary will receive.

Petitioners also claim the PTCs are not available to Iberdrola because its presently-operating wind projects are subject to tax equity structures that provide for the disposition of the PTCs (PIB 40). They then cite the PPM Ruling for the proposition that tax equity structures are a well-known feature of wind development.[5] The PPM Ruling, however, does not address PTCs and discusses only the exceedingly complex ownership arrangements Iberdrola, as parent of PPM Energy, Inc., has made for its Maple Ridge wind project. Except as yet another indication of how complex and difficult to penetrate Iberdrola's operations are, the PPM Ruling is irrelevant to this proceeding. Finally, as Staff pointed out at SIB 119-20, whatever tax equity structures may be in place for existing projects do not control the PTCs Iberdrola might earn in the future.

Moreover, existing PTCs remain on Iberdrola's balance sheets (SM 1548). Beyond that information, however, Iberdrola has declined to quantify the PTCs it expects its wind projects to yield (SM 1539-40). As a result, Staff conservatively included in its $1.6 billion calculation only the value of one year's worth of PTCs, at $150 million (Exh. 93). For these

[5] Case 06-E-1106, PPM Energy, Inc., et al., Declaratory Ruling on Regulation of Intra-Corporate and Other Transactions (issued October 19, 2006).

reasons, and those at SIB 119-20, the petitioners' analysis of PTCs should be rejected.

2. Spanish Tax Benefits

The petitioners' analysis of other benefits they will realize in the transaction is similarly disingenuous. In analyzing Spanish tax benefits, they protest that the tax deductions for goodwill expense available to Iberdrola in Spain if it acquires Energy East might be recaptured if the Energy East subsidiary is resold at a later time (PIB 43).

This hypothetical resale cannot be squared with petitioners' claims that Iberdrola's ownership will bring long-term benefits to Energy East (SM 512-14), or with their denials that future transactions in Europe are likely to affect ownership of the Energy East subsidiaries (SM 603-04, Exh. 58). Similarly, they claim that another Spanish tax offset, for up to 15% of a price paid for an acquisition, is no longer available (PIB 44). But the petitioners' actual testimony states only that realization of that tax benefit is "uncertain" (SM 536, line 4).

3. Comparison to KeySpan/Grid

In disputing Staff's comparisons of its $640 million in PBAs to the benefits the Commission considered acceptable in approving the KeySpan/Grid merger, the petitioners present, at Exhibit 79, an analysis of the $602 million benefit the

Commission found adequate in the KeySpan/Grid Order. They revise that number downward to $317.7 million, which they describe at Exhibit 79 as "unfunded mitigations," and claim even that figure could be reduced by another $261.5 million, because that amount is attributable to settlement of various disputes subject to "litigation risk" (SM 964, 988-90).

In the KeySpan/Grid Order, however, the Commission based its decision on $602.8 million in benefits, without describing any of that amount as "unfunded mitigations." The Commission's findings, and not the petitioners' contrived recalculation, controls. That the Commission found tangible, quantifiable benefits is what petitioners describe as "unfunded mitigations" and "litigation risk" shows that the petitioners also must produce such tangible benefits, and they have not.

F. <u>Iberdrola as a Superior Operator</u>

Petitioners claim that Iberdrola is a superior operator of T&D utilities (PIB 31), and that skill is a benefit justifying approval of the transaction. They buttress their claim with data from Iberdrola's utility subsidiaries located in Central and South America.

That raw data is not readily comparable to data from North America. The operational circumstances present in the North American climate and culture diverge from those in Central and South America. The data collection methods the various utilities employ may differ substantially from continent to continent. Consequently, claims of success in operating Central and South American utilities are, at best, difficult to quantify or verify, and are not readily comparable to North American circumstances. As a result, the petitioners' claim that Iberdrola is a superior T&D company operator cannot be confirmed.

II. THE TRANSACTION CREATES RISKS

A. Capital Structure Risk

1. Use of the Consolidated Capital Structure

Petitioners claim that Commission precedent does not require the use of a consolidated capital structure in setting NYSEG's and RG&E's rates (PIB 89-90). For support, petitioners cite a St. Lawrence Gas decision.[6] That decision, in a minor rate filing for a small utility company tied to an atypical Canadian holding company, is hardly convincing precedent.[7] Moreover, Canadian law restrictions on refunding debt prevent

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[6] Case 99-G-1188, St. Lawrence Gas Company, Untitled Order (issued March 27, 2000).

[7] In St. Lawrence Gas, the Commission relied on its earlier decision to use a stand-alone capital structure agreed to by Staff and the company. Case 97-G-0409, St. Lawrence Gas Company, Inc., Opinion No. 98-2 (issued January 22, 1998), p. 33. In this case, Staff and petitioners strongly disagree.

many Canadian firms from refinancing high cost debt, so their debt costs and debt rates are overstated.[8]

The petitioners also maintain that a stand-alone capital structure was approved in the KeySpan/Grid Order (SIB 90).[9] The KeySpan/Grid Order itself, however, merely notes that parties agreed, when contemplating a three-year rate plan, to an equity ratio of 47%, and when agreeing to a five-year rate plan, reset the equity ratio at 45%;[10] thus, the capital structure adopted in the KeySpan/Grid Order was a hypothetical one. Again, this is hardly convincing precedent.

Instead, the applicable precedent is the recent NYSEG Electric Order,[11] where the Commission set rates for NYSEG, one of the utilities whose acquisition is at issue here, using a consolidated capital structure. Petitioners seek to distinguish the NYSEG Electric Order by arguing that, in that case, Energy East had not separated NYSEG's capital structure from its own,

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[8] Case 94-G-0686, St. Lawrence Gas Company, Untitled Order (issued September 29, 1995; revised October 10, 1995), p. 14.

[9] Case 06-M-0878, National Grid plc and KeySpan Corporation, Order Authorizing Acquisition Subject to Conditions and Making Some Revenue Requirement Determinations For KeySpan Energy Delivery New York and KeySpan Energy Delivery Long Island (issued September 17, 2007).

[10] KeySpan/Grid Order, pp. 78-79.

[11] Case 05-E-1227, New York State Electric & Gas Corporation, Order Adopting Recommended Decision With Modifications (issued August 23, 2006).

whereas here, petitioners claim they have committed to the separation of NYSEG's and RG&E's capital structures from those of Iberdrola (PIB 91). The NYSEG Electric Order is not so readily distinguishable.

In the NYSEG Electric Order, the Commission explicitly stated that "the established regulatory practice in New York in fully litigated rate proceedings, like this one, is to use the consolidated capital structure of the holding parent company for ratemaking purposes."[12] The Commission made it abundantly clear that it would not depart from that well-established regulatory practice unless it could be demonstrated that the level of financial separation and insulation between the New York subsidiary and the holding company was sufficient to justify use of the subsidiary's stand-alone capital structures.

Petitioners have failed to make any such showing in this case. They claim, without specificity, that they have "committed themselves" to separate NYSEG's and RG&E's capital structures from those of Energy East and Iberdrola (PIB 91, n.76). They support this sweeping claim in part by referencing provisions of the Partial Acceptance (Exh. 50). Staff has shown those provisions are wholly inadequate to protect NYSEG and RG&E ratepayers from the financial risks posed by Iberdrola's ownership (SM 1458-59). The Partial Acceptance also falls short

[12] Case 05-E-1222, supra, at 87-89.

of the financial insulation and separation provisions adopted in the KeySpan/Grid Order, further undermining petitioners' reliance on that Order. As a result, the petitioners have failed to demonstrate that they would be exempt from application of the Commission's consolidated capital structure approach to ratemaking.

2. The Subsidiary Adjustments

Petitioners urge the Commission to reject Staff's recommended subsidiary adjustments to the consolidated capital structure -- removing non-jurisdictional operations at a 50% equity/50% debt ratio and removing goodwill at a 75% equity/25% debt ratio -- as "unprecedented" and "arbitrary" (PIB 91). As to the question of precedent, the Commission has frequently employed subsidiary adjustments to develop appropriate regulated capital structures for ratemaking purposes (SIB 76-77; SM 1328-29). The adjustments proposed here spring from a natural evolution of those precedents, even if not specifically employed before. The Commission is empowered to take reasonable steps, like Staff's proposed adjustments, in responding to changing circumstances and new challenges.

Removing Iberdrola's pre-existing competitive operations from its consolidated capital structure at a 50% debt/50% equity ratio is fully consistent with the 2007 NFG

Order,[13] and reflects Iberdrola's credit ratings at a business profile of 5 (SIB 77-78, n.28).[14] Removing goodwill from Iberdrola's consolidated capital structure is consistent with the removal of the effect of goodwill from regulatory books in the Verizon Order,[15] and because, in recent years, the risks posed by goodwill have become more apparent (SIB 70-71).

If this transaction is approved, the amount of goodwill on Iberdrola's books would amount to $13.4 billion, representing 46% of its equity (SIB 61). This massive goodwill burden poses material financial risks to NYSEG, RG&E and their ratepayers. Removing it from the Iberdrola capital structure at a ratio of 75% equity and 25% debt is appropriate, notwithstanding the petitioners' criticisms. The effect of unregulated operations has been removed from capital structures at ratios of up to 70% equity, and goodwill is riskier than unregulated operations (SM 1329-36).

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[13] Case 07-G-0141, National Fuel Gas Distribution Corporation, Order Establishing Rates For Gas Service (issued December 21, 2007).

[14] Petitioners' claim Staff's approach "makes no sense as Iberdrola is not a U.S. utility" (PIB 92-93); but, if this transaction takes place, Iberdrola will become a U.S. utility by virtue of its ownership of NYSEG and RG&E.

[15] Case 05-C-0237, Verizon Communications Inc. and MCI, Inc., Order Asserting Jurisdiction and Approving Merger Subject to Conditions (issued November 22, 2005), pp. 49-50.

The petitioners argue that, if Staff's recommended subsidiary adjustments were applied to the KeySpan/Grid transaction, a reduction in earnings amounting to $1.265 billion over a five-year period would have resulted (PIB 93). In effect, petitioners are arguing that, under different facts, the approach Staff recommends here would not be appropriate. The superficial rhetorical appeal of this argument is quickly dispelled because the ring-fencing provisions in the KeySpan/Grid Order distinguish that transaction from this one.[16] As a result, the effect the subsidiary capital structure adjustments proposed here would have on KeySpan/Grid is irrelevant.

Therefore, the record, prior Commission decisions, and sound financial theory all provide a basis for Staff's capital structure adjustments (SIB 76-80). These subsidiary adjustments would be needed here because petitioners have failed to accept the ring-fencing necessary to ensure, to the greatest extent practicable, that NYSEG's and RG&E's customers are financially protected, both from Iberdrola's $13.4 billion in goodwill, and the other risks that Iberdrola's ownership of Energy East would

[16] Unlike the petitioners, parties to another recent transaction proposed ring-fencing conditions similar to those Staff advocates here. Docket No. 072375, Puget Sound Energy, Inc., Application for an Order Authorizing Proposed Transaction (Washington Utilities and Transportation Commission, December 17, 2007), p. 19.

create. Consequently, petitioners' criticisms of the subsidiary adjustments Staff would make to a consolidated capital structure for ratemaking purposes should be rejected.

3. The Hypothetical Consolidated Capital Structure

The petitioners state that Staff recommends a capital structure of 38% equity (PIB 93). This is true only if the transaction is approved without ring-fencing provisions. Absent ring-fencing, an equity ratio above 38% would squander any benefits usually associated with a thicker equity ratio, because the threats of goodwill impairment and greater financial risk compromise the value of the equity.

If, however, the transaction is approved subject to the ring-fencing provisions Staff recommends (SM 1410-19), which are fully consistent with the KeySpan/Grid Order, the revenue requirement could be based upon a capital structure consistent with an A rating. The 45% equity ratio allowed in the KeySpan/Grid Order would then become suitable, and NYSEG and RG&E could obtain the strong A rating, above their current ratings, implied by that equity ratio.

B. Financial Risk

Staff has described in detail the financial risks Iberdrola's acquisition of Energy East poses to the financial health and stability of NYSEG and RG&E. The petitioners, however, find it "illogical" that Staff maintains Iberdrola's financial risks exceed National Grid's risks, even though Staff concedes Moody's views National Grid as a riskier company than Iberdrola (PIB 58). The petitioners misinterpret Staff's testimony and misunderstand Staff's conclusion.

Staff believes that credit rating agencies view National Grid and Iberdrola as roughly similar (SM 1158). Credit rating agencies, however, evaluate risks to bond holders and investors -- i.e., those risks that affect repayment of debt interest and principle. Staff, in contrast, is concerned with risks to NYSEG and RG&E ratepayers -- i.e., those risks that affect the cost of capital and cost of service.

From a ratepayer perspective, Iberdrola is a riskier company than National Grid. Iberdrola has a highly leveraged capital structure given its asset base; its balance sheet is encumbered with a distressingly high percentage of goodwill, and, the proportion of its business devoted to non-regulated operations is much greater than at National Grid (SM 1376). As a result, it is not illogical to believe that Iberdrola's ownership of New York's utilities will pose more risks to ratepayers than National Grid's ownership of such utilities.

C. Credit Rating Risk

1. Iberdrola's Credit Quality

The petitioners characterize Staff's concerns about Iberdrola's credit quality as "specious" (PIB 62). Petitioners base their credit quality arguments primarily on a narrowly-focused analysis of rating agency snapshots of Iberdrola's numeric ratings. Merely reciting that Iberdrola is currently rated A cannot obscure the credit quality risks Iberdrola faces.

More specifically, petitioners contend that Staff's 58% debt/42% equity ratio figure for Iberdrola is in error (PIB 63). Staff has explained its calculations and sources in detail, relying in part on information Iberdrola insisted be kept confidential (SM 1280-81). Staff stands by that analysis.

2. The Credit Quality Analysis Update

Staff continues to perform the searching analysis needed to truly assess the risks facing Iberdrola. That those risks are substantial is confirmed by the 2007 Iberdrola Sustainability Report, recently released by Iberdrola at www.Iberdrola.com. The Sustainability Report contains financial data in a public form -- notwithstanding that, when Staff most recently asked for the same financial data, Iberdrola demanded that the data be treated as confidential (SIB 47, 64). Attachment A hereto replicates Staff's Attachment 2 to its Initial Brief,[17] using the now-public 2007 Sustainability Report credit metrics.

[17] Attachment 1 and Attachment 2 to the Initial Brief were reversed in order from the references to them in the body of the Brief; the references here are to the Attachments as they are labeled at the end of the Initial Brief.

As Attachment A demonstrates, the 2007 data from the Sustainability Report 2007 data undermines the petitioners' positions. The petitioners place great emphasis on funds from operations (FFO) ratios in determining credit ratings (PIB 63). As Staff argued even before issuance of the Sustainability Report, a close analysis of FFO ratios did not support the petitioners' positions (SIB 64-65, Att. 2). The 2007 FFO data from the Sustainability Report demonstrates that those ratios have deteriorated significantly, and, as shown at Attachment A, are consistent only with credit ratings in the BBB range.

The Sustainability Report, at page 58, does indicate that Iberdrola's equity/debt ratio has improved for 2007 to 57.6% equity/42.4% debt, which would normally result in an improvement to a company's credit rating outlook. The value of that equity, however, is undercut, because it is subject to potential impairment by the "humongous, gargantuan...more startling" amount of goodwill on Iberdrola's balance sheet (SM 1575). The Sustainability Report sets that goodwill at €8.0 billion, not including another €7.1 billion in intangible assets that reside on the company's balance sheet, and not including the €1.8 billion in goodwill attributable to this transaction, if it is approved. As a result, it is likely that the value of Iberdrola's new, higher equity ratio will be discounted (SM 1279, 1288, 1322-23; Exh. 100).

Moreover, the equity ratio improvement is based on an "adjusted net debt" of €20.5 billion and "shareholders equity" of €27.8 billion. "Adjusted net debt" is computed by subtracting €1.6 billion of adjustments from "financial debt" of €22.1 billion. But "adjusted net debt" may be understated, because it does not appear to include the €5.8 billion of debt assumed by Iberdrola in the Scottish Power transaction. That debt is apparently categorized as "Other Long Term Debt" and is included in the €27.8 billion total "Group Company and Affiliate Debt" reported by Iberdrola on page 55 of its Sustainability Report. In addition, while the €3.2 billion of equity related to the proposed Energy East acquisition is shown on Iberdrola's balance sheet, the €2.4 billion of Energy East debt Iberdrola will assume is not. This has the effect of temporarily improving the equity ratio set forth in the Sustainability Report.

Taking into account these statistics, Staff has recalculated the debt ratio for Iberdrola, from the 58% Staff initially calculated as discussed above, to 50.7%, pro forma to the completion of the Energy East transaction. In performing this computation, Iberdrola's financial and other long term debt was added to Energy East's debt to develop the leverage ratio that is appropriate and is likely to exist after the transaction is completed. Like the most recent FFO metrics, this updated 50.7% debt/49.3% equity ratio is consistent with a BBB rating.

Because Iberdrola's credit metrics are now consistent with a credit rating of BBB, absent improvement in these credit metrics, the company's bond rating is likely to decline over the long run, and it has declined in the past (SM 1155, Exh. 89). Moreover, this most recent data renders moot any contentions by petitioners that Staff relies on outdated information (PIB 63).

3. Iberdrola's Impact on NYSEG/RG&E Credit Quality

The petitioners attribute the current negative outlook for the credit ratings of NYSEG and RG&E to the "unfavorable" NYSEG Electric Order (PIB 66). In this instance, the credit rating agencies contradict themselves. They describe 2007 as a period when NYSEG recovered financially -- even though that year is the time when the supposedly harsh rates were in effect (1303-05).

The petitioners dismiss Staff's contention that the 30 basis point differential between debt issued by NYSEG and debt issued by three proxy group companies was caused by Iberdrola-related risk (PIB 67). Petitioners blame the 30 basis point disparity on NYSEG's failure to qualify as index-eligible -- a qualification, the petitioners claim, which enabled the three proxy companies to command their slight price premium over NYSEG.

The petitioners' analysis of index-eligible companies is unsupported, except by an argument that index-eligible companies are more familiar to investors than other companies (PIB 67). If NYSEG and RG&E are unfamiliar to investors, however, the blame falls on Energy East -- the cause is that NYSEG and RG&E no longer issue public financial statements as a result of their affiliation with the holding company. Overlaying onto Energy East the more risky Iberdrola holding company will only exacerbate this lack of transparency, preventing NYSEG and RG&E from obtaining the interest rates that are otherwise available to companies of their rating.

D. Goodwill Risk

Petitioners seek to minimize the risks associated with the startling amount of goodwill on Iberdrola's books. They misquote Staff as conceding that a write-down of goodwill seems unlikely (PIB 69). What Staff actually stated, however, was that "in the short run a write-down of goodwill seems unlikely" (emphasis added)(SM 1322).

While petitioners are content to focus on their snapshot of Iberdrola's current financial condition, Staff must take a longer view of the risks posed to NYSEG and RG&E ratepayers, who will take utility service for many years after this transaction, if approved, closes. The risks of goodwill, for Iberdrola and ratepayers, are significant (SIB 71-75).

Although petitioners may be correct in asserting that the goodwill on Iberdrola's books might not be impaired "suddenly" (PIB 70), impairment over the long-run remains a real possibility. As Attachment A demonstrates, the slow decline in Iberdrola's financial picture continues (SIB 61, SM 1155; Exh. 100). At some point, Iberdrola could potentially find itself in the same position as American Water Works Company (AWW), discussed at SIB 17-18 and 70-71, where goodwill impairment overwhelmed financial health.

Moreover, Iberdrola continues to engage in merger and acquisition transactions, as discussed below. A proposal has been floated that Iberdrola itself could be worth €100 billion in a hostile takeover. But a sale of Iberdrola at that price would amount to about four times the value of the company's book equity, and the goodwill attributable to Iberdrola by the acquirer would represent more than 80% of that equity. At this point, a repetition of the AWW scenario becomes even more likely. As a result, petitioners have failed in their effort to disguise the risks goodwill poses to regulated ratepayers.

E. Hostile Takeover Risk

1. The Risks Continue

Notwithstanding the risks a proposed hostile takeover of Iberdrola might pose to NYSEG and RG&E ratepayers, the petitioners complain that the potential for Iberdrola's involvement in future acquisition transactions is not a proper topic for consideration in this proceeding (SM 81-2). They add a contention that there is no precedent for addressing such issues. The circumstances here, however, are also unprecedented, as discussed at SIB 49-52.

Developments concerning Iberdrola's involvements in other transactions continue to unfold.[18] On April 15, 2008, Reuter's reported that Iberdrola's Chairman announced that EdF, the French utility interested in a hostile takeover of Iberdrola (SIB 49-52), should submit a bid or "shut up." He also asserted that €100 billion could be a starting point for a bid. As a result, the evidence continues to mount that Iberdrola may disappear after a hostile takeover, or may engage in other acquisition or sale transactions that affect its corporate composition and financial attributes.

2. MI's Transaction Risk Remedies

Under these circumstances, it is appropriate to protect New York ratepayers from any adverse consequences attending Iberdrola's extensive merger and acquisition activities. MI suggests that, if this transaction is approved, a condition should be imposed requiring NYSEG and RG&E to cease paying dividends, and reduce rates by 25% each, if another

[18] On April 18, 2008, Economist.com further detailed Iberdrola's involvement in potential international energy company deals. Reuters updated that involvement on April 21, 2008.

entity acquires Iberdrola without obtaining PSL §70 approval (MI 70). Terminating dividends is an appropriate condition, which should be triggered automatically upon consummation of an unauthorized transfer involving entities in the holding company ownership structure for NYSEG and RG&E. Such a restriction will ensure that the two T&D utilities are not drained of cash while their ultimate ownership in the wake of an unauthorized transfer is determined.

Requiring rate reductions upon an unauthorized acquisition, however, may go too far, because it may weaken the financial health of the T&D companies and make it difficult for them to maintain safe and adequate service. Therefore, Staff does not support that condition.

F. Financial Transparency

The petitioners proclaim that the proposed transaction will not affect the Commission's ability to audit and regulate NYSEG and RG&E (PIB 71-73). But whatever the ability to audit NYSEG and RG&E, the burden on Staff to detect illicit transactions will increase. The risk that an illicit transaction will go undetected increases concomitantly. Rather than create circumstances where illicit transactions must be detected, it is better to prevent them from taking place at all (SM 1232-36, 1432-37).

The petitioners also protest that other foreign companies have been able to successfully invest in New York utilities without raising the risks Staff believes attend Iberdrola's acquisition of Energy East (PIB 15, 72). They undermine their own arguments by again referencing a company, AWW, that is in financial distress, as discussed above. They also proclaim the merger of Niagara Mohawk and National Grid a success, even though service quality in Niagara Mohawk's service quality declined after its acquisition, as they concede (PIB 109).[19]

G. Dividend Risks and Restrictions

Petitioners dismiss as "speculation" Staff's concerns that Iberdrola will exert pressure to increase dividends from NYSEG and RG&E (PIB 60). They also assert that the dividend and money pool restrictions they propose will adequately alleviate Staff's unjustified concerns.

Staff's concerns are not mere "speculation." In an April 15, 2008 press release, Iberdrola announced its proposal to increase dividend payments significantly above the nearly €1.4 billion currently disbursed to investors annually. The

[19] The petitioners do promise compliance with the applicable requirements of the Sarbanes-Oxley Act, even though, after the transaction, those requirements would no longer be directly applicable to Energy East (SM 548-49). Staff interprets the somewhat confusing wording at PIB 72 as confirming this on-the-record commitment.

increase also brings the dividend to 44% over 2006 levels. Recent credit agencies reviews expressed concern with Iberdrola's "high levels" of dividend payments, even when those levels were increasing at the previously-slower rate (SM 1301-04; Exh. 70, p. 13; Exh. 101, p. 7; Exh. 104, p. 3). The most current dividend increase will do little to assuage those concerns, but will increase the pressure to extract additional dividends from NYSEG and RG&E.

Staff's proposed dividend restrictions are needed to resist that pressure. The restrictions are fully consistent with prior Commission decisions in other energy industry mergers in New York State (SIB 146; SM 1405-08)). In contrast, petitioners' commitments do not go far enough to protect New York State ratepayers (SM 1400-10). Staff's recommended protections should be adopted instead.

III. MARKET POWER MITIGATION

A. The Auction Process

Pointing out that RG&E continues to seek to repower Russell Station in contravention of its commitment to divest the plant, IPPNY argues its remedy -- the divestiture of the generation that Energy East owns as a condition of approval of the transaction -- should be accompanied by firm deadlines and milestones for accomplishing the sale of the generation facilities (IPPNY IB 12). Staff agrees. Moreover, CPB, and MI present proposals for treatment of any proceeds that would be realized from the auctioning of utility-owned generation plant (CPB IB 7, MI IB 54). Therefore, if divestiture is required as a condition of approval in this proceeding -- a remedy petitioners concede is appropriate at least as to the gas-fired generation Energy East owns (Exh. 50) -- the Commission should establish a process for auctioning the generation facilities that must be divested.

The Commission should require the petitioners to consult with the parties and make a filing, within 60 days of the date of an Order here, detailing a process for the auctioning of the generation facilities. Comments on the filing should be due within 21 days thereafter.[20] That filing should provide for deadlines that conclude the auction process, with the selection of a new owner or owners, within a reasonable time, such as about six months after the Commission's approval of the filing. The filing also would address the proper allocation of auction proceeds.

[20] This process is similar to that followed when NYSEG divested its coal-fueled generation facilities. Case 96-E-0891, New York State Electric & Gas Corporation's Electric Restructuring Plan, Order Approving Transfer of Electric Generation Facilities, Approving Contracts Upon a Condition, and Making Other Findings (issued December 3, 1998) and Order Authorizing the Process For Auctioning of Generation Plant (issued April 24, 1998).

B. Divestiture of Wind Facilities

As Staff maintains, the petitioners should be required to sell all of their interests in generation facilities, not just the interests in fossil-fueled generation. Several parties, however, argue that Iberdrola should be permitted to continue to own and develop wind projects (CPB IB 12, ESD IB 7, MI IB 57, NRDC IB 2, SPM IB 34). These parties seem to suggest that the issue of Iberdrola's compliance with the Commission's Policy Statement on Vertical Market Power (VMP Statement)(SM 1248), in owning and developing the wind facilities, can be deferred to a later time or can be addressed through procedural remedies. It appears that some of these parties contemplate a process where a review of each individual Iberdrola project would be conducted to determine if Iberdrola can own and operate the project without raising VMP concerns (SM 686-89).

Conducting these individual project reviews would be burdensome and administratively inefficient, and would foster uncertainty concerning the future development of any particular project. Moreover, a project-by-project review is not adequate to prevent the harms attending VMP (SIB 92-109).

Iberdrola is also proposing to develop wind projects in the NYSEG and RG&E service territories (Exh. 57). Some of those projects will be qualifying facilities (QF) under Public Service Law (PSL) §2(2-b), because sized at less than 80 MW.

These QFs would be exempt from PSL regulation, by virtue of PSL §§2(4) and 2(13). As a result, a project-by-project review of compliance with the VMP Statement could not be conducted for those QFs, even though sited in the NYSEG and RG&E service territories where VMP concerns are greatest, unless Iberdrola were to accept a review process as a condition of approval in this proceeding.[21] Iberdrola, however, states it would not accept such a condition (SM 664). Therefore, procedural safeguards are inadequate to protect ratepayers from the deleterious consequences of the exercise of VMP.

C. Divestiture of Hydro Facilities

CPB opposes divestiture of the hydro units that NYSEG and RG&E own (CPB IB 9). There is no reason to treat hydro units differently than other forms of generating units. Since other utilities have successfully divested their hydro units to the benefit of their ratepayers,[22] NYSEG and RG&E should also be required to do so as a condition of approval of this transaction.

[21] IPPNY proposes to prohibit Iberdrola generation ownership within the NYSEG and RG&E service territories; Staff believes divestiture and departure from the generation business state-wide is the appropriate remedy.

[22] Case 96-E-0900, Orange and Rockland Utilities, Inc. - Plans For Electric Restructuring, Order Approving Transfer of Generating Facilities and Making Other Findings (issued June 24, 1999); Case 94-E-0098, Niagara Mohawk Power Corporation, Order Approving Transfer of Hydroelectric Generation Facilities and Making Other Findings (issued May 27, 1999).

IV. RATE ISSUES

A. The Need For Rate Plans

The petitioners maintain that new rate plans for NYSEG and RG&E are not needed to justify approval of this transaction (PIB 83-85). SPM would delay implementation of new rates until after the conclusion of rate cases that would not even be filed until four to six months following the closing of the transaction (SPM 2). In the KeySpan/Grid Order, however, promptly-effective rate plans were required, and the circumstances here are not distinguishable from the Commission's decision on that transaction. Moreover, rate plans are needed so that the benefits of the transaction can be flowed to ratepayers.

Staff has demonstrated that NYSEG and RG&E are over-earning and that a rapid review of their costs and revenues is warranted (SIB 176-77). Staff has proposed two alternative remedies. The preferable option is to conduct immediate, streamlined rate proceedings as a Phase II to this proceeding, so that the PBAs the Commission requires as a condition of this transaction can be flowed through to ratepayers, after the excessive rates that NYSEG and RG&E are currently charging are appropriately reduced. To accomplish those goals, the proceedings should be conducted expeditiously and, if they cannot be concluded by January 1, 2009, existing NYSEG and RG&E rates should be made temporary as of that date (SIB 172).

Another approach would be to adopt Staff's proposed Earnings Sharing Mechanisms (ESM) for delivery rates (SM 1680, 1742), after subtracting the PBAs from NYSEG and RG&E rates. This approach also presumes the adoption of a new rate design for RG&E's fixed price option under its commodity supply program, and a new ESM for the company's earnings on commodity supply (SM 1671-74). Once in place, these mechanisms would ensure that over-earnings from excessive rates are captured for the benefit of customers.

The arguments the petitioners present in support of their contention that new rate plans are not needed lack merit. They maintain that they are entitled to an 11-month suspension period proceeding (PIB 84). A suspension period process, however, is only necessary when a utility makes a major rate filing. Other means at arriving at rate plans have been adopted in the past, including the process that led to NYSEG's 2002 Rate Plan.[23]

The proposals made by the petitioners and SPM would delay rate relief for customers for far too long. The petitioners' proposal also renders their paltry PBA benefits

[23] See, Case 01-E-0359, New York State Electric & Gas Corporation, Order Clarifying Data Required (issued April 25, 2001).

completely illusory by allowing NYSEG and RG&E to continue to over-earn. Lengthy proceedings, which also would commence only after undue delay, are therefore not an appropriate solution to the creation and realization of the tangible benefits needed to justify this transaction.

B. The Earnings Sharing Mechanism

The petitioners criticize Staff's earnings sharing mechanism (PIB 94-95). Their criticisms, however, are based on the erroneous calculations at their Exhibit 29. Staff demonstrated, at SIB 127-31 and SIB Attachment 1, that the impact of its PBAs was substantially overstated by the petitioners at Exhibit 29. Since those impacts are overstated, the calculations of the ROEs that depend upon the Exhibit 29 assumptions, at PIB 95 and Exhibit 32, are meaningless, as is SPM's reiteration of those calculations (SPM IB 14).

C. ACF Filings

Instead of disagreeing with the substance of the regulatory adjustments Staff made to correct errors in Annual Compliance Filings (ACF) calculations (SIB 181-90), the petitioners protest that Staff delayed informing them of the errors. The fault for the delays lies with NYSEG and RG&E. They have failed to timely provide necessary information and have repeatedly revised the ACF initial filings, sometimes years later, making adjustments amounting to millions of dollars (SM

1654-55). The scope and breadth of the revisions the companies make are detailed at Exhibit 19 (Response IBER-0342), where over 100 changes to ACF filings are listed. Since it is the companies' belated submittals and continual updating of filings that prevent Staff from completing its ACF audits (SM 1754-55), the companies should not be heard to blame Staff for the delays that have resulted.

D. ROE

The petitioners complain that Staff calculated a return on equity (ROE) for NYSEG and RG&E at 9.0%, when 9.8% was granted in the KeySpan/Grid Order (PIB 89, 95). The 9.8% ROE in that proceeding, however, was tied to a five-year rate plan. The longer the rate plan, the higher the ROE, because the greater the risk a utility faces over the longer term. The KeySpan/Grid Order confirms this axiom, by noting that a three-year rate plan would justify only a 9.6% ROE, instead of the 9.8% ROE a five-year plan would warrant.[24]

Since Staff calculated its 9.0% ROE for a one-year period, in conformance with Commission approved methods (SM 1389-1400), its calculation is unaffected by the analysis in the KeySpan/Grid Order applicable to three-year and five-year rate plans. And Staff's 9.0% figure aligns with recent Commission

[24] KeySpan/Grid Order, p. 78.

decisions adopting one-year ROEs of 9.1%.[25] Therefore, Staff's ROE is reasonable.

E. Economic Development

ESD and Nucor propose expansion of economic development program and rate design measures intended, they say, to spur economic growth (ESD IB 3-5, Nucor IB 9-10). While ESD and Nucor correctly point out that economic development is an important goal that the Commission strongly supports, consideration of their proposals should await the development of the rate plans Staff recommends as a condition of approval of this transaction. A better record for evaluating their proposals can be assembled in the course of developing those rate plans.

F. Retail Access Issues

The petitioners protest that Staff's criticisms of their billing issuance and payment processing charge (BIPP) are "simply untrue" (PIB 111). As Staff has demonstrated, however, NYSEG and RG&E have repeatedly failed to comply with the Commission's BIPP policies. That the Commission has not yet remedied that failure is no reason to conclude the failure has not occurred. Again, both BIPP and other retail access issues

[25] Case 07-G-0141, National Fuel Gas Distribution Corporation, Order Establishing Rates For Gas Service (issued December 21, 2007), p. 41; Case 07-E-0513, Consolidated Edison Company of New York, Inc., Order Establishing Rates For Electric Service (issued March 15, 2008), p. 126.

should be addressed in the Phase II rate proceeding Staff recommends here (SIB 209-13), notwithstanding the petitioners' opposition to conducting that proceeding.

G. Revenue Decoupling

Nucor and MI question some aspects of the revenue decoupling mechanism (RDM) that Staff proposes for adoption in this proceeding. In particular, they maintain that some customer classifications should be exempted from the mechanisms (MI IB 59, Nucor IB 13). The issues these parties raise are best addressed after NYSEG and RG&E make their promised RDM filings.

MI notes that the Commission has required that an RDM be developed only for NYSEG (MI IB 63). Developing a mechanism for RG&E at the same time, however, is efficient and sensible.

H. MI's Rate Plan Terms and Conditions

MI and Staff agree on most rate plan issues (MI IB 131). MI, however, proposes two rate plan conditions with which Staff disagrees. First, MI believes that approval of the transaction should be conditioned upon a rate stay-out of at least two years (MI IB 26-27). If, however, as Staff believes, rates are currently overstated, such a stay-out would benefit the companies and harm ratepayers, as the companies would over-earn during the two-year period. Staff believes that the level of rates and the length of the rate plans should be determined in the rate plan process it proposes, after the Commission sets the level of PBAs that should be reflected in those rates.

Second, MI suggests that NYSEG and RG&E should be required to maintain existing personnel levels for some period of time following consummation of the transaction (MI IB 35). Again, if the personnel level selected is excessive, because NYSEG and RG&E could furnish safe and adequate service with fewer personnel, then ratepayers will be overcharged. As a result, these two MI conditions should not be adopted.

CONCLUSION

For the reasons discussed above, and in Staff's Initial Brief, the Commission should deny the petitioners' request for approval of Iberdrola's acquisition of Energy East. If the Commission decides instead to approve the transaction, it should do so upon the conditions that Staff has recommended.

Respectfully submitted,

Leonard Van Ryn

Leonard Van Ryn
Sean Mullany
Staff Counsel

Dated: April 25, 2008
Albany, New York

STANDARD & POOR'S METRICS

Standard & Poor's New Business Profile Scores Assigned for U.S. Utility and Power Companies; Financial Guidelines Revised

Iberdrola Total Debt+Affiliate Debt +Energy East Debt/Total Capital as of December 31, 2007 = 50.7%

		Total Debt/Total Capital (%)		
Business Profile	AA	A	**BBB**	BB
1	48-55	55-60	60-70	
2	45 52	52 58	58 68	
3	42 50	50 55	55 65	65-70
4	38 45	45 52	52 62	62 68
5	35 42	42 50	50-60	60 65
6	32 40	40 48	48 58	58 62
7	30 38	38 45	45 55	55 60
8	25 35	35 42	42 52	52 58
9		32 40	40 50	50 55
10		25 35	35 48	48 52

Standard & Poor's Power Companies

Iberdrola Total Debt+Affiliate Debt +Energy East Debt/Total Capital as of December 31, 2007 = 50.7%

Financial Ratio Guidelines

	A	**BBB**
Transmission and Distribution	55	65
Generators	35	45
Vertically Integrated Companies	45	56

IBERDROLA LEVERAGE AS ADJUSTED BY STAFF

	Per Sustainability Report		Staff
	2006	2007	Pro Forma
Sharholders Equity	10,567 €	27,832 €	27,832 €
Financial Debt	14,352 €	22,080 €	22,080 €
Adjustments	-1,234 €	-1,610 €	-1,610 €
Other Long-Term Debt	0 €	0 €	5,776 €
Energy East Debt	0 €	0 €	2,400 €
Adjusted Net Debt	13,118 €	20,470 €	28,646 €
Total Capital	23,685 €	48,302 €	56,478 €
Debt/Total Capital	**55.4%**	**42.4%**	**50.7%**
Equity Ratio	44.6%	57.6%	49.3%

Standard & Poor's Ratings Analysis Now Portrayed in the S&P Corporate Ratings Matrix
Iberdrola -Satisfactory Business Risk Profile with Aggressive Financial Risk Profile

		Fianancial Risk Profile			
Business Risk Profile	Minimal	Modest	Intermediate	**Aggressive**	Highly Leveraged
Excellent (1-2)	AAA	AA	A	BBB	BB
Strong (3-4)	AA	A	A	BBB-	BB-
Satisfactory (5-6)	A	BBB+	BBB	**BB+**	B+
Weak (7-8)	BBB	BBB-	BB+	BB	B
Vulnerable (9-10)	BB	B+	B+	B	B

Iberdrola Business Profile of 5, Financial Profile = Aggressive = BB+

MOODY'S METRICS

Iberdrola	Moody's Credit Analysis February 2008	Response IBER-0286.2 September 2007	**Estimated December 2007**
Business Risk	Low-Medium	Low-Medium	**Low-Medium**
FFO Interest Coverage	4.3X	2.55X	**2.5X**
FFO/Net Debt	18.90%	13.50%	**15.1%**
RCF/Net Debt	12.70%		

Moody's Rating Methodology: Global Regulated Electric Utilities

	A	**BBB**
Buiness Risk	Low-Medium *	Low-Medium *
FFO Interest Coverage	**3.25-5.85**	**2.55-4.5**
FFO/Debt	**17-26**	**9-19**
RCF/Debt	**11-22.5**	**5.5-15**

* Interpolation of Low and Medium Range to Match Iberdrola's Low-Medium Risk

	A	A	BBB	BBB
Buiness Risk	Medium	Low	Medium	Low
FFO Interest Coverage	3.5-6.0	3.0-5.7	2.7-5.0	2-4.0
FFO/Debt	22-30	12-22	13-25	5-13
RCF/Debt	13-25	9-20	8-20	3-10

Per Sustainibility Report

Cash flow/Interest-bearing debt	15.1%	includes Affiliate Debt
Cash Flow	4194.0	per page 221 Sustainability Report
Financial (Interest) Expense	1671	per page 218 Sustainability Report
FFO Intesrest Coverage	2.5	