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Via Hand Delivery

April 25, 2008

Hon. Jaclyn A. Brillling
Secretary
New York State Public Service Commission
Three Empire State Plaza
Albany, NY 12223-1350

Re: Case No. 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.

Dear Secretary Brillling:

Enclosed is an original and five copies of the *REPLY BRIEF OF INDEPENDENT POWER PRODUCERS OF NEW YORK, INC.*, filed in the above-referenced proceeding.

Thank you.

Respectfully submitted,

READ and LANIADO, LLP
Attorneys for Independent Power Producers
of New York, Inc.

By:


David B. Johnson

Enclosures

cc: Hon. Rafael Epstein (*Via Hand Delivery; w/enc.*)
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STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

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

Case 07-M-0906

**REPLY BRIEF OF
INDEPENDENT POWER PRODUCERS OF NEW YORK, INC.**

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**REPLY BRIEF OF
INDEPENDENT POWER PRODUCERS OF NEW YORK, INC.**

INTRODUCTION

Pursuant to Administrative Law Judge (“ALJ”) Rafael Epstein’s post hearing briefing schedule, Independent Power Producers of New York, Inc. (“IPPNY”) hereby submits its Reply Brief in the above-captioned proceeding. In its Initial Brief, filed in this proceeding on April 11, 2008, IPPNY demonstrated why Joint Petitioners’¹ commitment to divest RG&E’s fossil generation and affiliate Cayuga Energy’s 67 MW Carthage Peaking Unit in their Partial Acceptance Document (“PAD”) does not go far enough to comply with the New York State Public Service Commission’s (“Commission”) long standing policy that generation should be separate from transmission and distribution (“T&D”) to protect consumers from vertical market power that may be exercised as a result of generation and T&D being owned by the same company.² IPPNY advocated that if the Commission approved Iberdrola’s acquisition of Energy

¹ Joint Petitioners are: Energy East Corporation (“Energy East”), New York State Electric and Gas Corporation (“NYSEG”), Rochester Gas & Electric Corporation (“RG&E”), Iberdrola, S.A. (“Iberdrola”), RGS Energy Group, Inc. and Iberdrola’s wholly-owned subsidiary Green Acquisition Capital, Inc.

² Case 96-E-0900 *et al.*, *In the Matter of Orange & Rockland Utilities, Inc.’s Plans for Electric Rate Restructuring Pursuant to Opinion 96-12*, Appendix I, Statement of Policy Regarding Vertical Market Power (July 17, 1998) (hereinafter “VMP Order”; Appendix I, hereinafter “VMP Policy Statement”); IPPNY Initial Brief at 14.

East (the “Transaction”), the Commission should (i) require Joint Petitioners to divest all of NYSEG’s and RG&E’s generation within nine months of the Commission’s order; (ii) prohibit Joint Petitioners and their affiliates from owning or acquiring any electric generation interconnected with RG&E’s or NYSEG’s transmission or distribution system,³ unless ordered by the Commission; and (iii) prohibit Joint Petitioners and their affiliates from owning or acquiring electric generation in New York that is subject to cost-based rate regulation, unless ordered by the Commission.

In their initial brief filed on April 11, 2008, Joint Petitioners argued, *inter alia*, that the Transaction raises no vertical market power issues and therefore Joint Petitioners should not be required to divest NYSEG’s and RG&E’s hydroelectric generation and should not be prohibited from owning wind generation interconnected to the transmission or distribution systems owned by NYSEG and RG&E.⁴ In its initial brief, the New York State Consumer Protection Board (“CPB”) argued that Petitioners’ PAD goes far enough to satisfy vertical market power concerns with existing generation.⁵ Further, CPB argued that, because NYSEG and RG&E were not previously required to divest their hydroelectric assets, which provide the consumer benefit of low cost power, divestiture of the hydroelectric facilities must be justified on a substantive basis.⁶ As discussed in IPPNY’s Initial Brief and further discussed below, the record evidence

³ IPPNY carefully identified and demonstrated that Joint Petitioners’ would have the opportunity to exercise vertical market power if they own generation interconnected to the NYSEG or RG&E electric delivery systems -- either the transmission or distribution system. The voltage level at which the generation is interconnected is not the determining factor of whether vertical market power can be exercised.

⁴ Initial Brief of Joint Petitioners at 50, 57 (“JP Initial Brief”).

⁵ CPB Initial Brief at 5.

⁶ CPB Initial Brief at 8-9.

demonstrates that Joint Petitioners' ownership of both generation and T&D creates the incentive for the exercise of vertical market power that can only be eliminated by total divestiture of generation. Guarding against vertical market power is a hallmark to ensuring a competitive energy market and the benefits of the competitive market.

In their initial briefs, the New York State Department of Environmental Conservation ("DEC") and Natural Resources Defense Council ("NRDC") request that the Commission ensure that the State's goals for increased renewable energy are implemented in its decision making process on the Transaction. By adopting IPPNY's position in this case, the Commission can further the State's public policy goals while restricting Joint Petitioners' ownership of generation to ensure consumers are protected from vertical market power. Further, divestiture of NYSEG's and RG&E's hydroelectric generation will benefit customers because they will receive the proceeds of the divestiture and will not bear the costs of upgrades to these facilities, cost overruns, and the risks thereof.

I. JOINT PETITIONERS HAVE FAILED TO REBUT THE PRESUMPTION THAT THE TRANSACTION WILL PROVIDE THEM WITH THE INCENTIVE AND ABILITY TO EXERCISE VERTICAL MARKET POWER.

In their Initial Brief, Joint Petitioners argue that the record shows that the 1998 VMP Policy Statement's presumption that ownership of generation by a T&D company affiliate would unacceptably exacerbate the potential for vertical market power is inapplicable or has been satisfactorily rebutted.⁷ Joint Petitioners state:

(1) affiliates of Iberdrola Renewables currently own and plan to construct amounts of wind generation in New York that do not raise market power concerns, particularly given that all of this generation consists of intermittent wind power projects unable to influence market-clearing prices or congestion in the New York Independent System Operator, Inc. ("NYISO") markets; and (2) any lingering vertical market power concerns regarding this intermittent wind

⁷ VMP Policy Statement at 1-2.

generation are fully addressed by the robust measures implemented by the NYISO and the FERC.

....

Iberdrola's proposed affiliation with NYSEG and RG&E does not raise the concerns identified in the Commission's VMP Policy Statement. Iberdrola Renewables' existing and planned generation is on the low-price, unconstrained side of the Central-East constraint, and the Commission's concerns are therefore not present with respect to the proposed affiliation between Iberdrola and Energy East's TOs in New York (Tr. 820-21).⁸

Before addressing Joint Petitioners' arguments that their proposed wind projects raise no vertical market power concerns, it is important to note that Joint Petitioners have not argued that the VMP Policy Statement's presumption is rebutted with respect to generation technologies other than wind and hydroelectric generation that may be interconnected to RG&E's or NYSEG's T&D systems in the future. Similarly, Joint Petitioners did not respond to IPPNY's record position that Joint Petitioners and their affiliates should be prohibited from developing generation subject to cost-of-service regulation. Having failed to raise these arguments in their initial brief, the Commission should, at a minimum, prohibit Joint Petitioners and their affiliates from owning any fossil or nuclear generation interconnected to NYSEG's or RG&E's T&D systems and any cost-of-service regulated generation anywhere in the State.

Joint Petitioners argue that Iberdrola's planned wind development interconnected to NYSEG does not raise vertical market power concerns because wind is intermittent and the proposed projects are on the low-price, unconstrained side of the Central-East constraint.⁹ Joint Petitioners argue that, therefore, this generation will be unable to influence market clearing prices or congestion in the NYISO markets. Joint Petitioners' argument only addresses one potential way to exercise vertical market power. As Mr. Mark Younger demonstrated in his

⁸ JP Initial Brief at 49, 52.

⁹ *Id.* at 50-52.

testimony, there are other ways that Joint Petitioners can exercise vertical market power that are unrelated to the incentive to influence market clearing prices or congestion. Mr. Younger testified:

For example, [the Joint Petitioners] could make it easier for their own facilities to interconnect to their transmission systems while making it harder for their competitors to do so. The operation of the generating facilities requires ongoing interaction between the generators and the local T&D company to resolve issues related to operation and delivery. If the T&D company also owns generation, there will always be the potential that issues related to its own generators are resolved faster than the same issue for merchant generators and/or that the T&D company finds cheaper ways of resolving issues for the company's own generation than for its competitors. Since each issue with each generator is unique, it will be virtually impossible to determine whether the T&D company is treating all generation in a fair and equivalent manner (Tr. 917).¹⁰

As IPPNY discussed in its Initial Brief, the Commission recently rejected the argument, now made by Joint Petitioners, that regulatory measures available to the NYISO and the Federal Energy Regulatory Commission ("FERC"), which were not in place when the VMP Policy Statement was issued in 1998, are adequate to mitigate vertical market power concerns.¹¹ In the National Grid/KeySpan proceeding, the Commission reaffirmed its long-standing policy that divestiture, not regulation, is the best means to minimize market power abuse because vigilant regulatory oversight cannot timely identify and remedy all abuses.¹² Joint Petitioners have failed to offer any sound reasons why the Commission should depart from its long-standing policy in this case. To ensure that the energy markets in New York State remain competitive, it is

¹⁰ IPPNY Initial Brief at 13.

¹¹ *Id.* at 14.

¹² *Id.* at 15 (citing Case 06-M-0878, *Joint Petition of National Grid PLC and KeySpan Corporation for Approval of Stock Acquisition and Other Regulatory Approvals*, Order Authorizing Acquisition Subject to Conditions and Making Some Revenue Requirement Determinations for KeySpan Energy Delivery New York and KeySpan Energy Delivery Long Island (September 17, 2007) at 129 ("Grid/KS Merger Long Order") (citing VMP Policy Statement, p.1)).

important that the Commission reiterate its commitment to divestiture as the best means to guard against the creation of incentives for the use of vertical market power.

CPB argues in its Initial Brief that “as a matter of equity, there is no justification for treating Iberdrola differently than any current transmission owner. NYSEG and RG&E can, today, through unregulated subsidiaries, seek to construct wind generation projects inside or outside their service territories, as can National Grid, Consolidated Edison and Central Hudson.”¹³ CPB fails to recognize an important distinction between Iberdrola and the other T&D utilities it mentions.¹⁴ Since the Commission announced its policy in 1996 that generation should be separate from T&D, no T&D utility, other than Con Edison with its construction of generation primarily to serve its steam customers, has sought to build new generation in the State. In contrast, Iberdrola has stated on the record that they will aggressively seek to construct as many wind generation projects in the state as possible (Tr. 688). Indeed, Iberdrola has proposed three projects that would interconnect with NYSEG (Exh. 57).

As IPPNY explained in its Initial Brief and as recognized by CPB, these three units are “alternative energy production facilities” under PSL § 2(2-b) and therefore would not be subject to the Commission’s jurisdiction (PSL § 2(13)).¹⁵ Contrary to CPB’s argument that these projects do not raise any “legally cognizable vertical market power concerns,”¹⁶ Joint Petitioners would have an incentive to provide favorable interconnection and delivery service to these projects, as Mr. Younger explained in his testimony. While the Commission may not have

¹³ CPB Initial Brief at 12.

¹⁴ CPB also fails to recognize that National Grid agreed in its merger case with KeySpan that it would not build new generation (Grid/KS Merger Long Order at 64).

¹⁵ Mr. Hieronymous conceded this point (Tr. 882).

¹⁶ CPB Initial Brief at 12.

authority to prohibit construction of alternate energy production facilities, it certainly has the authority to prohibit a T&D utility subject to the Commission's jurisdiction from using its T&D system to favor its own and its affiliates' generation.¹⁷

A blanket prohibition, rather than a case-by-case prohibition, on the ownership of generation interconnected to NYSEG or RG&E is the best means to ensure that there are no incentives to exercise vertical market power. Regulatory oversight is extremely difficult and inefficient to apply on a case-by-case basis. In its Order requiring National Grid to divest the Ravenswood generation facility, the Commission reiterated its vertical market power policy: "it prefers divestiture as the means to minimize market power abuse because vigilant regulatory oversight cannot timely identify and remedy all abuses."¹⁸ Contrary to the suggestion of Joint Petitioners,¹⁹ a NYISO or FERC imposed financial penalty may not be adequate to prevent future market power abuse, and, in any event, it would not cure the effects of the market power abuse.

If the Commission does not act to impose a blanket prohibition on ownership of generation interconnected to NYSEG's and RG&E's T&D systems in the face of Iberdrola's stated plans to develop projects interconnected to NYSEG's system, the Commission will open the flood gates to the State's other T&D utilities developing new generation. Allowing Joint Petitioners to develop new generation connected to NYSEG's and RG&E's T&D systems if the merger is consummated would represent a marked and unsupportable departure from a

¹⁷ In its order approving the merger of KeySpan and National Grid, FERC stated that the "New York Commission is the appropriate body to determine whether the merger is consistent with the New York Commission's 1998 [VMP] Policy Statement." *National Grid plc, KeySpan Corporation*, 117 FERC ¶ 61,080 at ¶ 48 (2006).

¹⁸ Grid/KS Merger Long Order at 129 (citing VMP Policy Statement, p.1).

¹⁹ JP Initial Brief at 55-56.

successful and longstanding Commission policy and would signal to the market the weakening of the Commission's resolve to ensure the continued development of competitive energy markets in New York.

II. LIMITATIONS ON JOINT PETITIONERS' AND THEIR AFFILIATES' OWNERSHIP OF GENERATION ARE CONSISTENT WITH PUBLIC POLICY AND ARE IN THE PUBLIC INTEREST.

The Commission's VMP Policy Statement provides an opportunity to overcome its rebuttable presumption:

To guard against undesirable incentives, a rebuttal presumption will exist for purposes of the Commission's Section 70 review of the transfer of generation assets, that ownership of generation by a T&D company affiliate would unacceptably exacerbate the potential for vertical market power. To overcome the presumption the T&D company affiliate would have to demonstrate that vertical market power could not be exercised because the circumstances do not give the T&D company an opportunity to exercise market power, or because reasonable means exist to mitigate market power. Alternatively, the T&D company would need to demonstrate that substantial ratepayer benefits, together with mitigation measures, warrant overcoming the presumption.²⁰

Joint Petitioners have not demonstrated that there are adequate means to mitigate market power. For example, as demonstrated above and in IPPNY's Initial Brief, NYSEG or RG&E, through action or inaction, could favor their own or an affiliate's generation interconnected to the NYSEG or RG&E transmission or distribution system, and such action or inaction would be difficult to detect. Further, contrary to Joint Petitioners' assertion that a limitation on ownership of generation would have a chilling effect on investment, the potential chilling effect on investment is more likely to occur in NYSEG's and RG&E's service territories if they are permitted to continue to own generation or interconnect affiliate generation. Other developers may be less inclined to invest in new generation or energy efficiency measures because of the risk that NYSEG or RG&E may exercise vertical market power. For the same reasons, DEC's

²⁰ VMP Policy Statement at 1-2.

and NRDC's support for the Transaction is misplaced. The Commission's and the State's goals favoring renewables will not be undermined by the restrictions urged by IPPNY because there are many competitive developers, unaffiliated with companies owning T&D in New York, that are moving forward with renewable projects.

With the competitive marketplace that the Commission has long favored, there are many benefits, including reduced prices, customer choice of service options, including energy efficiency measures, and enhanced economic growth. Guarding against vertical market power is critical to ensuring a competitive market place and realizing the benefits thereof. Accordingly, a limitation on generation ownership is consistent with and in furtherance of the State's public policies.

III. DIVESTITURE OF NYSEG'S AND RG&E'S HYDROELECTRIC GENERATION WILL BENEFIT CONSUMERS AND IS IN THE PUBLIC INTEREST.

Joint Petitioners and CPB argue that the issue of whether NYSEG and RG&E should be required to divest their hydroelectric generation is unrelated to the Transaction because the "plants are already in the hands of entities that own and operate transmission and distribution systems."²¹ As IPPNY demonstrated in its Initial Brief, divestiture of all generation interconnected with NYSEG's and RG&E's T&D systems, including NYSEG's and RG&E's hydroelectric facilities, is necessary to protect consumers from the potential exercise of vertical market power. The fact that the hydroelectric facilities are already owned by the T&D utilities is not a rational basis for the Commission to ignore the potential harm Joint Petitioners could inflict on consumers by favoring the hydroelectric facilities over their competitors' generation. As discussed above, Iberdrola is proposing to develop generation that would interconnect with NYSEG's T&D system. The Commission should review Joint Petitioners' existing generation

²¹ CPB Initial Brief at 9.

portfolio and the potential ownership of new generation to determine how best to mitigate the potential exercise of vertical market power. In that regard, the Commission can best ensure that consumers will realize the benefits of competition.

Divestiture of the hydroelectric facilities is also in the public interest because it will allow the facilities to be upgraded with private investment dollars rather than captive ratepayer dollars. The viability of a new owner of RG&E's hydroelectric facilities increasing their capacity is demonstrated by RG&E's announcement on April 4, 2007 that it "plans to invest more than \$20 million over the next three years in its ... hydroelectric plants on the Genesee River in the City of Rochester [which] will result in additional generating capacity of 9 megawatts (mw) at the two plants that currently have a combined generating capacity of approximately 49 mw."²² As IPPNY explained in its Initial Brief, ratepayers will ultimately be put at risk of shouldering any cost overruns of such projects if RG&E or NYSEG perform the upgrades. In the case of a merchant developer performing the upgrades on a project it owns, the developer shoulders the risks and the cost overruns, not consumers. Further, because a merchant developer must rely on the market to cover its costs and produce revenue, they are forced to be more efficient (Tr. 903). Moreover, Joint Petitioners' have not demonstrated that their continued ownership of the hydroelectric facilities results in "substantial ratepayer benefits," as required to overcome the vertical market power rebuttable presumption against generation ownership.²³

²² See RG&E press release, April 4, 2007, "RG&E to Invest Millions in Upgrading Hydroelectric Plants," available at, <http://www.rge.com/OurCompany/News/news04042007.html> (last visited April 25, 2008).

²³ VMP Policy Statement at 2.

CONCLUSION

For the above reasons and those provided in IPPNY's Initial Brief, IPPNY respectfully requests that Your Honor recommend that the Commission impose the conditions set forth in IPPNY's Initial Brief if it approves the Transaction.

Respectfully submitted,

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