

STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

In the Matter of

Case 07-M-0906

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.

Initial Brief

On behalf of

Strategic Power Management, LLC

Dated: April 11, 2008

Daniel P. Duthie
P.O. Box 8
Bellvale, NY 10912
845-988-0453
Fax: 845-988-0455
duthie@attglobal.net

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Executive Summary

In its Initial Brief to Administrative Law Judge Rafael Epstein, Strategic Power Management, LLC ("SPM") argues that the public interest will be well served based on the record in this proceeding. Accordingly, Judge Rafael is urged to quickly recommend approval of this merger to the Commission.

The public interest is served because NYSEG's and RG&E's rates will be reduced on an annual basis by \$50 million

immediately as a result of Iberdrola accepting over \$200 million of Staff proposed Positive Benefit Adjustments ("PBAs") also known as write-offs.

Iberdrola will retain all jobs and will invest at least \$100 million in upstate New York for the development of wind generation over the next three years.

SPM disagrees with the totality of Staff's PBA menu consisting of 21 separate adjustments since it leads to rate reductions that are far too excessive and down-right confiscatory. Instead SPM, to bridge the PBA divide, submits a modest proposal to take 50% of Staff's proposed PBAs, subtract the \$200 million Iberdrola has agreed to, convert the balance into a revenue requirement and then make that amount subject to refund. Whether the customers will receive the additional rate relief that is made subject to refund would be determined in full blown rate cases for both companies to be filed in 4 to 6 months following the closing.

SPM also agrees with Staff's financial conditions including the recommended acquisition adjustment and credit quality conditions, dividend limitations, money pool rules and structural protections.

Introduction

Your Honor is asked to consider a deceptively simple and, at this point dispositive,¹ question.

Should Iberdrola be allowed to acquire Energy East?

Or to pose the legal query: Is this transaction in the public interest pursuant to Section 70 of the Public Service Law?

Section 70 states in relevant part:

No consent shall be given by the commission to the acquisition of any stock in accordance with this section *unless it shall have been shown that such acquisition is in the public interest.* (emphasis added.)

Admittedly the term "public interest" is one of broad scope and reach.

We think it is plain enough that the term "public interest" is directly related to and limited by the main purposes of the Public Service Law. These purposes, so the Legislature has once said, are "to guarantee to the public safe and adequate service at just and reasonable rates, to the stockholders of public service corporations, a fair return upon their investments, and to bondholders and other creditors, protection against impairment of the security of their loans." (Laws of 1929, chap. 673, § 3.)

International Railway Company v. Public Service Commission, 264 AD 506 (3rd Dept. 1942). If the record satisfies the above standard, which this brief will argue it does, then Your Honor

¹ The Joint Petitioners have secured all other utility jurisdictional regulatory approvals from Connecticut, Maine, New Hampshire, and the Federal Energy Regulatory Commission.

should recommend that the merger, albeit with conditions, be approved.

SPM has carefully reviewed the extensive discovery that was conducted since this proceeding began, has reviewed other sources, and, more importantly, the record² that was compiled in four full days of hearings and is convinced that this transaction is in the public interest both as a matter of law and of common sense. In agreement on the record are New York State Department of Environmental Conservation ("DEC"), Empire State Development ("ESD"), Greater Rochester Enterprise ("GRE"), and the Natural Resources Defense Council ("NRDC"). Other than Staff, no party opposes the merger.

Staff's opposition appears to derive from its commendable customer centric focus and its not so commendable slavish adherence to the Commission's Order approving with conditions the acquisition of KeySpan by National Grid. As the Joint Petitioners have shown on the record that acquisition is about as different from the instant case as night is from day, particularly in that Iberdrola has already financed the acquisition of Energy East through a \$4.5 billion equity issuance. Tr. 507. National Grid acquired KeySpan entirely

² The Transcript is 1908 pages long and there are 136 Exhibits, most of which consist of numerous pages. This is a testament to how elusive finding the public interest can be.

through debt. There are no synergy savings in this case since Iberdrola does not own any operating transmission and distribution utilities in this country.

As a result of the Partial Acceptance of over \$200 million in Staff proposed PBAs, the rates that result will be just and reasonable and lower; the service provided will be safe and adequate and should further improve; the shareholders, both current and future, will receive a fair return on their investment; and bond holders' security will not be impaired. The public interest as defined by *International Railway* is more than satisfied.

Staff's opposition to this merger, although well intentioned, is improvident. Its PBA conditions in totality do not meet the judicially defined public interest standard and, if imposed, would likely not pass muster under *Hope* and *Bluefield*.

The vast majority of Staff's other conditions are reasonable and supportable on the record before Your Honor.

As the record attests, the seemingly simple inquiry of whether this transaction is in the public interest has spawned a multitude of subsidiary issues which is not surprising consider the breath of the term "public interest". As will be seen most of these numerous issues are not fully developed, even on this

extensive record, because they are essentially issues that go to NYSEG and RG&E's future rates, e.g., capital structure, return on equity, etc., and must be resolved in rate proceedings.

Suffice it to say that there are two key unresolved issues facing Your Honor in this Section 70 proceeding. One is highly conceptual and theoretical, Vertical Market Power ("VMP") relating to wind generation, and the other is politically pragmatic, the size of the Positive Benefit Adjustments ("PBA") required to meet Staff's position on tangible ratepayer benefits or to appease stakeholders who demand immediate results for allowing the merger to proceed.

The identification of the two key issues is not to minimize the other issues, but it is to focus Your Honor's attention on where the parties are furthest apart. Accordingly this brief will address these two issues, but first a few observations about Iberdrola are in order.

Iberdrola

Iberdrola's credit is several notches above Energy East. It has a global presence which naturally diversifies its business and operating risk. Its 100 years of experience in the utility and energy field is hard to beat. Iberdrola is internationally

recognized for its environmental policies and performance³. Tr. 80. Iberdrola has an excellent reputation with its employees and their bargaining units.

Iberdrola is ranked 122nd out of the 2,000 largest companies in the world by Forbes. It is ranked 6th in the world in the "utilities" category⁴.

A key part of its strategic plan which has not been sufficiently mentioned is its commitment to training its employees. It is instructive to review a February 2008 press release that starts with "MORE THAN 810,500 CLASS HOURS FOR IBERDROLA EMPLOYEES IN 2007 -- Some 84% of the staff took part in some of the 11,000 courses given last year." Iberdrola plans on providing 3 million hours of training over the next three years at a cost of 275 million euros. The complete press release is attached hereto for convenience.

A company that devotes that much attention to training its personnel intends to be in the business for the long term and

³ Iberdrola has achieved best in class rankings "for both the Electric Utilities category for environmental behavior by Storebrand Investments and for the global level in the 2006 Climate Leadership Index," along with a host of other awards and top rankings. Tr. 480. Not surprisingly, its senior management is considered best in class as well. Tr. 485 - 486.

⁴ See Forbes, April 21, 2008, page 194. The rank is a composite of sales, profits, assets and market value. www.forbes.com/forbes2000/.

that is an insight Your Honor should keep in mind when judging whether this merger is in the public interest.

Your Honor should also consider Iberdrola's vision and values:

The Iberdrola vision, covering all economic, social and environmental aspects of sustainability, is founded on five values to which the company is firmly committed.

Ethics and corporate responsibility: Iberdrola is committed to the best practices in corporate governance, business ethics, and transparency in all its activities. The responsible conduct of all those who are a part of Iberdrola is an essential feature of its...

Financial results: Iberdrola's commitment to meeting profit and growth objectives established in its strategic plans is a pillar of its business model, while at the same time meeting the demands and expectations of those involved with the company.

Respect for the environment: Iberdrola's commitment to clean energy is one of the mainstays of its model for the 21st century. The company's aim is for its environmental stance to be recognized as a distinguishing feature among its peers.

Confidence: Iberdrola's goal is to generate a climate of confidence around all its activities, through permanent dialogue

Sense of belonging: At Iberdrola, no effort is spared to create strong and permanent ties with its interest groups, forging a sense of ties with an outstanding company, to the extent that they identify with its goals.

The commitments contained in Iberdrola's vision and values are no mere declaration of principles, they are put into practice every day in the company's activities.⁵

⁵ Iberdrola's web site. Go to "About Us", and then select the "Vision and Values" tab.

In the Best Interests of New York State, NYSEG, RG&E and Their Customers

It is in the best interest of New York State to have Iberdrola acquire Energy East and deploy more fully its substantial expertise in renewable generation development, utility management and its superior access to capital. 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. To shun Iberdrola's wind energy as Staff has recommended over a hyper-theoretical vertical market power concern is cutting one's nose off to spite one's face.

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? This is blatant hypocrisy which makes New York look foolish, at best, and inhospitable to investment, at worse.

This is hardly a positive signal to send out into the world arena where investment decisions are made at a time where the dollar is weak and the financial markets roiled. New York has a reputation both domestically and internationally as a difficult place to do business. Upstate New York is especially in need of significant economic development. Job growth is

nonexistent or negative. Iberdrola has committed to preserve all NYSEG and RG&E jobs, plus make a minimum \$100 million investment in wind generation and that will logically be focused upstate. Exhibit 50. Given the level of intelligence and expertise found among Staff and the Joint Petitioners personnel, it is not conceivable there are no additional safeguards or procedures that can be created to allow Iberdrola to develop wind generation in New York. There must be some place for such provisions in the Standards Pertaining to Affiliates⁶.

It is in the best interests of New York State Electric and Gas Corporation's ("NYSEG") and Rochester Gas and Electric Corporation's ("RG&E") customers to have Iberdrola bring its superior financial strength and management expertise to their service territories. Both companies need significant capital investment to upgrade the infrastructure which is critical to modern life and business. Both companies, while providing good service based on service quality and customer service metrics, will improve further by benefiting from Iberdrola's vast expertise, international best practices and comprehensive training.

⁶ It is recommended that the existing NYSEG and RG&E standards be reviewed and update based on concerns expressed in this case.

Risks

Are there risks associated with this merger? Yes, there are always risks inherent with a change in ownership. But there are risks maintaining the status quo which Your Honor should consider. Alternatively if Iberdrola is allowed to walk away⁷ from Energy East, who will take its place? It is not likely that a suitor superior to Iberdrola will be found. This is another risk that Your Honor should consider.

SPM considers the "status quo" or "another acquirer" risks unacceptable. Allowing Iberdrola to acquire Energy East will actually reduce the risk of harm to the operating companies and their customers. In fact, it would be against the public interest, indeed tragic, if Iberdrola does not consummate this transaction. Can anyone say that the continuation of the status quo is desirable? In this case change is for the better.

The record reflects a number of recommendations, some already accepted by the Joint Petitioners. These conditions are designed to minimize the risk that this merger will adversely affect the operating companies or their customers should financial peril befall Iberdrola. These conditions will

⁷ Considering the well intentioned but highly aggressive position of Staff in this matter, it would not be surprising if Iberdrola, now that it has gotten to know its regulators-in-law, no longer desires to wed Energy East.

be discussed later in this brief along with recommendations that have not been accepted by the Joint Petitioners at this point but which should be part of the conditions of approval.

Staff's Proposed Adjustments to NYSEG and RG&E Rates

Joint Petitioners Rate Adjustments Panel identified 21 Adjustments proposed by Staff that add up to \$854 million and convincingly explain why each adjustment is inappropriate. See Tr. 331 to 341. The following menu identifies the 21 adjustments and the operating entity to which the adjustment applies:

1. Loss on Reacquired Debt (all four)
2. Sarbanes Oxley and Other (NYSEG gas)
3. Low Income and MTA Surcharge (NYSEG electric)
4. Gas Pension Deferral (NYSEG gas)
5. Deferred Gas Costs (NYSEG gas)
6. 2006 Flood (NYSEG gas)
7. Environmental - SIR (all four)
8. 2003 Ice Storm (RG&E electric)
9. Property Tax Deferral (RG&E gas)
10. Voice Your Choice (RG&E electric)
11. Pipeline Integrity (RG&E Gas)
12. Variable Rate Debt (RG&E Gas)
13. Storm Reserve (NYSEG and RG&E electric)

14. OPEB Top-Off to ASGA (NYSEG electric)
15. Stray Voltage (NYSEG electric)
16. Saranac IPP Cost (NYSEG electric)
17. Nine Mile 2 Sale (GR&E electric)
18. Nine Mile 2 Mirror CWIP (RG&E electric)
19. Oswego 6 Sale (RG&E electric)
20. Allegheny Buyout (RG&E electric)
21. Russell and Beebee Decommissioning (RG&E electric)

The majority of these adjustments are associated with deferrals which have benefitted from prior scrutiny, are customary or were previously supported by Staff⁸ and authorized by the Commission. Without looking too far under the hood, it appears that all deferrals are likely to be recoverable and/or are being recovered in the rates of NYSEG and RG&E.

Although laboring under a very narrow view of the public interest standard, Staff identified these adjustments as providing the required tangible ratepayer benefits that could support, *inter alia*, the merger. Staff's approach is creative and helpful since it provides a known and certain one-time adjustment that leaves the Joint Petitioners with a definite cost to be added to the other costs of the merger. SPM suggests, that while not necessary to meet the public interest

⁸ At least these deferrals have been conceptually approved, if not the exact amount of the deferral which is always subject to audit.

standard, Staff's approach is preferable to ginning up synergy savings. Guesstimated synergy savings are then imputed into rates inducing a high level of uncertainty as to whether those savings can actually be achieved. This places unbearable financial strains on the operating utilities.

As in many areas of life, more is not necessarily better and this is the case here. Staff's proposed PBAs amounts to \$445.2 million for NYSEG split \$369.4 million for NYSEG electric and \$75.8 million for NYSEG gas. Tr. 325. For RG&E, Staff proposes \$409.5 million split \$362.4 million for RG&E electric and \$47.1 million for RG&E gas. Tr. 326. In total, Staff's adjustments amount to a staggering \$854.7 million. And while Staff blithely characterizes these as "paper assets" they have real value and drive real revenue requirements as will be seen.

Staff's adjustments result in a revenue requirement reduction of \$346.4 million for NYSEG and \$381.6 million for RG&E or a combined reduction in revenues of \$728 million over five years. Exhibit 107. What does this mean for shareholder returns? The Joint Petitioners Rate Adjustment Panel forecast that by year 5 "the highest possible ROE is 8% for NYSEG Electric and 7.2% for NYSEG Gas, respectively. At RG&E the highest potential ROE is a mere 2.4% at RG&E Electric and 8.0% at RG&E Gas." (emphasis added). Tr. 329. If Staff's PBAs were

adopted in full, it is highly likely that continuing investment in these businesses will be compromised since the opportunity to deploy capital elsewhere will be too compelling. Based on Commission approved ROEs today, such an outcome would likely violate constitutional protections as informed by *Hope* and *Bluefield*.

These forecast outcomes which are unchallenged on the record represent large red flags that suggest Staff's PBAs have gone too far. How could Iberdrola's management, recognizing its fiduciary responsibility to its shareholders, recommend to its Board of Directors that the transaction should proceed under such conditions? To the extent Staff's PBAs have merit aside from just achieving the results oriented goal of tangible rate relief, they should be carefully considered, but outside of this Section 70 proceeding. For if they are considered in this proceeding, Your Honor has to reject these proposed rate conditions since they would lead to a result that is clearly not in the public interest even if the Joint Petitioners fell under a spell and accepted them. Such spells⁹ leading to irrational economic decision making have been observed to occur in other mergers.

⁹ The causes of these spells require further study. Extreme fatigue coupled with change in control payments are considered possible factors.

Furthermore, there is no analytical framework in the record to guide Your Honor in a PBA selection process or to evaluate when one reaches a level of PBAs that breaks the camel's back.

The testimony of the companies' Rate Adjustments Panel submitted in rebuttal to Messrs. Benedict's and Haslinger's proposed PBAs consists of numerous issues that are complex and have various effects on the utilities books and rates. Unlike the National Grid -- KeySpan merger case wherein KeySpan filed two full blown rate cases for its gas operating companies on Long Island and in New York, the record contains very little rate case quality data for the four operating entities that are the targets of Staff's PBAs.

The one point that comes across is that the Staff adjustments were intended or to be one-time adjustments. But these one-time adjustments have continuing negative cash flow effects as Staff acknowledges. See for example, Tr. 1760 (PBA Absorption of Saranac 2009 IPP costs).

If adopted, Staff's recommended PBAs, will make both companies smaller financially. Smaller companies typically face more volatile financial results. Whether that is sustainable and in the long-term best interests of those companies and their customers, is also a matter for discussion in full blown rate cases. However, it is clear that the new shareholders who

bargained for acquiring Energy East under assumptions that the Commission's rate policies would be consistent and stable, now suffer substantial injury as assets are sacrificed on the altar of political expediency ironically through a way too narrow reading of the public interest.

Are existing bond holders made less secure by removing otherwise sound assets from the operating companies' books? If so, and it is hard to fathom how they would not be made less secure, then how does that approach square with the public interest test? This is equivalent to a bank saying that they are confiscating 11.2% (Exhibit 107) of the interest income because you are transferring the account to your Spanish uncle. This does not pass a simple fairness test.

Notwithstanding the obvious confiscation, Staff apparently takes comfort from the fact that this number is about one-half of the benefits Staff sees accruing to various Iberdrola - Energy East stakeholders as follows:

1. Energy East shareholders	\$930 million (Tr. 1219)
2. Energy East executives	\$ 78 million (Tr. 1220)
3. Investment bankers, lawyers	\$ 45 million (Id.)
4. Spanish tax benefits	\$476 million (Tr. 1221)
5. US Production tax benefits	<u>\$150 million (Id.)</u>
Total	\$1.679 billion (Id.)

In other words, "This is just a way to evaluate the PBA amounts that Mr. Benedict and Mr. Haslinger quantified. And it's a way to do it in a case where there really isn't any guidance in the precedents we looked at as to how to develop positive benefits to ratepayers." Tr. 1510. "This justifies the PBAs". Tr. 1512. On the other hand, if the Commission does not find that these are benefits of the merger then the effectiveness of the justification is reduced according to Staff's own testimony. Id. So a closer look at these benefits is in order.

First, it must be recognized that Staff has implicitly chosen as broad a definition of "benefit" as it has a narrow definition of the public interest. Energy East shareholders will pay, at the very least, a capital gains tax on the difference between the purchase price of \$28.50 to be paid upon closing and their cost basis. Tr. 1527). The \$28.50 payment is coming from Iberdrola's shareholders (Tr. 1507 to 1508) since this acquisition is funded 100% by equity capital. More importantly, the Con Ed - Orange and Rockland merger and accompanying Staff Reply Statement (Exhibit 113) make it clear that where there is no transfer of utility assets out of the utility, as is the case here, the ratepayers are not entitled to any portion of the benefits accruing to the shareholders. See Tr. 1516 to 1519.

Deduct \$930 million; Benefit Balance = \$749 million

Second, Energy East executives' compensation is not just due to the merger, but includes substantial benefits earned over their years of service. Besides, the ratepayers are not picking up any of those costs (Tr.542) and are largely derived from their stock holdings so the Con Ed - ORU precedent applies as well.

Deduct \$78 million; Benefit Balance = \$671 million

Third, the "benefits" to the investment bankers, advisors and lawyers are simply part of their compensation for service rendered. For some lawyers, it will mean the potential loss of long term clients - hardly a benefit. Again, these "benefits" are being paid out of shareholder funds, not ratepayer funds and are not benefits but economic costs of the transaction.

Deduct \$45 million; Benefit Balance = \$626 million

Fourth, as was explained, the Spanish tax benefits are entirely speculative and have not been shown to be available to Iberdrola. Tr. 534 to 536.

Deduct \$476 million; Benefits Balance = \$150 million

And finally, the Production Tax Credits associated with wind generation have been used by the equity investors in those projects and thus are unavailable to Iberdrola. Tr. 529.

Deduct \$150 million; Benefits Balance = \$0

Accordingly, Staff's justification for the proposed PBAs, when examined, evaporates as quickly as water on a hot Albany street in August.

Staff further argues that its PBA position is buttressed by the tangible ratepayer benefits found in four other merger transactions it reviewed. The problem with Staff's analysis is that the mergers reviewed and relied on involved operating companies on both sides of the isle. That is not the case here.

Staff should have looked at Cases 99-W-1542 and 94-W-0486 involving the petition by United Water Resources, Inc. and Lyonnaise American Holding, Inc. for approval of the acquisition by Lyonnaise of UWR stock it did not already own.

The public interest standard under section 89-h [comparable to Section 70 but applicable to water companies] does not inherently require that the proponents identify affirmative benefits to customers as a result of the acquisition. But, even if it did, the public interest criterion would be 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 why the opponents. In addition United Water faces tasks common to many water utilities, insofar as it eventually must find the resources to maintain an aging infrastructure and meet increasingly rigorous water quality standards. Here again, the affiliation with SLDE offers invaluable benefits for the company and its customers.

Order Approving Stock Acquisition (issued an effect of July 27, 2000) at pages 7 to 8. In that case the existing rate plan was simply extended without change for an additional year.

Staff should have reviewed Case 02-W-1447, Joint Petition of Philadelphia Suburban Corporation, AquaSource Utility, Inc., et.al.

Philadelphia appears to be building its future in the water industry by acquiring small systems, such as; Cambridge, Dykeer, Kingsvale, Waccabuc, and Wild Oaks. With the acquisition of these five New York companies, Philadelphia will have a base of operations in New York. Philadelphia also has committed to discuss potential further expansion in New York with us. The transfer is in the public interest as it will provide the New York companies with the support of a large financially sound company that has extensive experience in meeting water quality standards and providing water service. These attributes should assist the New York affiliates in meeting current and future needs and regulatory requirements. Ratepayers will not be adversely impacted by the transfer because the purchasers did not request for recovery of any purchase premiums, nor will they be allowed recovery under the existing long-term (11-year) rate plans for the New York companies. Finally, the transfer presents opportunities to obtain economies of scale that may benefit the New York companies potentially mitigating the need for future rate increases.

Order Authorizing Stock Transfer (Issued and Effective, March 11, 2003) at page 6.

In Philadelphia Suburban, the Commission did not require any rate concessions but found that the large financially sound new owner with extensive experience in the water business was sufficient to meet the public interest standard and so it should be here as well.

That is not to say that Staff is not to be commended for its efforts to find ratepayer benefits. Common sense suggests that there will be some cost reductions as a result of this

first mover transaction whether through avoidance or best practices. Iberdrola did not decide to enter New York for the sheer joy of being scrutinized, probed, prodded, discovered and questioned by the Staff of the Commission. In fact, one can imagine Iberdrola's shock at being subjected to such a contentious process. It is quite understandable if Iberdrola is now feeling unwelcomed and unappreciated.

Instead of being courted for its investment and expertise, Iberdrola is treated as a potential corporate terrorist, a time bomb ticking, according to Staff, with so much goodwill that it will ravage the New York operating utilities if they are not subjugated by numerous conditions. Undoubtedly Iberdrola can identify with Lemuel Gulliver in Lilliput upon awakening from his shipwreck¹⁰.

The Joint Petitioners did not do any synergy savings studies so the Staff had nothing to work with and cleverly came up with the PBA approach as an alternative. There is always more than one way to skin a cat and Staff succeeded since the

¹⁰ "For as I happen'd to lye on my Back, I found my Arms and Legs were strongly fastened on each Side to the Ground; and my Hair, which was long and thick, tied down in the same Manner. I likewise felt several slender Ligatures across my Body, from my Armpits to my Thighs. I could only look upwards; the Sun began to grow hot, and the Light offended my Eyes. I heard a confused Noise about me, but in the Posture I lay, could see nothing except the Sky." Gulliver's Travels, A Voyage to Lilliput by Jonathan Swift. The confused noise in this case may be the apparent disagreement among Staff, CPB and the DEC as to what constitutes the public interest for New York.

Joint Petitioners unilaterally adopted some of the PBAs. Despite some confusion on the record as to the meaning and import of the Unilateral Partial Acceptance (Exhibit 50), it is quite clear that this document creates the Joint Petitioners starting position for this litigation and it is an excellent start at that and should reduce Your Honor's work load, particularly if Your Honor comes to the conclusion that there is no basis to consider further PBAs or rate adjustments.

Can Iberdrola provide more rate relief so it can permanently enjoy New York regulation? Perhaps, but SPM suggests that can only come in the give and take of further negotiations. The record here supports no more than that which the Joint Petitioners have stipulated as discussed in the next section.

Joint Petitioners' Partial Acceptance

On Friday, March 14th, the last business day before the hearings would start, the Joint Petitioners submitted to all parties and Your Honor a partial acceptance of some of Staff's and the other parties litigation positions and/or concerns.

1. Vertical Market Power

The Joint Petitioners agreed to divest the Russell Station, the 63 MW Allegany Station, the 14 MW Peaker Station 3 and the

14 MW Peaker Station 14, along with the 67 MW Carthage Peaking unit owned by Cayuga Energy. In one fell swoop, the VMP issue all but disappeared, but not quite.

What is left for Your Honor to decide is the relatively easy question of whether Iberdrola should face any additional restrictions on the development of wind generation in this state by its affiliate, Iberdrola Renewables. To foreclose that resource while this state struggles with recession and its 15 x 15 goals makes no sense.

2. Rates

Iberdrola, in an extraordinary gesture of good faith, has demonstrated its willingness to compromise on matters of rate relief. This rate relief would not be available in the absence of this merger and Iberdrola's agreement. As will be discussed, the PBAs proposed by Staff are derived largely from approved deferrals. The denial of recovery of those deferrals in future rate cases is unlikely. So while SPM will argue that the public interest test is not equated with immediate rate relief, Iberdrola has accepted \$201.642 of PBAs as specified on the Attachment to Exhibit 50, rendering such an argument moot.

This produces the equivalent of approximately \$50 million a year of immediate rate reductions. Tr. 614. And while not

necessary to satisfy the public interest test, Iberdrola's acceptance removes any debate over that issue, except whether it is sufficiently large to sate the parties' hunger for even lower rates.

Thus, 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. Staff's PBA position is without question a deal breaker. So is there some number higher than Iberdrola's unilateral offer? Perhaps, but Your Honor should remember that going beyond that level increases the risk that the deal will crater and as already argued, that is decidedly not in the public interest.

More importantly, there is no legal or logical justification on the record for further rate relief without the Joint Petitioners' consent. Staff's menu of PBAs were developed without the benefit of a substantive rationale for each adjustment, but rather as a mechanism to pragmatically come up with tangible ratepayer benefits whether appropriate or not. It is a classic case of the end result justifying the means.

Both NYSEG and RG&E are covered by existing rate orders and this record lacks rate case quality data and analysis on which Your Honor can base further *a la carte* selections from Staff's

PBA menu. There is no support in the record to have Your Honor condition the Joint Petitioners' merger on having them eat the whole PBA enchilada. If such were the case, Iberdrola will politely excuse itself from the table.

3. Renewable Commitment

Iberdrola "will support and encourage investments by Iberdrola Renewables in excess of \$100 million in the development of wind generation in New York in the next three years." That is squarely in the public interest and is likely to be applauded by NRDC, Rochester, ESD, GRE, DEC and CPB. SPM supports this commitment noting that the language used creates a minimum level of investment over the next three years.

4. Electric Cooperatives and the Village of Sherburne

The Joint Petitioners have set forth a procedure to resolve these parties' concerns regarding reliability, storm response and improved communications. That procedure will include conducting, within 90 days of the closing, a transmission study to determine the age and capacity of NYSEG owned transmission facilities serving substations owned by these parties. Best efforts will be used to implement the resulting measures to improve reliability. Of course, this provision is in the public interest and fully supported by SPM.

5. City of Rochester

The Joint Petitioners agree to begin comprehensive collaborative discussions with the City, Staff and DEC regarding the remediation of RG&E's Beebee Station and Andrews Street sites and to provide safe public access to the 81 South Avenue facility. This is squarely in the public interest and fully supported by SPM.

* * * *

This is quite a good start, but not sufficient, to satisfy the public interest standard. SPM suggests that there is more work for Your Honor to do before recommending that the Commission approve the merger. But before leaving the PBA arena, SPM would like Your Honor to consider a modest proposal as a step forward to aid in resolving the PBA stalemate.

A Modest Proposal

As an alternative, if Your Honor believes that Staff's adjustments have merit or the rate relief Iberdrola has agreed to is insufficient to counter balance the perceived risks Staff has enumerated, please consider the following.

Accept 50%¹¹ of the Staff PBAs less the amount Iberdrola has agreed to as of the date the merger closes, and require as a condition to merger approval, that the companies make the associated incremental revenue requirement subject to refund pending the outcome of full rate cases.

It is hard to evaluate the impact that the PBA adjustments will have on the operating companies. It's far better to resolve these issues in a full blown rate case. In addition, the full implementation of a revenue decoupling mechanism is better left to a rate case.

Accordingly, SPM recommends that upon the completion of the merger transaction that NYSEG and RG&E rates be reduced immediately to the level associated with the accepted PBAs and a roughly equivalent amount be made subject to refund. Any further changes to rates should only be made after full rate investigation using a complete analysis and rate case quality data.

¹¹ 50% has the virtue of minimizing the chance of being completely wrong on either side and splits the litigation risk neatly in two. Here is the math: 50% of \$854 million equals \$427 million. Subtract out the agreed to PBAs of \$201 million and the remaining PBAs equal \$216 million which would then be converted into a revenue requirement that would be made subject to refund. This approach preserves for ratepayers an additional level of rate benefit if it can be proved to be justified in full blown rate cases.

The operating companies should be given at least four to six months from the closing of the transaction to submit rate filings. New rates should go into effect January 1, 2010. This will provide the parties with ample opportunity to review the level of revenues and costs for each company in a forum that is designed for such review. Having roughly \$50 million in rates subject to refund will provide a powerful incentive that will ensure the companies will file their rate cases promptly.

Remaining Vertical Market Power Issue

One perplexing area of controversy that still remains in this case is the issue of Vertical Market Power and Iberdrola's unregulated affiliate to own and develop wind generation in New York. Staff insists that the only remedy is divestiture of Iberdrola Renewables' wind generation in New York, along with a permanent ban on future development. To say that this makes no sense, even if New York had not committed to aggressive renewable energy goals, is an understatement of the first order. Tr. 518.

To ban the world leader in wind energy ownership, operation and development from New York would be a major policy error that is without any logical or factual support. On the one hand, Staff speculates that Iberdrola's presence in New York will discourage other developers of wind energy. That is not the

case as the NYISO queue attests. Equally telling is the fact that there is not a single wind energy developer who has intervened in this well publicized proceeding to make that argument. Finally, Pedro Azagra Blazquez testified "I note that in Iberdrola's extensive and global wind experience, it has not witnessed any adverse impact on the level of wind development activities in the regions where Iberdrola owns both transmission/distribution businesses and wind generation." Tr. 517.

Your Honor has these facts on the record as well as the sworn testimony of a nationally recognized expert, Dr. Hieronymus, attesting to the lack of vertical market power. FERC approved this transaction before the Joint Petitioners agreed to divest all of their fossil generation. Here is what FERC had to say on this issue:

23. In mergers combining electric generation assets with inputs to generating power (such as natural gas, transmission, or fuel), competition can be harmed if a merger increases the merged firm's ability or incentive to exercise vertical market power in wholesale electricity markets. For example, by denying rival firms access to inputs or by raising their input costs, a merged firm could impede entry of new competitors or inhibit existing competitors' ability to undercut an attempted price increase in the downstream wholesale electricity market. Here, as discussed below, Applicants have shown that the proposed transaction does not raise any of these concerns.

24. Applicants have shown that the proposed combination of electric transmission and generation assets will not harm competition. We reject IPPNY's and AES's assertions that

the merger would create vertical market power because Applicants will be able to use their transmission to favor their affiliated generation over other competitive generation. Turning over operational control of transmission facilities to an independent entity mitigates any concerns about transmission-related vertical market power because it eliminates a company's ability to use its transmission system to harm competition. In a number of cases, we have stated that both the ability and incentive to exercise vertical market power are necessary for a merger to harm competition.¹² Here, Energy East has turned over control of its transmission facilities to two independent entities - NYISO and ISO-NE - so it has no ability to use its transmission to disadvantage its competitors. Moreover, Iberdrola has no transmission facilities other than those needed to connect to the transmission grid. Therefore, there is no need to impose vertical market power mitigation.

25. We are not persuaded by IPPNY's assertion that, after the merger, Iberdrola's wind generators will have a competitive advantage in terms of interconnection in New York over competing wind generators. As noted by Applicants, the Commission requires the NYISO to adhere to the standardized interconnection terms and conditions in its OATT and requires all jurisdictional transmission owners in New York to comply with the Large Generator Interconnection Procedures. In addition, in Order No. 2003, the Commission concluded that such a "standard set of procedures as part of the OATT for all jurisdictional transmission facilities will minimize opportunities for undue discrimination and expedite the development of new generation."¹³ Therefore, we conclude that the merger will not result in undue preference in terms of interconnection for Iberdrola's wind generation capacity.

26. Similarly, Applicants have shown that the combination of natural gas transportation and electric generation assets will not harm competition. Applicants will not be

12 See, e.g., National Grid plc and KeySpan Corp., 117 FERC ¶ 61,080, at P 45 (2006) (National Grid); American Electric Power Co., 90 FERC ¶ 61,242, at 61,788 (2000), review denied sub nom. Wabash Valley Power Assn. v. FERC, 268 F.3d 1105 (D.C. Cir. 2001). See also Order No. 642 at 31,911.

13 Order No. 2003, FERC Stats. & Regs ¶ 31,146 at P 11.

able to favor their own generation, raise rivals' costs, or otherwise disadvantage rivals because: (1) the generation they own or control in the relevant markets is de minimis, (2) all the generators Iberdrola has in the relevant markets are wind generators and thus do not use natural gas, and (3) none of the Energy East affiliates own major interstate or intrastate gas transmission pipelines.¹⁴ Applicants have also shown that there are no other barriers to entry that would raise vertical market power concerns.

And to repeat, this order was issued by FERC approving the merger on December 6, 2007 in Docket No. EC07-122-000 more than three months before the Joint Petitioners unilaterally agreed to divest all of their fossil generation, both regulated and unregulated.

All existing and pipeline wind projects are located in unconstrained areas of the NYISO market. Wind generators are price takers for obvious reasons. To say that Iberdrola will be able to manipulate both the wind and its transmission assets under the control of the NYISO to exert vertical market power is such a remote theoretical construct as to be outside of the zone of rational discourse. Besides even if such conduct could be undertaken, how much can Iberdrola make on an incremental basis? Would Iberdrola take such risks in view of the consequences, under FERC's expanded enforcement powers bestowed by EAct'05?

In discovery, Iberdrola was asked to identify the business reasons to justify the acquisition of Energy East. Iberdrola

¹⁴ Application at 42.

was also asked to explain how the goal of development of wind generation in New York is related to the acquisition of Energy East. Iberdrola responded "as is the case in many many cross-border and other acquisitions, companies often see a long-term strategic value in acquiring businesses in a new market. Those values are set forth in our response and attachments to DPS-49 (IBER-0093}." Response to IBER-0125, see Exhibit 19.

After setting forth Iberdrola's extensive experience the discovery response when on to state "Iberdrola's decision to develop a particular wind project in New York or elsewhere is based on the economics of such project, and is wholly unrelated to the Proposed Transaction. However, since Iberdrola cannot reasonably locate every opportunity for investment throughout the country, Iberdrola anticipates that renewable development in the US will have to be located in a finite number of states or regions, rather than dispersing its investment throughout all of the US. Iberdrola expects that renewable generation opportunities will more readily be on its radar screen in regions in which Iberdrola already has significant existing investment." Id.

In other words, the fact that Iberdrola acquires Energy East and its two New York operating companies is going to enhance the prospect that it will seek wind generating

opportunities in this state. That is not only good business, but common sense. It takes time to understand the complexities of the New York wholesale and retail marketplaces, NYISO requirements and this Commission's regulatory practices and customs which on first encounter can seem quite challenging.

Can Iberdrola develop wind projects in New York without owning utility properties? Of course, but it will be far more likely to concentrate on growing its assets in regionally proximate locations. Approving this merger will enhance that potential and secure an immediate \$100 million jump start.

Iberdrola should not be put in a position of advantage or disadvantage in terms of developing wind generation in New York. The way to keep the playing field level while simultaneously recognizing the ownership of transmission is to simply note, as Iberdrola has acknowledged, that the Commission's VMP Policy Statement is alive and well and Iberdrola has agreed to live with it. SPM submits that nothing more is needed and Your Honor should resolve this issue accordingly.

Financial Protections and Reporting

The Joint Petitioners have testified that they "will fully comply with the Commission's and the FERC's standards, regulations and policies with respect to the relationship between its regulated and unregulated affiliates (e.g.,

Standards of Conduct, Codes of Conduct, etc.).” Tr. 559. The Joint Petitioner have gone further and have promised to continue to utilize Energy East’s cost allocation methodologies and Energy East will allocate costs to NYSEG and RG&E from Iberdrola “only to the extent that such costs are properly chargeable to utility operations and accepted by the Commission.” Tr. 560. This should put to rest any concerns that Staff or other parties may have about the parent’s unrelated utility costs finding their way into the rates of NYSEG and RG&E.

The Joint Petitioners have agreed to maintain separate and independent accounting records and financial statements. Id. There will be no assets sales without Commission approval and all sales to affiliates will be at an arm’s length basis subject to market v. book value tests. Id. NYSEG and RG&E will not loan money to Iberdrola, nor provide credit support or guarantees of any kind. Id.

Finally, the Joint Petitioners have testified that they will not seek recovery of the acquisition premium or transaction costs either directly or indirectly from customers in any proceeding. The transaction costs include investment banking fees, legal fees change in control payments to executives, etc.

While these commitments are commendable, SPM agrees with Staff that more is needed to protect NYSEG, RG&E and their

customers should Iberdrola's sailboat hit gale force financial winds. Those additional ring fencing conditions, will not be repeated here for the sake of trying to keep this brief, well brief. These important conditions are clearly set forth in the record and cover broadly:

1. Acquisition Adjustment Conditions. Tr. 1402 - 1403.
2. Credit Quality Conditions. Tr. 1403 - 1405.
3. Dividend Limitations. Tr. 1405 - 1408.
4. Money Pool Rules. Tr. 1409 - 1410.
5. Structural Protections. Tr. 1410 - 1418.

Conclusion

From the standpoint of the definition of the public interest, this transaction benefits all of New York since it allows Iberdrola to do business in New York in a manner that will find it far more engaged than if the merger is not approved. Iberdrola will help New York to achieve its 15 x 15 goal. NYSEG and RG&E will benefit as a result of Iberdrola's superior credit and access to capital. As NYSEG and RG&E see infrastructure improvements, their customers will benefit in the long run. Meanwhile Iberdrola has pledged a minimum of \$100 million toward wind energy development and an annual rate

decrease of \$50 million. So this transaction covers both the narrow and the broad aspects of the public interest, including Staff's beloved tangible ratepayer benefits. Your Honor should find that the merger, conditioned as recommended, be approved by the Commission as quickly as is reasonable.

Respectfully submitted,

Daniel P. Duthie

Daniel P. Duthie, Esq.

Counsel to Strategic Power
Management, LLC

Dated: April 11, 2008

Warwick, NY

MORE THAN 810,500 CLASS HOURS FOR IBERDROLA EMPLOYEES IN 2007

Some 84% of the staff took part in some of the 11,000 courses given last year

IBERDROLA gave more than 810,000 class hours of training to its employees in 2007, a 22.7% increase from the previous year. Training, a pillar of company strategy, reached 84% of the group's employees last year.

Some of 22,000 employees sat for an average of 37 hours in one of more of the 11,041 courses given in the year. Technical training represented 44% of the total, while workplace health and safety accounted for 18.5%, and foreign languages for 10%.

Under the strategic plan for the 2008-2010 period, Spain's largest power company plans to give more than 3 million class hours to employees, at a cost of some €275 euros.

The company plans to beef up its existing training centres in Cumbernauld, Scotland, and Hoylake, near Liverpool in England, and will also open the "Iberdrola campus" now under construction in San Agustín de Guadalix, near Madrid. The

Spanish centre will feature 35,000 m² of classrooms on a 150,000 m² site.

In these training centres IBERDROLA will give its employees quality international training in new technologies and management tools as applied to the company's business and to ensuring a safe and healthy working environment.

Human resources management is a strong point with the IBERDROLA group, which now employs some 26,200 people.

The chief aims of IBERDROLA training programmes are to endow employees with new skills in order to achieve a qualitative and quantitative improvement in their contributions to the organisation, while fostering their professional advancement.

AREA	No. Class Hours	Share
Technical	357,199.56	44.07%
Health and Safety	149,501.86	18.44%
Languages	81,923.65	10.11%
Others	221,945.46	27.38%
Total	810,570	100.00%