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.

Reply Brief

On behalf of

Strategic Power Management, LLC

Dated: April 25, 2008

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Introduction

Initial Briefs were addressed to Judge Rafael Epstein by the Joint Petitioners, Staff, Independent Power Producers of New York (“IPPNY”), the New York State Rural Electric Cooperative Association and the Village of Sherburne (“Rural Coops”), Nucor Steel Auburn, Inc. (“Nucor”), the Department of Environmental Conservation (“DEC”), the Consumer Protection Board (“CPB”), Empire State Development Corporation (“ESD”), Multiple

Interveners (MI”), and the National Resources Defense Council (“NRDC”).

For the most part, except for Staff, all parties support the acquisition of Energy East by Iberdrola. Staff has taken the position that as a result of merger approvals in the last 10 years the Commission has effectively rewritten the public interest standard of Section 70 of the Public Service Law to require “substantial monetary” or “tangible ratepayer” benefits. The Public Service Law does not require the Commission to approve a merger only if there are “substantial monetary benefits”. All that is required is that it be shown that the merger is in the public interest. Under the law, water companies are no different than any other public utility in New York and it is clear that case law demonstrates that the public interest test is not satisfied only by substantial monetary benefits.

To buttress its position Staff discusses numerous risks if this transaction is completed without the conditions it recommends. There are the holding company, hostile takeover, credit rating, goodwill, and capital structure risks. While Strategic Power Management, LLC (“SPM”) believes Staff's risk assessment is somewhat overstated, to say the least, the conditions Staff has recommended and the Joint Petitioners have accepted neutralize or at least substantially minimize these risks. There are still disagreements between Staff and Joint Petitioners on how far some of the conditions proposed by Staff need to go to provide the appropriate protections from the foreseeable risks. Objectively the distance between the Staff and Joint Petitioners on these issues is rather small compared to the gulf on vertical market power and PBAs.

Before addressing Staff's risk scenarios, a few observations about the regulatory compact in New York are in order. Staff states "No such thing as the regulatory compact, however, exists in New York," citing Energy Ass'n v. Public Service Commission, 169 Misc. 2d 924, 938 (Sup. Ct. Alb. Cty. 1996). If Staff means that utilities in New York are not guaranteed recovery of prudently incurred stranded costs no matter what the current rates are producing for shareholders as one of the issues discussed in Energy Ass'n, then SPM agrees. However, SPM interprets the regulatory compact in New York to mean that

> When the wheat is separated from the chaff, the one immutable rule of ratemaking comes down to this: Is the 'end result' 'just and reasonable' – and fair as between the utilities' customers and stockholders. That is a determination of the regulatory body, subject only to the prohibition against arbitrary and capricious decision making. The courts must otherwise defer to the expertise of the regulatory body!

Energy Ass'n at 941. SPM further observes that the regulatory compact comes into play primarily in the ratemaking arena. It is not typically associated with Section 70's public interest test, per se[1].

But if this merger is to be conditioned on rate adjustments, then the regulatory compact is directly triggered and Your Honor must determine if the end result, i.e., the new rate levels, are just and reasonable. SPM submits that there is insufficient evidence on this record to make that determination which is why such an analysis should be left to future rate proceedings where all factors can be considered. It appears Staff finally agrees, as well. See Staff Brief at page 170 to 172.

Staff's PBA menu, as discussed, is proposed as a pragmatic means to an end. And it has served that end by the Joint

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1 But it does come into the broad public interest standard as defined by International Railway Company v. Public Service Commission, 264 AD 506 (3rd Dept. 1942) to the extent that just and reasonable rates are always required.

> 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.)

Petitioners concessions. Exhibit 50. To select any or all PBAs not already conceded is arbitrary and capricious since there is no real way such a selection can balance fairly the interests of the ratepayers and the stockholders. Virtually all of the PBAs have been vetted. So forcing stockholders to write off deferred assets without justification because Staff believes such is required under the public interest test is pushing too far and risks the departure from New York of an exceptionally sound company. That is not a theoretical risk, but one that is quite real.

Theoretical Risks

1. Holding company risk. In Staff's Initial Brief there are four aspects of the holding company risk that are discussed. First, Staff cites several regulatory compliance issues that Iberdrola subsidiaries had to confront since 2000. Staff points to 26 interconnection complaints and two anti-competitive problems. Staff Initial Brief ("Staff IB”) at 41. Staff expresses concerns about Iberdrola’s ability to prevent similar abuses from occurring in New York.

Staff also expresses concern about delays in translating Spanish documents for Staff review. Staff concludes that "if this transaction is approved, enforceable conditions are needed to ensure that Staff can access, in English, the information necessary for assuring that Iberdrola will use fair business practices in New York, and that its operations and corporate relationships will be transparent to inquiries and investigations." Staff IB at 42.

As will be seen, a combination of conditions agreed to by the Joint Petitioners and recommended by Staff will meet these concerns.

The second risk in this category is the unregulated subsidiary risk. Here Staff argues that because Iberdrola owns a wide variety of domestic and foreign, regulated and unregulated, businesses it will have a greater incentive to pass costs from unregulated businesses to regulated businesses for recovery from ratepayers. Staff further argues that the incentive for improper cross subsidization is greater under Iberdrola’s structure than Energy East's structure since Energy East has proportionately more subsidiaries which are domestic utilities. SIB 42 to 43.

SPM does not understand the logic behind this argument since the incentive for unregulated businesses in the family to lean on regulated businesses is not necessarily dependent on the number of those businesses but on the unregulated businesses operating results. And it is not just a one-way street. Utilities that are over-earning may seek to absorb enterprise costs to avoid having their rates reduced. Nevertheless, the conditions that have been recommended will eliminate this concern.

The third risk in this category is called complexity risk which Staff further subdivides into the scope and scale of operations and Gamesa and Community Energy. Here Staff expresses concerns that “[t]he bewildering array of subsidiaries and ownership relationships laid out in the [organizational] chart speaks for itself as a vivid presentation of the vast reach and extent of Iberdrola’s operations, and the scope and variety of its businesses." Staff IB at 44.

What Staff fails to appreciate is that the diversity of Iberdrola’s operations both geographically and categorically reduces risk to the overall enterprise much like a diversified portfolio reduces risk for the investor. Despite the Iberdrola lack of voting power in Gamesa, Staff insinuates that this affiliation gives rise to the exercise of market power. SPM offers proposals that will eliminate the incentive to exercise market power later in this Reply Brief. With respect to Community Energy, Staff asserts that this pre-merger agreement contract now violates existing codes of conduct. If Staff is correct, then the merger should be conditioned on modifying that contract to enable compliance or alternatively discontinuation of the arrangement.

The fourth and final category of risk from Staff’s perspective is termed confidentiality risk. In this category Staff states it will have difficulty in overseeing the jurisdictional operating companies because of Iberdrola’s alleged propensity to over designate information as being confidential. SIB at 47 – 49. SPM suggests that part of Staff’s concern with Iberdrola in this area stems from a difference in business cultures between Europe and the United States. The quest for transparency in the United States may be ahead of the European experience. Nevertheless, the conditions that have been recommended should eliminate this concern.

2. Hostile Takeover Risk. Even if one were to assume that this risk was imminent, which it does not appear to be, it is clear that Section 70 review would be triggered and the Commission would have the opportunity to look at the situation and make a determination as to whether or not the acquiring entity was a suitable owner in the public interest. No party takes issues with this interpretation of the Public Service Law. So this risk which Staff discusses at pages 49 to 52 of its Initial Brief is not a risk at all but simply an acknowledgment

that if a takeover were to occur then a new and different Section 70 proceeding would be awaiting the parties.

3. Credit Rating Risk. Staff downplays the benefits of the equity funding of this acquisition maintaining that the acquisition of Energy East's goodwill coupled with the goodwill created in this transaction squanders that benefit. Staff IB at 53. Staff also argues that Iberdrola's credit ratings are in a declining trend. Staff IB at 54. However, the rating agencies, upon the completion of the Renewables IPO, have maintained the ratings characterizing them as stable. This hardly looks like a declining trend. To enhance the credit rating risk, Staff conjures all sorts of future scenarios that could impair the credit rating.

Increasing dividends while pursuing an aggressive investment program is one such scenario. Staff ignores the fact that Iberdrola has committed itself to maintaining its existing credit ratings.

> While there is no way of predicting future events that could impact Iberdrola's credit rating, Iberdrola is unquestionably committed to undertaking all reasonable efforts to maintain its current "A" category ratings. Quite simply, doing so is good for Iberdrola's business, and for its customers and shareholders.

SM at 510.

Pursuing opportunities outside of its Strategic Plan is another troubling scenario to Staff. Staff IB at 55. SPM sees the ability to seize opportunities when they present themselves as highly desirable contrasted with being hidebound to a formal Strategic Plan[2].

Ironically, Staff expresses concerns that deterioration in Iberdrola's credit ratings will adversely affect the New York operating companies. How then does Staff balance that concern against its $854 million PBA position which will certainly be considered enormously negative by the rating agencies, especially given their views of the last NYSEG rate case? Perhaps Staff's fears about deteriorating credit ratings are more an acknowledgment of what will occur if its PBA position were adopted than Iberdrola's propensity to get itself into financial hot soup.

Vertical Market Power

The vertical market power issue has been comprehensively briefed by the parties from every conceivable angle. SPM does not see as a practical matter how Iberdrola would be able to exercise vertical market power and get away with it even if it were foolish enough to be so inclined. SPM is supportive of the

2 If you want to make God laugh tell her your plans.

DEC’s position as testified to by J. Jared Snyder, Assistant Commissioner for Air Resources, Climate Change and Energy.

> We would like to suggest that the PSC not automatically foreclose Iberdrola’s development and ownership of wind energy holdings in New York State and that it find a way to work with Iberdrola in encouraging more wind energy projects.

SM at 112. Trying to “find a way”, SPM offers for Your Honor’s consideration additional conditions to mitigate vertical market power.

Any Iberdrola affiliate wind generation project, before it can interconnect with NYSEG’s or RG&E’s transmission system, must agree to a long term contract with pricing based on a cost of service formula or rate. The power purchased by NYSEG or RG&E would be solely for physical delivery to NYSEG and RG&E customers. NYSEG and RG&E could not resell it. The fixed rate with future O&M adjustments would be designed to compensate the equity investor for the risk of a wind project. In other words, the rate of return on equity would be higher than that which is appropriate for a fully regulated pipes and wires business. How much higher would be based on negotiation or a Commission determination at the time the project seeks authorization in order to support financing. There would be no guaranteed monthly payment. All project revenues would derive from a $/MWH charge so the project developer would literally be at the mercy of the wind.

In order to avoid the potential benefit a project under contract would have compared to other projects that would experience market based rates, a non-Iberdrola affiliate would have an option to take a cost of service contract with NYSEG and RG&E[3] on the same terms and conditions as the Iberdrola affiliate or to take the market option. This election would have to be made up front and will be permanent. Switching between the market and contract rate would not be allowed to avoid gaming the system. Finally, a special monitor could be appointed or the NYISO Market Monitor could be requested to oversee all interconnection requests and the progress thereof to ensure a level playing field.

This contract condition and interconnection oversight for Iberdrola wind affiliates proposing to interconnect with NYSEG and RG&E transmission systems should cure any vertical market power concerns that Staff, IPPNY, other parties or Your Honor may have while enabling Iberdrola to carry out one of its central missions. This condition would place this transaction in a form that is comparable to the National Grid – KeySpan

3 Obviously, some limitation on the amount of wind power projects would have to be discussed.

transaction where KeySpan owned substantial generation on Long Island under contract to LIPA.

A second alternative would be to require an Iberdrola affiliate to contract all output to a third party at a fixed price. This would also avoid any vertical market power incentives that have been discussed.

A third alternative is to condition the merger on the sale of NYSEG and RG&E transmission assets.

SPM offers these alternative conditions, notwithstanding that its primary recommendation is that Your Honor need do nothing more than to remind Iberdrola that the Commission's Vertical Market Power Policy Statement is in full force and effect and will have to be honored should an Iberdrola affiliate generating project be considered for interconnection with NYSEG or RG&E transmission systems.

Banning Iberdrola affiliated wind generation from New York State is far too draconian a remedy and totally inconsistent with the State's RPS and EEPS goals. Regulation should be even handed and balanced against the goals to be achieved[4]. History

4 In that regard it is instructive to note that Iberdrola affiliate generation in the Maple Ridge and Jordanville projects amounts to 259 MWs. If one assumes a wind generator capacity factor of 30% (See Exhibit 19, IBER-0205) then one can expect output of 680,652 MWHs annually from these projects. To place

teaches that too heavy a regulatory hand actually harms the ratepayers intended to be protected. Rather than simply taking advantage of this merger as an opportunity to arbitrarily reduce distribution rates, Your Honor should "explore alternatives that would allow the state and its citizens to take advantage of Iberdrola's vast wind energy experience." SM at 113.

On April 23, 2008 the Commission issued a press release quoting Chairman Garry Brown:

> The generation of electricity from renewable sources increase energy diversity and promotes a better environment for us all … It is critically important to strengthen and promote renewable energy and other types of earth-friendly initiatives in New York. These are fundamental initiatives that will benefit us all in the future.

In view of the critical importance Chairman Brown places on renewables, does it not make sense to try to find a way to "take advantage of Iberdrola's vast wind energy experience"? Or does

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this number in context according to the NYISO 160,209,000 MWHs was the New York State load in 2004. So the entire output of the affiliate wind projects amounts to 0.42% of the state load (as of 2004). Obviously, the Joint Petitioners would not be able to exercise vertical market power over all output. So let's say they are able to exercise market power over 10% (or 0.042% of the state load) and further assume that such exercise of VMP will garner them $5 per MWH of additional revenues. This will produce ill gotten gains of $340,326 per year assuming Iberdrola owns 100% of both projects. Does this *de minimus* potential justify a complete ban on wind power development by Iberdrola? Would anybody be so dumb to try to exercise VMP when its payback is so tiny?

Staff consider itself immune from the Chairman’s views and goals?

Merger Conditions

While continuing to assert the transaction should be rejected, Staff nevertheless recommends that certain conditions be incorporated in any Commission approval. Broadly, Staff recommends three categories of conditions: (1) tangible ratepayer benefits; (2) complete divestiture of all generation (along with a ban on Iberdrola developing wind projects in New York)to address vertical market power issues and (3) the imposition of certain financial and structural conditions to protect the regulated utilities from the risk of being affiliated with Iberdrola.

In SPM’s Initial Brief it was observed that Your Honor has no basis for selecting among the PBA menu provided by Staff. SPM IB at 12 to 23. The companies agreed to $201.6 million of PBAs which have an associated annual revenue requirement decrease of $54 million. SPM recommends that those benefits be implemented immediately upon closing or as soon thereafter as possible.

To bridge the gap between Iberdrola’s offer and Staff’s recommendation, SPM suggested taking 50% of the Staff position less the $201.6 million PBA concession and making the revenue requirement effect of that amount subject to refund. SPM IB at 27 to 29.

Staff's PBA position was invented as a proxy for the unknown synergy savings that would probably materialize at some level and, one could argue, as a reprimand for not submitting a synergy savings analysis.

Finally, it should be observed that Staff has not attempted to quantify how its $854 million in PBAs offset the perceived risks to enable Your Honor to determine whether this transaction is in the public interest. It is simply a number that comes close to 50% of the alleged benefits of $1.6 billion which flow to shareholders via the stock purchase premium; and to Energy East executives and advisors as fees and change in control payments; and to Iberdrola via Spanish and federal tax advantages. Staff has agreed that to the extent these benefits are not available then the justification for the level of PBAs recommended is reduced proportionately.   All of the Staff alleged benefits are not benefits in an economic sense that can be used to justify any PBAs, as pointed out by Joint Petitioners and SPM in their Initial Briefs. Furthermore tangible ratepayer benefits are not required under the public interest test. See SPM IB at 12 to 23.

There is testimony that the Staff position would harm the very utilities that Staff seeks to shelter by its conditions. See Joint Petitioners Rate Adjustment Panel, SM at 319 to 411 generally and specifically at SM 329 showing the <u>highest possible</u> return on equity expected for RG&E's electric business is a mere 2.4% five years later.

That is somewhat ironic result if Staff wants to protect the credit ratings of RG&E.   Moreover, Your Honor is asked to review unredacted page 113 of Staff's Initial Brief to obtain further support for what would be considered an appropriate range of synergy savings derived from similar transactions that involved the merger of operating companies on both sides.

The synergy savings that were analyzed in the National Grid-KeySpan merger were the result of combining the operations of three New York operating companies, NMPC, KEDLI and KEDNY. So it is unfair to openly speculate on the potential but unknown existence of synergy savings and then use a case where everyone agreed there would be significant synergy savings as a yard stick for this transaction. It is as illogical as expecting the next college athlete to walk into the gym to be five feet six inches simply because the prior athlete was five feet six inches tall. The extraordinary conditions placed on the National Grid – KeySpan merger were deemed necessary due to the nature of that merger, the financial conditions of the companies, the fact that the acquisition was based 100% on leverage, etc. Here Staff suffers from denial and appears to refuse to acknowledge that Iberdrola is not National Grid.

Ultimately, if synergy savings materialize, the ratepayers will get the benefit. Furthermore, synergy savings do not occur immediately at the closing. Time is required even when there are operating companies involved on both sides of the transaction in the same jurisdiction or region. In view of the rate plans that will be required, the Joint Petitioners could be requested to submit a study of synergy savings as part of the next rate cases. If they do not provide such information, then Staff's or other parties' synergy savings adjustments or proxies can be used by the Commission.

Using the Central Maine merger approval from the Maine Commission to demonstrate tangible rate payer benefit (see Staff IB at 124) misses the mark as well. Forgoing the $306 million acquisition adjustment is the equivalent of saying one just saved $65,000 because you did not buy a Mercedes. Virtually, no state commission requires ratepayers to pick up in rates the premium paid in a utility acquisition. Regarding Maine, Staff does make a good point which supports some of its conditions, that the law in Maine enables post-merger divestiture where that is not an option here if Iberdrola gets into trouble. Staff IB at 125.

SPM will not further debate the lack of merit to the PBAs since that debate should be held in a full blown rate case and urges Your Honor to avoid that trap as well in the Recommended Decision. Even Staff recognizes that rate plans are required after the merger is approved and provides in over 50 pages of its Initial Brief a good laundry list of the issues that need to be resolved in those plans, e.g., PBAs, software costs, over-earnings, standby deferral, storm costs, capital structure, rate of return, etc. See Staff IB at 170 to 223.

Iberdrola Partial Acceptance

Staff claims that the substantial concessions that the Joint Petitioners have made are "entirely inadequate since it does not adequately compensate for the cost and risks associated with this transaction (SM 1456). " The problem with Staff's "entirely inadequate" position is that the perceived risks are not quantified and probably unquantifiable. Staff does not even posit a probability of occurrence of its alleged risks so it is quite impossible to weigh the potential risks against the enormous PBA position. As we have seen, the $1.6 billion in benefits cannot be justified under rational economic analysis or Commission precedent. So this is a double boot strap. Staff raises the shibboleth of unimaginable consequences to NYSEG and RG&E based on the “risks” Iberdrola brings to the table and then commendably devises conditions to mitigate those risks. However, Staff goes too far demanding huge rate concessions that are likely to harm the companies and ratepayers Staff seeks to protect. At the very least, prudence dictates that before such extensive write-offs and write-ups are required their effects should be fully tested and analyzed in rate cases.

Iberdrola did not have to offer any concessions to meet the public interest test, but demonstrating its good faith to meet some of Staff’s concerns, provided substantial benefits by way of rate reductions associated with the accepted $201.6 million of PBAs, the commitment to invest a minimum of $100 million in wind generation in New York along with the promise to divest all fossil generation, including unregulated generation.

Ironically, Staff gives the Joint Petitioners almost no credit, literally or figuratively, for this concession. Certainly, there will be cash coming in from the divestiture of generation that will benefit both shareholders and ratepayers under traditional sharing formulas.

Credit Quality

It appears that the Joint Petitioners have agreed to or are very close to accepting the five conditions Staff espouses for the maintenance of credit quality. See Staff IB at 139. Joint Petitioners IB at 5. There are some minor disagreements over whether Iberdrola will provide the supporting data for rating agency presentations, whether it should submit a plan to remedy a downgrade or whether ratepayers should be insulated from downgrades that are occasioned not by Iberdrola but by Commission action.

SPM recommends that the underlying data and workpapers to credit agency presentations be provided to Staff on a confidential basis and to submit a plan to remedy the situation in the event of a downgrade or warning. The Joint Petitioners do not have any credible grounds to deny the Commission this information.

If the Commission takes actions to cause a downgrade of NYSEG or RG&E, the customers of those companies should not be insulated from the effects of that downgrade if solely occasioned by the Commission. Otherwise one creates perverse incentives where the Commission is rendered unaccountable for populist ratemaking.

In the main, Staff's conditions appear reasonable and appropriate and should be adopted by Your Honor.

Dividend Restrictions

Staff sets forth five dividend restriction conditions. Staff IB at 143 – 144. SPM believes these restrictions are appropriate and urges Your Honor to adopt them as conditions to the merger approval.

Money Pool Arrangements

As with the Credit Quality conditions, Staff and the Joint Petitioners are not all that far apart with respect to the proposed money pool conditions. See Staff IB 146 – 147. Joint Petitioners silence on the indirect loan prohibition should be interpreted as acceptance. Staff's cross-default language should be adopted as it was in the National Grid – KeySpan transaction to protect NYSEG and RG&E.

Staff's Golden Share Condition

SPM agrees with Staff that a Limited Purpose Entity ("LPE") be created but solely for the purpose of keeping NYSEG and RG&E out of bankruptcy. The use of the LPE to enforce dividend and money pool restrictions, as Staff recommends, is going too far and inserts the LPE into management decisions. The Commission has more than adequate powers to remedy such violations and does not need to deputize the golden shareholder and make him or her walk a regulatory beat[5] that is properly walked by the Commission alone as required under the Public Service Law.

Staff's Structural Conditions

Staff seeks other conditions including restrictions on transactions between utilities and affiliates to prevent cross-subsidization, an updated code of conduct and enhanced financial reporting and access requirements. Staff IB at 152. Again there are minor difference between the Staff positions and what the Joint Petitioners have agreed to.

Your Honor should adopt Staff's recommendations in all three areas.

Rate Plan Issues

Staff recognizes that there is not enough time or information on the record here to develop rate plans for all four operating entities. So it recommends that rate plans be developed to be become effective on January 1, 2009. Staff IB at 171. To the extent those plans cannot be implemented by that date, then Staff recommends that its position be adopted on January 1, 2009 on a subject to refund basis. Staff IB at 172.

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5 Besides, the uniform, night stick, service revolver, pay and benefits can make this remedy quite costly, even if it were found to be within the Commission's powers.

SPM does not object to this recommendation but prefers to place one-half of Staff's PBAs less the Joint Petitioners concessions subject to refund as of the closing of the merger. First, Staff is not likely to win all of its PBA adjustments. Indeed, it would be lucky if Staff won half of the proposed PBAs. Such victories are more likely to be based on using them as a mechanism to reduce overearnings rather than based on the substantive merit of the write-off. Second, it provides an incentive sooner to complete the rate plans while preserving some benefit for the customers immediately upon the closing.

Conclusion

As expected, the Initial Briefs did not see a single party depart in any significant way from their litigation positions. What is more interesting is that for all of the numerous issues and pages and pages of testimony and exhibits the parties are not that far apart except for vertical market power and PBAs. Rate plans are needed for both companies and must be addressed whether the merger is approved, not approved or Iberdrola flees the jurisdiction and leaves Energy East at the altar.

Fortunately, Your Honor need not delve into the complicated rate arena other than to acknowledge the numerous issues that should be dealt with in those future rate plans as itemized by Staff.

The PBA controversy can be temporarily resolved or sidestepped by the 50% solution proposed in SPM's Initial Brief at pages 27 to 29.   There are a number of mitigation measures Your Honor can consider to address Staff's vertical market power concerns, which in the context of the New York market are truly *de minimus*, short of throwing the precious baby out with the bath water and ignoring Chairman Brown's goals, as discussed in this Reply Brief at pages 10 to 14.

Finally, SPM recommends, in view of its observation that the parties are really not that far apart on the vast majority of the issues in this litigation, one more attempt at negotiating a settlement that would include rate plans[6] for both companies. In that way the resulting Joint Proposal that is sent to Your Honor and the Commission will provide rate stability and a mutually beneficial resolution for the next several years so the Joint Petitioners can concentrate on improving utility operations and fostering the further development of wind generation.

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6   Staff and the Joint Petitioners if they so chose could probably engineer rate plans in a four week time frame since there does exist a tremendous amount of financial data that has been developed to date. It would be difficult, but not impossible, to whip it into rate case format to serve as the foundation for rate plans, particularly since the information, data and issues are so fresh in the minds of Staff and Joint Petitioners.

Do the Joint Petitioners to the extent they emerge "victorious" in the merger case, wish to see their benefits removed in subsequent rate cases? Is it not better to live with a known result rather than lie awake wondering what will Staff and the parties think of in the next rate cases where they will have many more months to conjure up legions of synergy savings like sheep interminably jumping over a fence. Surely that is not a scenario that will make for a good night's sleep for Energy East's new owners.

The trouble with litigation is that some parties become enamored of their position, especially when they have spent so much time and energy, doing the analyses, writing it all down and swearing to it on the record under oath. So it is to be expected that there may be a degree of stubbornness or reluctance to compromise exhibited by Staff and the Joint Petitioners both of whom no doubt think they have produced a record on which they cannot lose. Thus, neither side is likely to pick up the phone and request a final attempt to settle the case lest it be considered an admission of weakness.

Therefore, SPM requests Your Honor to suggest that the parties try again. Perhaps Your Honor could kick off the session with some thoughts of where you see the case going from your perspective. In that way, the parties might be inspired or frightened into settling this matter.

Respectfully submitted,

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Daniel P. Duthie, Esq.

Counsel to Strategic Power Management, LLC

Dated: April 25, 2008

Warwick, NY