BEFORE THE
NEW YORK STATE
PUBLIC SERVICE COMMISSION

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

Case 07-M-0906

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BRIEF ON EXCEPTIONS OF JOINT PETITIONERS IBERDROLA, S.A. AND ENERGY EAST CORPORATION

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I. INTRODUCTION AND STATEMENT OF THE CASE

Under Section 70 of the New York State Public Service Law ("PSL"), the Commission evaluates mergers under a "public interest" standard. The Commission has previously held that this standard is met if a merger would result in "positive net benefits." In determining "positive net benefits," the Commission balances the benefits and risks of a transaction, and approves the transaction if its identifiable benefits outweigh its risks. Recently, for example, in the National Grid/KeySpan merger proceeding, the Commission required certain positive benefits to outweigh the negative attributes of that transaction before granting approval.

The Commission has not limited its consideration of a transaction's benefits solely to rate-related benefits, but has also evaluated non-rate-related benefits. These non-rate benefits have included the structure and terms of a merger, the technical competence and financial strength of an acquiror, access to capital markets, and the impact of the transaction on reliability, the local economy, the environment, and employees. The Commission has found that the ability of a transaction to further certain State goals and policies, such as the development of renewable energy programs, is a benefit. The Proposed Transaction[1] offers many of these benefits, and others, which should have been, but were not, afforded any weight in the Recommended Decision ("RD").

Under a "positive net benefits" analysis, the benefits of the Proposed Transaction must be weighed against its identified risks. The Proposed Transaction presents no real risks to the State or its ratepayers. While the RD does not specify or quantify any real or anticipated risks, the RD nonetheless adopts a variety of financial and structural conditions to mitigate the

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1 The Proposed Transaction is the acquisition of the stock of Energy East Corporation ("Energy East"), the parent company of New York State Electric & Gas Corporation ("NYSEG") and Rochester Gas and Electric Corporation ("RG&E"), by Iberdrola, S.A. ("Iberdrola") (collectively, along with RGS Energy Group, Inc. ("RGS") and Green Acquisition Capital, Inc. ("Green"), the "Joint Petitioners").

hypothetical risks alleged by the Department of Public Service Staff ("Staff"). The RD recommends that these alleged risks need not be balanced against any benefits of the Proposed Transaction in a "positive net benefits" analysis, because such alleged risks already would be mitigated by the RD's proposed financial conditions.

The RD recommends that the Commission reject the Proposed Transaction because, according to the RD, the rate-related benefits to ratepayers (in the form of Proposed Benefit Adjustments or "PBAs") are not as high as the level Staff requests. The RD describes the benefits of the Proposed Transaction (including the $201 million offered by Joint Petitioners in PBAs) as not "sufficient." However, the correct test under the Public Service Law is whether the Proposed Transaction will have *any* positive net benefits (as determined by weighing the benefits and the risks), and not whether the positive net benefits meet an arbitrary level that is deemed to be "sufficient" by reference to a level of benefits demanded by a party to the proceeding.

This error should be corrected by the Commission to be consistent with its past rulings. Simply put, the Commission should approve the Proposed Transaction under a "positive net benefits" analysis, because it will indeed result in positive net benefits to ratepayers and the State.

A. Iberdrola Is A Global Leader And A Unique New Entrant In New York

Iberdrola is unlike any other Section 70 applicant that has come before the Commission. It is a unique new entrant into New York State:

- Iberdrola is a global leader in the energy industry with extensive experience owning and operating gas and electric transmission and distribution systems throughout the world. Its technical competency and management skills are not in question.

- Iberdrola has a strong "A" level credit rating and is financially stronger than Energy East, RG&E, and NYSEG.

- Iberdrola is one of the world's leading renewable energy producers in the world with over 7,000 MW of installed wind capacity, and it has the ability to quickly propel New York State into a national leadership position in renewable energy development, which would further New York's policy goal of increased renewables and reduced energy prices.

Iberdrola also has a track record of investing substantial capital in regions in which it acquires utility systems. Just like the 3 billion Euros that Iberdrola announced that it planned to invest in the United Kingdom after its acquisition of Scottish Power, Iberdrola plans to make significant investments in New York. As part of Joint Petitioners' Partial Acceptance, Iberdrola has committed in this proceeding to invest a minimum $100 million in the renewable energy industry in New York State, which will help the State's economy, particularly in Upstate New York.

B. The Proposed Transaction Provides Substantial Benefits To The State

Based on its unique attributes, the Proposed Transaction is unlike any other Section 70 transaction considered by the Commission. In most transactions, the acquiror incurs substantial debt to purchase a utility system. By contrast, Iberdrola has completely financed the Proposed Transaction by raising $4.5 billion from an equity offering. The RD disregards the all-equity payment for Energy East.

Another unique aspect of the Proposed Transaction is that it is Iberdrola's first entry in the regulated utility business in the United States, which makes Iberdrola a "first-mover." First-mover transactions like this one have numerous advantages for New York, including that, in contrast to traditional utility mergers where job reductions are the major driver of the transaction, the Proposed Transaction is not based on job reductions. Moreover, if Iberdrola acquires any other utility systems in the United States following the Proposed Transaction, New York could position itself to be part of a platform for future growth, which could actually *increase* jobs.

This analysis is consistent with recent reports and studies concluding that acquisitions of United States companies by foreign companies in first-mover transactions have a tendency to increase jobs dramatically. Earlier this week, the Wall Street Journal published an editorial confirming that, "while the goal of domestic mergers is often to gain efficiencies – eliminate duplication, trim the workforce – foreign acquisitions are more likely to lead to job creation."[2]

C. The Proposed Transaction Presents No Realistic Risks

The Proposed Transaction presents no real risks to the State or its ratepayers. The RD recommends that the Commission determine that any risks could be "neutralized" through financial and structural conditions, and therefore need not be weighed against the benefits of the Proposed Transaction. Joint Petitioners have agreed to almost all of the conditions proposed by Staff in this proceeding, including bankruptcy protection, and have therefore neutralized all of Staff's alleged risks to ratepayers, even though the alleged risks were not specified, quantified or realistic.

D. The Proposed Transaction Presents Real Quantifiable Benefits

Even though no rate-related benefits should be required to approve this transaction, Joint Petitioners have offered over $201 million of PBAs as part of their Partial Acceptance, which will immediately result in 4.4% of delivery rate reductions on average for customers of NYSEG and RG&E. Additionally, Joint Petitioners have agreed to sell all of Energy East's fossil generating facilities in New York, and to provide 90% of the "above-book" proceeds from these divestitures to ratepayers. Since most of the sales price is likely to be part of the "above-book" value because these facilities have been largely depreciated, this divestiture

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[2] Review and Outlook, WALL ST. J., June 23, 2008, at A16.

commitment is a real, tangible and ultimately quantifiable ratepayer benefit. Of course, there are numerous other benefits of the acquisition (none of which would exist absent the Proposed Transaction), including the $100 million renewable investment commitment, as well as the commitments to the Electric Cooperatives and the City of Rochester to resolve their issues.

E. The RD Rejects The Real Benefits Of The Proposed Transaction

Incredibly, the RD recommends that the Commission find that none of the benefits offered as part of the Proposed Transaction should be given any weight. According to the RD, that means that:

- The over $201 million in PBAs, and the resulting immediate delivery rate reductions of more than $54 million (or 4.4%) for customers, should be disregarded.
- The $100 million minimum renewable development commitment should not be considered.
- The commitment to divest certain fossil generation and provide up to 90% of above-book proceeds to ratepayers has no value.
- The unilateral commitments to resolve the Electric Cooperatives' and City of Rochester's concerns should not be considered.
- Iberdrola's strong financial standing, as evidenced by its "A" level credit rating, is not a positive attribute and should not be considered.
- The fact that jobs are not slated for elimination has no value.
- Iberdrola's strong experience as a global energy leader and its technical expertise should not be considered. Its experience as the leading owner and operator of renewable generation globally is irrelevant to the renewable goals of the State.
- Iberdrola's commitment to wind and renewables as a way to reduce energy costs in New York and to promote the State's "15x15" policy to encourage renewable resources is of no value.

The RD ignores the fact that none of these benefits would exist absent the Proposed Transaction.

Inexplicably, the RD finds that none of the $201.6 million in PBAs offered by Joint Petitioners should be considered a benefit of the Proposed Transaction simply because it is less than the inflated $646.4 million in PBAs proposed by Staff. In fact, the RD states that "the shortfall relative to Staff's $646.4 million prevents the petitioners' proposed concessions from being counted as a net benefit on behalf of the transaction" (RD at 54). This approach defies logic. What makes the RD's decision on this critical point all the more surprising is that it is unable to present any cogent, much less compelling reason, to accept the level of PBAs proposed by Staff. Indeed, the RD finds serious flaws in two of the three methodologies Staff used to support its PBA level and ignores the third—removing all bases for these PBA levels. The RD's embrace of Staff's proposed level of PBAs appears to be based solely on a belief that this level of PBAs "would set a salutary precedent by raising the bar for other mergers" in New York (RD at 123). The fundamental question now before the Commission is whether it wants to preclude ratepayers and the State from receiving any of the benefits of the Proposed Transaction by increasing the barriers for Iberdrola and other companies to invest in New York.

F. The RD Rejects The Real Renewable Generation Benefits Of The Proposed Transaction

The RD adopts the Independent Power Producers of New York ("IPPNY") position and part of Staff's position prohibiting Iberdrola and its affiliates, including its subsidiary Iberdrola Renovables, S.A. ("Iberdrola Renewables"), from owning and operating wind generation facilities interconnected with NYSEG's or RG&E's transmission or distribution facilities.[3] The RD also recommends that the Commission require NYSEG and RG&E to divest their interests in hydroelectric generation assets.

The RD makes a number of factual errors and policy misstatements in its discussion of renewable energy and vertical market power, including:

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[3] As discussed herein, Joint Petitioners have already committed as part of this proceeding to divest all of Energy East's fossil-generating facilities in New York, including the Russell Station.

- The RD assumes that the State does not need assistance in meeting its renewable energy goals.
- The RD assumes that the State does not need assistance attracting investment in Upstate New York.
- The RD assumes that every other renewable developer can find capital and turbines, and locate and develop wind projects in the State as effectively as Iberdrola and its affiliates. The RD ignores the need to attract renewable investment and the challenges the State faces in meeting its aggressive renewable goals.
- The RD ignores the reality that Energy East's existing hydroelectric plants provide protection against the increasing market price for power (driven in large part by fossil fuel prices) and that such protection would disappear if the plants are sold to unregulated entities (divesting the hydroelectric plants would increase customer costs by $50 million per year).

The RD provides no adequate justification for the proposed prohibition and required divestiture of wind and hydroelectric generation facilities or any explanation of how such intermittent generation facilities could create a vertical market power concern. The record in this proceeding contains extensive and irrefutable evidence regarding the intermittent and unpredictable nature of wind and hydroelectric generation projects, including: (a) the inability of renewable generation to turn on and off on command; and (b) the fact that renewable generation is a "price-taker" in the markets, meaning that it bids zero to make sure that it will clear the market, and will never set the clearing price. These characteristics ensure that renewable generation could not realistically exercise market power. The RD further ignores the fact that the Federal Energy Regulatory Commission (the "FERC") found that the Proposed Transaction does not raise any market power concerns. Nonetheless, the RD maintains that renewable resources are no different from other generation resources for purposes of evaluating vertical market power concerns, and ignores the fact that any residual vertical market power concerns are already fully mitigated under existing federal law and the New York Independent System Operator ("NYISO") market rules and oversight mechanisms.

For these reasons, the Commission should not impose any of the RD's recommended prohibitions and divestitures with respect to Iberdrola's current or future development of wind generation facilities and Energy East's existing hydroelectric facilities. Such measures are not only unnecessary from a market power perspective, but they would also be bad for energy prices and customers, who benefit from renewable generation since its costs are not affected by the ever increasing price for fuel.

G. Joint Petitioners Have Accepted Most Of The Recommended Financial Protections In The RD Even Though They Are Unnecessary

Joint Petitioners have adopted almost all of the proposed financial and structural conditions recommended in the RD, including all of the important aspects of the proposed "Golden Share," which Joint Petitioners refer to as an "Independent Bankruptcy Consent Right." The few conditions recommended by the RD that are not accepted by Joint Petitioners are not needed to address any real ratepayer risks and most of them are unprecedented.

The RD recommends that the Commission adopt any and all conditions proposed by the parties as long as those conditions are not "burdensome." Using this new standard (which is contrary to existing Commission precedent on financial conditions), the RD recommends adopting all of the parties' proposed conditions, other than two proposed by Staff and one by Multiple Intervenors that the RD states are burdensome and unreasonable. Under the existing legal standard, the very limited number of proposed conditions that Joint Petitioners do not accept are not required to offset any ratepayer risks alleged by Staff.

H. The Proposed Transaction Is In The Public Interest And Should Be Approved

All of the alleged risks of the Proposed Transaction have been neutralized by Joint Petitioners' acceptance of certain financial conditions. In addition, the Proposed Transaction will result in numerous rate and non-rate-related benefits to ratepayers and the State, including more than $201 million of PBAs and an associated immediate delivery rate reduction for customers, the divestiture of Energy East's existing fossil generation in New York, and $100 million in renewable energy investment. As such, the Proposed Transaction provides "positive net benefits" to the State and therefore should be approved by the Commission as in the public interest.

II. EXCEPTIONS

A. STANDARD OF REVIEW

The RD correctly concludes that Section 70 requires mergers to satisfy a "positive net benefits" standard for approval, which reduced to its essence simply requires the Commission to determine if the benefits of a particular transaction outweigh its risks (RD at 23). In practice, however, the RD does not apply this standard to evaluate the Proposed Transaction. Instead, the RD creates a new standard based on an arbitrary and undefined level of "sufficient" benefits (RD at 123). The manufactured level of benefits the RD recommends amounts to an "entry fee" to do business in New York and is incompatible with the standard of review that the RD purports to apply. Moreover, the RD's flawed approach gives little or no weight to what it considers the intangible or unquantifiable benefits of the Proposed Transaction, even though the Commission has recognized similar benefits in previous mergers.

Exception No. 1: The RD recommends that the Commission require Joint Petitioners to provide an arbitrary level of benefits, above and beyond those necessary to provide "positive net benefits," which amounts to an "entry fee," and is without basis in Commission precedent, the evidence or reason.

Joint Petitioners take no issue with the standard of review that the RD states *should* have been applied to the Proposed Transaction (*i.e.*, a "positive net benefits" standard) (RD at 21). However, Joint Petitioners strongly object to the standard of review that was *actually* applied in the RD because it is without basis in law, fact, policy or reason.

The RD begins with three correct recitations of the Commission's standard under Section 70. First, the RD states that, in order for the Proposed Transaction to be approved as "in the public interest" under Section 70 of the PSL, Joint Petitioners must demonstrate that the Proposed Transaction will provide positive net benefits to New York (RD at 23). Second, consistent with the Commission's general standard of balancing public interest costs against public interest benefits,[4] the RD states that in order for the Proposed Transaction to meet the public interest standard, the Proposed Transaction's "identifiable benefits must outweigh its detriments" (RD at 23). Third, the RD explains that, in weighing the benefits and risks of the Proposed Transaction, risks that are mitigated need not be taken into account in this balancing function (RD at 113). Joint Petitioners take no issue with any of these three statements relating to the Commission's positive net benefits standard.

Despite the RD's initial correct characterization of the positive net benefits standard as only requiring that the benefits of the Proposed Transaction outweigh its costs, the RD recommends that the Commission disapprove the Proposed Transaction because the benefits are "inadequate" (RD at 28) or not "sufficient" (RD at 123). To be clear, the RD did not claim that the benefits are not adequate or insufficient when compared to the risks of the Proposed Transaction—in fact, the RD specifically finds that its recommended conditions would eliminate those risks (RD at 113). Rather, the RD states that the level of the benefits offered by Joint Petitioners (after full mitigation of risks) was simply too low. Those benefits include over $201 million in PBAs that equate to an immediate annual reduction in delivery rates of over $54

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4 See Case 06-M-0878 - *National Grid plc and KeySpan Corp., Order Authorizing Acquisition Subject to Conditions and Making Some Revenue Requirement Determinations for KeySpan Energy Delivery New York and KeySpan Energy Delivery Long Island*, at 121 (Sept. 17, 2007) (hereinafter "*Grid/KeySpan Order*"); *see also* Case 05-C-0237 - *Verizon Communications, Inc. and MCI Inc., Order Asserting Jurisdiction and Approving Merger Subject to Conditions*, at 60-61 (Nov. 22, 2005) (describing balancing of benefits and risks).

million or an average 4.4% reduction in delivery rate revenues, and other tangible benefits proposed by Joint Petitioners (Exh. 50 at 1). As discussed in Exception No. 4, the RD's conclusion that these benefits are insufficient is wrong. The arbitrary application of a vastly different "positive net benefits" standard that mandates a pre-designated level of benefits consistent with Staff's targeted level amounts to an "entry fee" for Iberdrola to invest in New York. The RD fails to provide any rationale or justification for applying this new and different standard.

The Commission has never determined that a specific number or amount of "positive net benefits" is required for approval under Section 70. The Commission has found that the public interest standard may be satisfied through a variety of benefits, including intangible or unquantifiable benefits, without requiring any specific level of benefits, or any immediate rate reductions. In particular, the Commission has previously approved non-synergy mergers such as the Proposed Transaction that did not result in synergy savings from the combination of utility operations (*e.g.*, because there were no utility operations to combine), and therefore did not provide immediately quantifiable savings for ratepayers.[5]

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[5] *See* Case 07-M-0906 - *Initial Brief of Joint Petitioners Iberdrola, S.A. and Energy East Corporation*, at 14-18 (Apr. 11, 2008) (hereinafter "Joint Petitioners IB"); Case 07-M-0906 - *Reply Brief of Joint Petitioners Iberdrola, S.A. and Energy East Corporation*, at 9 (Apr. 25, 2008) (hereinafter "Joint Petitioners RB") (citing Case 07-W-0176 - *Aquarion Water Co. of New York, Inc., et al., Order Approving Corporate Restructuring and Transfers Subject to Conditions* (Apr. 19, 2007) (hereinafter "*Aquarion/United Waterworks Order*"); Case 06-W-0244 - *United Water New York Inc. and United Water South County, Order Approving Merger and Adopting Three-Year Rate Plan* (Dec. 14, 2006) (hereinafter "*United Water/United Water South County Order*"); Case 02-W-1447 - *Philadelphia Suburban Corp., et al., Order Authorizing Stock Transfer* (Mar. 11, 2003) (hereinafter "*Philadelphia/AquaSource Order*"); Case 01-W-1949 - *Long Island Water Corp., et al. Order Adopting Terms of a Joint Proposal* (Nov. 27, 2002) (hereinafter "*Long Island Water/Thames Order*"); Case 01-W-1770 - *Aquarion Co. and New York-American Water Co., Inc., Order Adopting Terms of Joint Proposal and Approving Stock Transfer* (Apr. 17, 2002) (hereinafter "*Aquarion/New York-American Order*"); Case 99-W-1542 - *United Water Resources, Inc. and Lyonnaise American Holding, Inc., Order Approving Stock Acquisition* (July 27, 2000)

Even in the synergy merger cases on which the RD and Staff rely, the Commission never required applicants to satisfy a pre-determined notion of "sufficiency;" rather, the Commission only required benefits (including rate concessions) that were based on a balancing of transaction-specific risks and benefits in the form of expected synergy savings (and a sharing of those savings necessary to provide positive net benefits).[6] For example, in the National Grid-KeySpan proceeding ("Grid/KeySpan"), the Commission engaged in a straightforward weighing of benefits of the Grid/KeySpan Joint Proposal against the potential risks of the transaction.[7] The Commission found that the "benefits to New Yorkers can be seen as the positive side of the ledger in a simple cost benefit analysis. They comprise a significant part of the context within which we evaluate whether the proposed terms in [the Joint Proposal] are collectively in the public interest."[8]

Accordingly, as discussed further under Exception No. 4, the appropriate benchmark for determining whether something is a benefit of a transaction is whether it would

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(as modified by Errata Notice issued Aug. 1, 2000) (hereinafter "*UWR/LAH Order*")); *see also* Tr. 936-37.

6 *See, e.g.*, *Grid/KeySpan Order*, at 115-22 (discussion of synergy savings); Case 01-M-0075 - *Niagara Mohawk Holdings, Inc., Niagara Mohawk Power Corp., National Grid Group plc and National Grid USA, Opinion and Order Authorizing Merger and Adopting Rate Plan*, at 6, 63 (Dec. 3, 2001) (hereinafter "*NIMO/NG Order*") (describing synergy savings); Case 98-M-0961 - *Consolidated Edison, Inc., Consolidated Edison Co. of New York, Inc. and Orange and Rockland Utilities, Inc., Order Authorizing Merger*, at 1, 4-5 (Apr. 2, 1999) (hereinafter "*ConEd/O&R Order*") (anticipated synergy savings to be equitably distributed between customers and investors); Case 97-M-0567 - *Long Island Lighting Co. and The Brooklyn Union Gas Co., Opinion and Order Adopting Terms of Settlement Subject to Conditions and Changes*, at 13-15, 36-37 (Apr. 14, 1998) (hereinafter "*LILCO/BUG Order*") (cost savings made possible by synergies resulting from the merger to be shared by customers and shareholders); *see also* Case 01-M-0404 – *Energy East Corp., RGS Energy Group, Inc., et al., Order Adopting Provisions of Joint Proposal with Modifications*, at 4 (Feb. 27, 2002) (hereinafter "*EE/RGS Order*") (synergy savings included in rates established by the parties' Joint Proposal); Tr. 935-36.

7 *Grid/KeySpan Order*, at 121.

8 *Id.*

occur in the absence of the transaction,[9] and not whether the benefit is less than the highest level of claimed benefit proposed by a party in the proceeding. The Commission should find Joint Petitioners' proposal of $201.6 million in proposed PBAs, and the immediate rate reductions that would result from those PBAs, as a tangible and material customer benefit that meets the Section 70 standard. The RD's attempt to hold the Proposed Transaction to a standard which requires Joint Petitioners to provide an arbitrary level of benefits above and beyond those necessary to provide positive net benefits can only be characterized as an "entry fee" to conduct business in New York, which would be bad public policy as it would deter future mergers that could be beneficial to the State (Tr. 958; 1000-01; *see also* Joint Petitioners IB at 34-35; Joint Petitioners RB at 91).[10] The Commission should reject the RD's attempt to impose a standard of review that is based on a notion of "sufficiency," and instead apply its traditional positive net benefits standard, which even the RD recognizes "consistently has been part of the Commission's interpretation of PSL [Section] 70" (RD at 32).

Exception No. 2: The RD errs in applying a public interest standard that requires synergies or other rate reductions, and that gives little or no weight to intangible or unquantifiable benefits.

As described in detail below, the Proposed Transaction offers numerous tangible benefits to New York, in addition to intangible and unquantifiable benefits, which the RD should not have summarily disregarded. Indeed, the RD itself acknowledges as a general matter, but fails to consider with regard to the Proposed Transaction, that "[s]ome benefits may be

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9 *See Grid/KeySpan Order*, at 116 (recognizing certain savings "that would not be made in the absence of the acquisition" as benefits); *see also id.* at 119 (The Commission did not credit certain other efficiency savings as merger savings, because they were expected to occur even if there were no merger).

10 The RD does not dispute that harm could result from the charging of an "entry fee" (*see* RD at 30; *see also* RD at 31 (acknowledging that it is "entirely credible" that the imposition of numerous conditions could cause a transaction to become economically unattractive)).

intangible, yet neither illusory nor insubstantial" (RD at 37) and that "the lack of a dollar value attached to the benefit does not mean the benefit should be ignored" (RD at 21). The RD also states that "intangible benefits – such as management expertise or financial stability – were relevant and material in meeting the [Section] 70 standard." (RD at 37; *see also* RD at 21-22 ("Some benefits are real but intangible, *i.e.*, ultimately not quantifiable; for example, a corporate reorganization can improve management's performance in ways that cannot be evaluated economically."))

In practice, however, the RD's analysis gives little or no weight to these same kinds of intangible and unquantifiable benefits that are offered by the Proposed Transaction—for example, Iberdrola's utility expertise and financial strength—that formed the basis for the Commission's approval in other utility mergers. Contrary to Commission precedent, the RD completely discounts the intangible and non-quantifiable benefits that will result from the Proposed Transaction, concluding that the Proposed Transaction will provide no "other benefits" (RD at 31).

According to the RD, a merger may only be approved under Section 70 if it results in rate reductions, whether through synergy savings or in the form of PBAs as "a necessary remedy for the ... lack of synergies" (RD at 123; *see also* RD at 121 ("PBAs are needed not as a proxy for projected synergy savings but as a source of customer benefits mandated by a net benefits test under PSL [Section] 70"); RD at 23-30 (discussing synergy savings)). Based on this standard, the RD ultimately recommends that the Commission disapprove the Proposed Transaction, and incorrectly suggests that all of the numerous unquantifiable benefits to New York State should be disregarded.[11]

Contrary to the RD's suggestion that synergy savings or PBAs are the only important component of an approved transaction, the Commission has approved non-synergy mergers that do not produce immediate savings for customers based on a recognition that the Section 70 public interest standard can be satisfied through a variety of intangible and unquantifiable benefits.[12] The Commission has also found that sufficient public interest benefits are demonstrated in cases where a large and sophisticated holding company with financial means and technical skills will enhance a utility's ability to serve the public (such as here with Iberdrola),[13] and where an acquisition has the *potential* to create future efficiencies that would result in savings that can be flowed through to ratepayers in later rate cases (such as here with the Proposed Transaction).[14]

The RD attempts to excuse its failure to adhere to Commission precedent by arguing that the non-synergy mergers previously approved by the Commission "are not analogous to this case in any relevant sense" because they concern water utilities (RD at 25).

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11 Of course, in this case, there are also over $201 million in quantifiable and quantified PBAs that Joint Petitioners offer in the Partial Acceptance and that the RD also disregards merely because the level of those offered PBAs is less than the level proposed by Staff. *See* Exception No. 4.

12 For example, the Commission approved the acquisition of United Water Resources by Lyonnaise American Holding, Inc., "because SLDE – one of the world's largest water distribution and treatment companies – can provide enormous technological and financial assets to help the subsidiary meet precisely those unique local challenges cited by opponents." *UWR/LAH Order*, at 7-8.

13 *See Aquarion/United Waterworks Order*, at 26 (stable financial profile and technical expertise); *Philadelphia/AquaSource Order*, at 6 (support of a large financially sound company with extensive experience); *Long Island Water/Thames Order*, at 6 (better access to capital markets and knowledge, research and development acquired elsewhere); *Aquarion/New York-American Order*, at 9 (long-term strength of utility secured through affiliation with a well-qualified entity).

14 *See United Water New York/United Water South County Order*, at 36 (potential to keep costs lower); *Philadelphia/AquaSource Order*, at 6 (opportunities to obtain economies of scale, potentially mitigating the need for future rate increases).

While the RD, like Staff, attempts to rely on the Commission's Statement of Policy on Small Water Company Mergers, the water utility merger precedent relied on by Joint Petitioners does not involve small water companies. In addition, Joint Petitioners have responded to Staff's attempts to distinguish the water cases from the Proposed Transaction based on the functional differences between the provision of water services and gas/electric services (*see* Tr. 970-71; *see also* Joint Petitioners RB at 10-11). And, while the RD dismisses Joint Petitioners' comparison to a non-synergy merger of water companies because the water companies served a smaller customer base than NYSEG and RG&E (RD at 27-28), nothing in either PSL Section 70 or PSL Section 89-h suggests that *the legal standard* for evaluating whether a transaction is in the public interest varies according to the relative size of the companies involved.[15]

Critically, the RD ignores the fact that the same legal standard applies to the evaluation of mergers in the energy and water industries. In fact, both Section 70 (applicable to gas and electric utility mergers) and Section 89-h (applicable to water utility mergers) are identically worded to require a "public interest" finding by the Commission.[16] The RD does not, and cannot, offer any valid rationale for applying a different standard of review to gas/electric and water utility mergers in light of this identical language. Similarly phrased and similarly intended statutory provisions "are to be construed together and 'as intended to fit into existing

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15 The RD states that because Long Island Water is smaller, its "need for a larger parent's support was commensurately greater" (RD at 28). Joint Petitioners established, however, that Long Island Water had no pressing need for capital and was a well-performing utility prior to the Thames acquisition. *See Long Island Water/Thames Order*, at 6 (noting that customers had enjoyed stable rates since 1997); Press Release, Garry A. Brown, Chairman, *PSC Approves Three-Year Rate Plan for Long Island Water* (Feb. 13, 2008); *see also* Joint Petitioners RB at 12.

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

laws on the same subject unless a different purpose is clearly shown.'"[17] The RD's insistence that the water utility merger cases are inapplicable here, based upon functional differences between water and electric/gas companies, is contrary to the statutory requirements of the PSL and to the need for consistent utility regulation.[18]

Exception No. 3: The RD errs in its inconsistent treatment and valuation of the benefits and risks of the Proposed Transaction.

The RD incorrectly finds that Joint Petitioners have failed to satisfy the "positive net benefits" standard by employing a fundamentally flawed and unfair approach that completely discounts or ignores benefits even though tangible and quantifiable, that are less than those requested by another party, as well as any benefits that are unquantifiable. By contrast, and without explanation, the RD's recommendations assume that alleged risks should be accepted and not discounted regardless of how speculative or unquantifiable those risks may be or the fact that alleged risks are mitigated by proposed conditions.

The RD also errs in discounting the allegedly speculative or intangible benefits identified by Joint Petitioners, stating that "to the extent a particular benefit is speculative or unquantified, it deserves less weight than a benefit that is less speculative or more quantifiable" (RD at 21-22). As an initial matter, this reasoning is contrary to the RD's own acknowledgment that:

> the lack of a dollar value attached to the benefit does not mean the benefit should be ignored. Some benefits are real but speculative, in the sense that one cannot predict whether they will

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

18 As Mr. Meehan explains, "one of the fundamental tenets of utility regulation is the development and application of a consistent set of standards by which conduct and transactions are to be evaluated," which is important to provide parties with necessary predictability (Tr. 942).

> materialize.... Some benefits are real but unquantified (or estimated or unknown), meaning that they might be quantified when they become better known; for example, a merger can create operating efficiencies whose economic value is difficult to predict over the long term.

(RD at 21). Contrary to the RD's suggestion, and as discussed above, the Commission has previously found that even benefits that are not guaranteed can constitute grounds for Section 70 approval.[19]

The RD's error in its method of assessing the benefits of the Proposed Transaction is compounded by its inconsistent and one-sided treatment of alleged risks. First, the RD asserts that Joint Petitioners are required to "overcome the opponents' demonstration that the alleged risks are, at least, realistic concerns," even though "the nature of the allegations is such that the Commission ultimately will not be able to identify an objective or quantifiable level of risk associated with the transaction" (RD at 112). This standard assumes, incorrectly, that it is appropriate to consider any and all identified risks under Section 70, regardless of merit. On the contrary, the Commission first assesses the alleged risk to determine its reasonableness and likelihood before imposing remedial conditions or taking it into consideration in the "positive net benefits" analysis.[20] The RD, however, simply assumes that all identified risks are reasonable and all protective measures proposed by Staff should be adopted, with two exceptions.[21]

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19 For example, the Commission has held that an acquisition that has the *potential* to result in future savings should be considered to provide a benefit to ratepayers. *See United Water New York/United Water South County Order*, at 36 (potential to keep costs lower); *Philadelphia/AquaSource Order*, at 6 (opportunities to obtain economies of scale, potentially mitigating the need for future rate increases).

20 *See, e.g., NIMO/NG Order*, at 62, 71 (evaluating and rejecting concerns raised by intervenors regarding risks of the transaction); *LILCO/BUG Order*, at 28, 30 (same).

21 *See* RD at 114-16 (declining to recommend Staff's proposed Code of Conduct condition, as well as its proposal to hold RG&E and NYSEG customers harmless from increased capital costs resulting from credit deratings).

The RD appears to find that as long as the Commission can identify positive benefits of the Proposed Transaction, the risks do not need to be weighed so long as certain protective measures are adopted (RD at 113).[22] Joint Petitioners agree that the Commission need not be concerned with future hypothetical risks, because the protective measures that Joint Petitioners have agreed to accept (which include most of Staff's proposed conditions with only a few exceptions), neutralize any potential future risks. Joint Petitioners disagree, however, that the record shows no net benefits weighing in favor of approving the Proposed Transaction. It is evident, for example, that an immediate annual 4.4% delivery rate reduction and the commitment to invest at least $100 million in renewable resource development are net benefits when weighed against speculative risks that have been neutralized by protective conditions.

B. BENEFITS

The RD errs in its recommendation to disregard the tangible, quantifiable benefits and certain unquantifiable benefits proposed by Joint Petitioners in the Section 70 analysis. With regard to quantifiable benefits, the RD asserts that over $201 million in benefits offered by Joint Petitioners fails to constitute a benefit because the dollar amount is less than that proposed by Staff (RD at 54). The RD dismisses the Joint Petitioners' commitment to divest certain generation facilities and share divestiture proceeds with ratepayers for the same reasons (*i.e.*, because the amounts of the divestiture and the sharing are less than what other parties proposed and the Commission could have proposed a similar sharing mechanism).

As for benefits that are not quantifiable, the RD correctly states that benefits relevant to a "positive net benefits" analysis "may be intangible, yet neither illusory nor

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[22] The RD further states that it "treats the transaction's alleged risks as a subject for possible remedies rather than attempting to weigh them in the balance vis-à-vis the transaction's asserted benefits" (*Id.*).

insubstantial" and that quantifiable benefits "may be merely one component of a set of overall benefits that could satisfy [Section] 70" (RD at 37). The RD incorrectly continues, however, that purportedly "vague or uncertain benefits" that were demonstrated on the record here, must be discounted (*Id.*).[23] The RD compounds this error by citing virtually no evidence in support of its conclusions. To be sure, Joint Petitioners strongly disagree that the presently unquantifiable benefits they have identified in support of the Proposed Transaction are in any way "not real" or "insignificant" and therefore should be discounted (*See* RD at 38). However, even assuming for the sake of argument that there may be uncertainty as to the extent of certain benefits in the future, it is arbitrary and capricious for the RD to recommend dismissing these benefits altogether without any rational explanation of why they are not relevant or why the extensive record demonstrating their existence should be ignored.

Exception No. 4: The RD errs in finding that Joint Petitioners' offer of over $201 million in proposed PBAs, which translates into approximately $54.8 million in immediate annual delivery rate reductions (on average a 4.4% reduction) for Energy East's New York customers, will not provide any benefits.

The RD incorrectly finds that the $201.6 million of PBAs offered by Joint Petitioners should not be "counted as a net benefit on behalf of the transaction" simply because of "the shortfall relative to Staff's $646.4 million" (RD at 54) and that "$201.6 million in concessions does not constitute a benefit when offered as an alternative to $646.4 million" (RD at 55).[24] The idea that the $201.6 million in PBAs proposed by Joint Petitioners is not a benefit

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23 In doing so, the RD inappropriately applies a one-sided standard that considers fully relevant virtually all of Staff's alleged "risks" of the Proposed Transaction, regardless of how speculative those risks may be, while at the same time discounting or deeming irrelevant entirely the benefits that the RD finds to be uncertain.

24 Joint Petitioners explain, *infra*, why the RD's endorsement of Staff's $646.4 million in PBAs is erroneous.

simply because $201.6 million is less than the $646 million proposed by Staff defies logic and is unsupported by the record and Commission precedent.

It cannot be seriously disputed that there are immediate, tangible benefits that would flow from Joint Petitioners' offer to provide over $201 million in proposed PBAs (Exh. 50). This offer includes a commitment to flow through to customers the rate impact of those write-offs, write-downs and reserve increases *immediately* following the closing of the Proposed Transaction (Tr. 614; Exh. 50; Joint Petitioners RB at 77). The implementation of this flow-through would result in an approximately $54.8 million immediate annual delivery rate reduction, which is on average a 4.4% reduction for Energy East's New York customers (Tr. 614; Exh. 50; Joint Petitioners IB at 21; Joint Petitioners RB at 78).

Failing to consider this offer as a benefit of the Proposed Transaction merely because the amount is less than that proposed by Staff reveals a patent fallacy that becomes a theme in the RD. Pursuant to the *Grid/KeySpan Order*, the appropriate benchmark for determining whether something is a benefit of a transaction is whether it would occur in the absence of the transaction,[25] and not whether the benefit is less than other benefits proposed by another party. The Commission should properly view Joint Petitioners' offer of over $201 million in proposed PBAs, and the immediate rate reductions that would result from those PBAs, as a tangible, material benefit for customers. In the absence of the Proposed Transaction, there would be no PBAs at all to reduce customer rates.

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[25] *See Grid/KeySpan Order*, at 116 (recognizing certain savings "that would not be made in the absence of the acquisition" as benefits); *see also id.* at 119 (the Commission did not credit certain other efficiency savings as merger savings, because they were expected to occur even if there were no merger).

Exception No. 5: The RD errs in finding that Joint Petitioners' offer to divest Energy East's existing fossil-fueled generating facilities in New York, including the Russell Station, will not provide any benefits.

In the Partial Acceptance, Joint Petitioners commit to "competitively bid and auction (i) Russell Station; (ii) the 63 MW Allegany Station; (iii) the 14 MW Peaker Station 3; and (iv) the 14 MW Peaker Station 9" (Exh. 50 at 1). Cayuga Energy, an unregulated subsidiary of Energy East, will also competitively bid and auction the 67 MW Carthage Peaking Unit (*Id.*). In addition, Joint Petitioners have committed to share with ratepayers, in a manner and amount to be determined by the Commission, the above-book net proceeds resulting from the auction of Energy East's divested New York fossil assets, which could amount to up to 90% of those above-book proceeds (Joint Petitioners RB at 2). The RD incorrectly finds that Joint Petitioners' divestiture commitments are not a benefit of the transaction (RD at 54-55). Applying the same illogical reasoning as it did to the $201.6 million in offered benefits (in Exception No. 4), the RD states "it would be inconsistent to categorize petitioners' limited divestiture offer as a benefit when offered in lieu of complete divestiture" (*Id.* at 55). The RD, however, provides no reasoned basis explaining why divestiture, along with ratepayer sharing of proceeds resulting from the divestiture, is not a benefit, other than to state "the Commission would have the authority" to require this outcome regardless of whether it is part of the Proposed Transaction (*Id.*). This reasoning should be rejected.

As explained above, the test for whether the fossil divestiture creates a benefit is whether it would occur in the absence of the transaction.[26] Here, most of the fossil divestitures would not have occurred at all in the absence of the Proposed Transaction. Even if a divestiture were to occur (*i.e.*, the possible divestiture of Russell, which Energy East was planning to have

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[26] *See Grid/KeySpan Order*, at 116, 119 (crediting benefits that would not occur but for the acquisition and denying others that would).

the Commission revisit for a potential conversion to a natural gas-fired facility), there was no commitment by the upstream owner to agree to a schedule like the one proposed by Joint Petitioners or to share up to 90% of the above-book proceeds with ratepayers (which will be left to the Commission's discretion). Therefore, the Commission should properly view Joint Petitioners' divestiture commitment and associated above-book sharing of proceeds as tangible, material benefits of the Proposed Transaction. In addition, eliminating the alleged concerns raised in this proceeding with respect to vertical market power associated with these assets is also a benefit.[27]

Exception No. 6: The RD errs in finding that Iberdrola's expertise in the development of renewable resources and its commitment to economic development in the State, including at least $100 million of new investment in renewable resources, will not provide any benefits.

The RD incorrectly finds that "Iberdrola's assets as a potential wind energy developer in New York should not be deemed benefits of the proposed transaction and therefore should not figure prominently in the Commission's determination" (RD at 41). The RD actually goes so far as to conclude that Iberdrola's renewable expertise, "if coupled with its ownership of distribution companies pursuant to the proposed transaction, would be a public detriment rather than a benefit" because of alleged vertical market power concerns (RD at 42). The RD's recommendations are unsupported, misguided and contrary to New York's stated renewable energy goals.

Exception No. 9 addresses why the ownership and operation of wind generators in New York by Iberdrola's affiliates do not raise any vertical market power concerns. Furthermore, under the RD's own recommendation, there are no vertical market power concerns

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27 *See* Case 07-M-0906 - *Initial Brief of the New York State Consumer Protection Board*, at 6 (Apr. 11, 2008) (hereinafter "CPB IB") ("All vertical market power issues related to these facilities were removed by the Partial Acceptance Document.").

for facilities that are interconnected with entities other than NYSEG or RG&E. It is illogical for the RD to claim that, at least for those projects that would interconnect to utilities other than NYSEG or RG&E, there would be no State benefit. Iberdrola's ability to bring its expertise and investment in renewable generation to New York is a significant benefit because Iberdrola will be able to assist the State in meeting its renewable goals (*See, e.g.*, Tr. 515-16; 1166-67).

The RD also incorrectly concludes that, even in the absence of vertical market power concerns, "it is doubtful that Iberdrola's environmentally beneficial philosophy, resources, or expertise should be regarded as features linked to the proposed transaction" (RD at 42). The RD bases its conclusion on the flawed premise that Iberdrola's renewables expertise should not be considered a benefit of the Proposed Transaction because Iberdrola will invest in New York if it is economical to do so, regardless of whether the Proposed Transaction is consummated.

The RD fails to recognize the reality that Iberdrola has a finite amount of investment resources that it can dedicate to renewable development in the United States, and Iberdrola has consistently emphasized that it will pick and choose locations that are optimally designed to meet a variety of goals. Regardless of the RD's views on this subject, if the Commission does not approve the Proposed Transaction with conditions that are reasonable, then Iberdrola would not view New York as an attractive state in which to target future investment (Tr. 519-20), and Iberdrola would seek to redirect resources from New York to other locations wherever economically feasible. Iberdrola does not know how it could be more clear on this point.

The record developed in this proceeding confirms Iberdrola's leadership in renewables development. Iberdrola is the world's leading producer of electricity from wind generation with over 7,000 MW of installed wind capacity (Tr. 514) and unparalleled expertise, capacity and resources at its disposal, and is therefore uniquely positioned to help New York meet its renewable goals (Tr. 514-15). Many other parties have acknowledged Iberdrola's extensive experience, expertise and proven success in the development of wind generation (*See, e.g.*, CPB IB at 14; Case 07-M-0906 - *Initial Brief on Behalf of Strategic Power Management, LLC*, at 9 (Apr. 11, 2008) (hereinafter "SPM IB"); Tr. 1030 (NRDC); Tr. 108 (DEC); Tr. 1764 (City of Rochester)). Such expertise will be critical in meeting the State's renewable energy goals because, as the evidence in the record reflects, there are a number of wind development projects in New York that are not backed by developers as experienced as Iberdrola, and those projects are unlikely to be constructed and go into commercial operation (*see* Tr. 665; 816). As Iberdrola's witness Mr. Azagra testified, "Iberdrola brings reality to [wind development] projects" (Tr. 665) and has "a most impressive track record with respect to the completion of such projects" (Tr. 520). It is surprising that the RD not only disregards the benefits that Iberdrola offers with respect to meeting the State's renewable goals, but also makes recommendations that would effectively prevent the world's largest wind energy producer from bringing its expertise, capacity and resources to New York.[28]

In the Partial Acceptance, Iberdrola offered a binding merger commitment that it would support investments in excess of $100 million by its affiliate, Iberdrola Renewables, in the development of renewable generation in New York over the next three years (*see* Exh. 50, at 2). As noted, the standard for determining whether something constitutes a transaction benefit is

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

whether it would occur in the absence of the transaction.[29] Here, Joint Petitioners' offer of supporting investments in renewable development in excess of $100 million unquestionably falls in the category of tangible and material benefits for the State, as it is a commitment that *will not exist* if the Proposed Transaction does not occur.

The RD's dismissal of Iberdrola's $100 million investment commitment is contrary to reasoned decision-making in that it disregards without explanation the critical economic development benefits to Upstate New York that will result from this investment. The only other reason set forth by the RD, that the commitment is "too vague to be monitored by reference to objective criteria" (RD at 49), is not supported by any evidence in the record. It is undisputed that Iberdrola's commitment to invest in renewable generation in New York will bring new jobs and related investment in the renewable generation industry in the State, in particular Upstate New York. As Mr. Azagra testified, Iberdrola sees the Proposed Transaction as "the platform in which we want to do much more business in the [S]tate" (Tr. 642). Iberdrola has a strong history of regional investment in those areas where it has completed major acquisitions and the Commission should count Iberdrola's $100 million commitment as a positive net benefit when evaluating the "positive net benefits" of the Proposed Transaction.

The economic development opportunities offered by the Proposed Transaction are even more significant in light of the fact that Upstate New York, particularly the areas served by NYSEG and RG&E, are struggling to attract and retain quality jobs.[30] In fact, Governor Paterson recently called on New York's business and government leaders to develop a stronger

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29 *See Grid/KeySpan Order*, at 116 (recognizing as benefits certain savings "that would not be made in the absence of the acquisition"); *cf. id.* at 119 (the Commission did not credit certain other efficiency savings as merger savings, because they were expected to occur even if there were no merger).

30 Case 07-M-0906 - *Initial Brief of Nucor Steel Auburn, Inc.*, at 7 (Apr. 11, 2008).

alliance to ensure expanded job growth in the State, noting in particular that the government should "strengthen green business through the State."[31] The Commission has recognized economic development as a benefit when evaluating previous utility merger transactions,[32] as well as the fact that the revitalization of Upstate New York is a top priority (Tr. 1599-1600). The Commission has also acknowledged that promoting and facilitating the State's renewable energy policies provide benefits that should be considered in Section 70 proceedings.[33] Accordingly, consistent with its own precedent and with New York State policy, the Commission should consider Iberdrola's expertise in developing renewable resources and its commitment to economic development in the State when performing a "positive net benefits" analysis of the Proposed Transaction.[34]

Exception No. 7: The RD inappropriately discounts Iberdrola's superior credit rating and financial strength as a benefit of the Proposed Transaction.

It is not disputed that Iberdrola's "A" level category credit rating is superior to that of NYSEG, RG&E and Energy East, and that superior credit can be expected to provide NYSEG and RG&E with greater access to capital at a lower cost than they would have on a

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

32 *See LILCO/BUG Order*, at 8 (recognizing settlement's stimulation of economic development as a benefit); *see also* Case 96-C-0603 - *New York Telephone Co., et al., Order Approving Proposed Merger Subject to Conditions*, at 28 (May 30, 1997) (holding that maintaining corporate headquarters in New York was one of the benefits that caused the NYNEX/Bell Atlantic merger to be in the public interest).

33 *See NIMO/NG Order*, at 72 (finding a renewable certificates program included in the Joint Proposal to have a laudable goal of facilitating the sale of renewable energy and thus consistent with the Commission's policy of encouraging and facilitating the development of renewable energy resources).

34 A recent opinion in the *Wall Street Journal* concluded, "[w]hile the goal of domestic mergers is often to gain efficiencies—eliminate duplication, trim the workforce—foreign acquisitions are more likely to lead to job creation." *See* Review and Outlook, WALL ST. J., June 23, 2008, at A16.

stand-alone basis as subsidiaries of Energy East (Tr. 508-09).[35] In addition, Iberdrola is a larger, stronger and more diversified holding company than Energy East (*See, e.g.*, Exh. 41 at 2-5; Tr. 490-91; 505; 507-08; *see also* Joint Petitioners IB at 28).

The RD acknowledges these aspects of Iberdrola's financial strength as "benefits" but then immediately discounts them as "potentially impermanent" (RD at 47) and therefore insignificant in applying a "positive net benefits" analysis (*See id.* at 38). The RD cites only one item of record evidence in support of its conclusion of the speculative nature of the benefit of Iberdrola's financial strength—an exhibit provided by Joint Petitioners' that demonstrates that Iberdrola has grown from the 19th largest utility to the fourth largest and that, at the same time, other firms have declined in size (RD at 47, citing Exh. 42). Thus, according to the RD, superior credit ratings and financial strength are irrelevant, because corporate firms may change in size in the future for reasons that "are too varied to identify or predict" (*See id.* at 47).

This conclusion does not result from reasoned decision-making. Under similar logic, an acquiror with a recently downgraded credit rating should not be viewed negatively because the acquiror could experience a rise in that rating. The Commission has not evaluated financial strength or weakness based upon the panoply of future events that could occur (without regard to whether any such events are realistic or not). Rather, the Commission has evaluated the financial benefits and risks of an acquiror based upon realistic assessment of risks, including by looking at an acquiror's current credit ratings.

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35 *See also* Joint Petitioners IB at 28; Case 07-M-0906 - *Initial Brief of Multiple Intervenors*, at 19 (Apr. 11, 2008) (hereinafter "MI IB") ("the proposed transaction may result in the realization of financial benefits related to Iberdrola's higher ratings from credit agencies compared to Energy East"); *cf.* Case 07-M-0906 - *Staff Reply Brief*, at 22 (Apr. 25, 2008) (hereinafter "Staff RB") (acknowledging Iberdrola's "A" level category rating)).

The best and most relevant evidence of whether Iberdrola's financial strength is a positive benefit of the Proposed Transaction is based on the financial profile and credit ratings of Iberdrola. These credit ratings are forward-looking, and cannot be described as mere "snapshots" as they incorporate "an assessment of all future events to the extent they are known or can be anticipated" (Tr. 750-51; *see also* Joint Petitioners RB at 85). Iberdrola's financial strength and stability have been well-established in this proceeding and are appropriately recognized by the market, as evidenced by Iberdrola's market capitalization of over $67 billion and its successful issuance of $4.5 billion of equity to fund the Proposed Transaction (Tr. 504; 507). As for credit ratings, Iberdrola's senior unsecured debt ratings/outlook from S&P, Moody's and Fitch are A-/Stable, A3/Stable and A/Negative, respectively (Tr. 742; *see also* Exh. 70 (Moody's recent February 2008, report reaffirming its rating for Iberdrola)). The evidence in the record further shows that Iberdrola's "A" level category credit ratings are one to three notches higher than those of Energy East (Tr. 742; *see also* Tr. 750-51).

The RD's conclusion that Iberdrola's present credit ratings might change in the future and therefore are not a benefit of the Proposed Transaction (RD at 47) is flatly inconsistent with positions Staff has recently taken in other cases. In the recent Consolidated Edison ("Con Ed") rate case, for example, Staff assumed that Con Ed's then-current rating, as well as the then-current ratings of a proxy group of utility companies, should be used in setting Con Ed's forward-looking rates.[36] Staff asserted that Con Ed's then-current higher rating relative to the then-current lower ratings of the companies in the proxy group justified an upward credit quality adjustment to Con Ed (thereby resulting in a lower return on equity for forward-looking ratemaking purposes) because "[r]ating agencies have reviewed the risk of the companies in the

[36] *See* Case 07-E-0523 - *Consolidated Edison Co. of New York, Prepared Testimony of Staff Finance Panel*, at 23-29, 41-44, 56-58 (Sept. 2007).

proxy group and they are all riskier than Con Edison."[37] The Commission agreed that there were significant risk differences between the other companies in the proxy group and Con Ed, "as evidenced by Con Edison's higher bond rating."[38] Similarly, Staff relied in part on "S&P predicting the Company will be at the top of the recommended A-range" to argue that it "fail[ed] to see how the Company's financial ratios would be considered weak by the investment community."[39] Staff's inconsistent position on the relevance of credit ratings in this proceeding strongly suggests that it is taking an outcome-determinative approach to this proceeding, to which the Commission should accord little weight.

Most recently, in the Gaz de France/Suez merger, the Commission specifically cited access to capital markets as benefits of that transaction, even though the benefit was not quantified: "the petitioners state that the regulated water companies have better access to the capital markets after the proposed merger. . . . [T]he merger, if successfully consummated, would assure that UW and UWNJ continue to have ready access to the financial markets at reasonable terms."[40] Even though the Commission found no significant synergy savings, the Commission approved the acquisition as in the public interest,[41] based on the same financial market access benefit demonstrated in the record here.

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37 *Id.* at 43.

38 Case 07-E-0523 - *Proceeding on Motion of the Commission as to the Rates, Charges, Rules and Regulations of Consolidated Edison Company of New York, Inc. for Electric Service, Order Establishing Rates for Electric Service*, at 124 (Mar. 25, 2008).

39 Case 07-E-0523 - *Con Ed, Prepared Testimony of Staff Finance Panel,* at 59.

40 Case 06-W-1367 - *Joint Petition for a Declaratory Ruling Disclaiming Jurisdiction or, in the Alternative, for approval of the Merger of Gaz de France SA and Suez SA, and the simultaneous Initial Public Offering of shares of Suez Environment, Order Authorizing Reorganization and Associated Transactions*, at 6 (June 25, 2008) (hereinafter "*Gaz de France/Suez Order*").

41 *See id.*

It is pointless and irrelevant here to speculate about what might or might not happen in the future based on Staff's vague concerns. To do so would effectively declare that Staff is a better judge of future ratings of Iberdrola than the ratings agencies. The evidence unequivocally demonstrates, and the Commission should find, that Iberdrola's financial strength and credit rating are superior to that of Energy East, NYSEG and RG&E and that Iberdrola's financial strength and superior credit rating are tangible benefits that weigh in favor of approving the Proposed Transaction.

Exception No. 8: The RD errs by failing to find that Iberdrola's sharing of best practices and global utility expertise is not a benefit relevant to the Section 70 analysis.

Joint Petitioners have submitted evidence demonstrating Iberdrola's extensive global utility expertise and its sharing of best practices with affiliates (*see, e.g.*, Tr. 485; 512-14; *see also* Joint Petitioners IB at 30-32; Joint Petitioners RB at 86-88). The RD dismisses most of this record without discussion, finding such benefits are "not even identifiable" "much less enforceable" (RD at 38). This conclusion is erroneous. In particular, Iberdrola provided specific testimony attesting to its record of implementing best practices in subsidiaries outside of Spain while retaining local management for those subsidiaries, as well as specific evidence regarding its superior levels of performance under recognized measures of utility service quality (Tr. 490-91; 513; Joint Petitioners IB at 31-32). This evidence demonstrates real, tangible benefits of the Proposed Transaction, which should be taken into account in the Commission's "positive net benefits" analysis.

Iberdrola has over 100 years of diversified utility experience and that this global utility expertise will result in benefits to NYSEG and RG&E and their customers (Tr. 512-13). Iberdrola has a demonstrated track record of sharing information about best practices among its operating utility subsidiaries (Tr. 943-44; 982). The RD offers no sound basis for dismissing this evidence.

The RD errs by utterly ignoring Commission precedent finding that global utility expertise is a relevant benefit under the PSL. The Commission regularly treats demonstrated global utility expertise of an acquiring entity as a benefit when evaluating a potential utility merger.[42] Most recently, in the Gaz de France/Suez merger, the Commission noted global access to technology, research and development, and access to capital markets in its discussion of that transaction, even though none of those benefits was quantified:

> The petitioners claim that the regulated water companies and their customers will benefit from the proposed merger because they will be a part of a much larger international company with greater access to technology and research and development in utility operations management. In addition, the petitioners state that the regulated water companies will have better access to the capital markets after the proposed merger. Based upon our review . . . it appears that there are no significant synergy savings or operational benefits to UW's New York ratepayers as a result of proposed transaction. . . . [T]he merger, if successfully consummated, would assure that UW and UWNJ continue to have ready access to the financial markets at reasonable terms.[43]

Importantly, the Commission found no significant synergy savings or operational benefits,[44] but with these facts, the Commission approved the acquisition as in the public interest.

The RD, by contrast, cites no Commission authority for the proposition that evidence concerning a diversified, global utility's over 100-year expertise serving millions of

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42 *See* Joint Petitioners IB at 31; Joint Petitioners RB at 87-88 & n.105 (citing *Long Island Water/Thames Order*, at 6 (holding that the fact that Thames was an international firm with vast holdings in 44 countries would provide "American affiliates and subsidiaries the benefits of the knowledge, research and development it acquires elsewhere")); Case 99-W-1128 - *Kelda Group plc and Aquarion Company, Order Approving Stock Acquisition and Merger*, at 7 (Dec. 20, 1999) (hereinafter "*Kelda/Aquarion Order*") (recognizing the potential for sharing of best practices among U.S. and U.K water utilities as a significant benefit, as well as the fact that the utility would obtain access to Kelda's ongoing research and development efforts).

43 *Gas de France/Suez Order*, at 6.

44 *See id.*

points of supply and with a reputation as a global leader for environmentally responsible service, should be dismissed as not "identifiable." Staff has acknowledged the benefit of parent companies' "transmitting the value of their extensive expertise and greater knowledge to [their] subsidiaries."[45] Accordingly, the RD's determination that Iberdrola's expertise merely answers the "threshold question whether Iberdrola is qualified to manage Energy East," but does not confer an affirmative benefit (RD at 38), should be rejected. It would be inappropriate for the Commission to discount the demonstrated benefits offered by Iberdrola's global utility expertise and the sharing of information regarding best practices that would result from the Proposed Transaction.[46]

The RD also errs in disregarding record evidence showing the benefits Iberdrola has brought to subsidiaries in other countries, and adopts Staff's illogical position that Iberdrola's policies favoring retention of local management, and the sharing of best practices, are somehow mutually exclusive (RD at 38). On the contrary, Joint Petitioners' Policy Panel testified that commitment to local management does not mean that Iberdrola will not be able to help improve the operations of NYSEG and RG&E for the benefit of their customers (Tr. 514), and gave concrete examples of such implementation of best practices internationally.[47] Thus,

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45 Case 07-M-0906 - *Staff Initial Brief*, at 16 (Apr. 11, 2008) (hereinafter "Staff IB").

46 *See, e.g.*, *Long Island Water/Thames Order*, at 6 (foreign parent acquirer's ability to provide the local utility with better access to capital markets, and the benefits of knowledge, research and development the parent had acquired elsewhere, satisfied the public interest standard); *UWR/LAH Order*, at 7-8 (finding that the foreign parent acquirer's ability to provide technological best practices and financial assets satisfied the public interest standard).

47 The suggestion made by Staff and apparently endorsed by the RD that Iberdrola's commitment to local management is inconsistent with any intent to supervise and work with utility subsidiaries to incorporate best practices, is wholly unsupported by the record (*see* Staff IB at 16-17; RD at 38). Iberdrola's demonstrated history of working with local management to improve the operations of its utility subsidiaries in Brazil and Guatemala is clear evidence that Iberdrola works collaboratively with local management (Tr. 514). Iberdrola's ongoing efforts to enhance the T&D standards at its utility subsidiaries in Spain and the U.K. are further evidence that Iberdrola

while local management at utility subsidiaries in Brazil and Guatemala was retained, that same local management instituted various programs and upgrades as a result of Iberdrola's sharing information about best practices among its operating subsidiaries (*see* Tr. 514; Joint Petitioners RB at 87). Iberdrola has managed to have a measurable and positive influence on the operations of its utility subsidiaries in Brazil and Guatemala despite their geographical distance from Iberdrola's headquarters in Spain (*Id.*). The RD's wholesale failure to discuss or otherwise acknowledge this evidence is arbitrary, capricious and contrary to reasoned decision-making.

Finally, the RD erroneously dismisses evidence of Iberdrola's demonstrated commitment to service quality (RD at 48-49). Joint Petitioners submitted evidence showing the tangible benefits that Iberdrola can bring to the State from a service quality perspective, namely, with reference to the Customer Average Interruption Duration Index ("CAIDI") and the System Average Interruption Frequency Index ("SAIFI"). Relative to U.S. benchmarks, Iberdrola over the last three years has delivered results that would rank in either the first or second quartile of U.S. utilities (Tr. 513; 490-91). Without citing anything in the record, the RD inexplicably disregards the evidence that Iberdrola has shared best practices that have positively influenced operations in subsidiaries in Brazil and Guatemala, and instead finds that there is clouded "ambiguity" over Iberdrola's policies. No such ambiguity exists, however. The fact that NYSEG and RG&E seek out opportunities to improve service and that the Commission has authority to impose service quality standards (RD at 49) does not undermine the fact that Iberdrola's strong service quality performance will bring benefits to NYSEG, RG&E and their customers (Tr. 253; *see also* Joint Petitioners RB at 87-88).

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is committed to working with local management to improve the operations of its utility subsidiaries (Exh. 42, IBER-0030, slides 8-9).

C. VERTICAL MARKET POWER

The RD recommends that if the Proposed Transaction is approved the Commission should prohibit Joint Petitioners and their affiliates from owning or operating, and should require Joint Petitioners and their affiliates to divest, any wind generation facilities interconnected with NYSEG's or RG&E's transmission or distribution facilities. The RD further recommends as a condition to approval that the Commission require the divestiture of NYSEG's and RG&E's approximately 112 MW of existing hydroelectric generating facilities. The RD bases each of these recommendations on alleged concerns of vertical market power arising from the Proposed Transaction based on the Commission's Vertical Market Power Policy Statement (the "VMP Policy Statement"). The RD, however, loses sight of the fact that the VMP Policy Statement establishes only a rebuttable presumption against a transmission owner acquiring or being affiliated with generation in New York, and not an absolute prohibition. The RD further ignores that the nature and characteristics of Iberdrola's affiliated renewable wind development activities and Energy East's existing renewable hydroelectric generation, and the fact that any vertical market power concerns are already fully mitigated by other means—facts which clearly rebut that presumption here.

As described in Exception No. 6 above, Iberdrola's expertise in developing wind generation resources offers significant benefits in terms of helping the State to meet its aggressive renewable energy goals. The RD's recommended prohibition on certain wind generation development activities of Iberdrola and its affiliates simply fails to recognize (i) the fundamental nature of wind-powered generation, which is intermittent and unpredictable due to its rapidly variable input levels, and is therefore not suited to the exercise of vertical market power; (ii) the fact that Iberdrola's wind development projects are all located on the low-cost side of the most significant transmission constraint in New York, and therefore NYSEG and

RG&E are not able to influence transmission constraints to raise prices for affiliated Iberdrola wind generation; and (iii) the comprehensive regulatory framework of market rules and other oversight and mitigation mechanisms that have been adopted by the FERC and NYISO since the issuance of the VMP Policy Statement and that directly address any vertical market power concerns that could potentially arise from the Proposed Transaction.

Similarly, with respect to its recommended divestiture of NYSEG's and RG&E's approximately 112 MW of existing hydroelectric facilities, the RD fails to recognize (i) the intermittent and unpredictable nature of these "run-of-the-river" facilities that generate electricity only through the natural flow and elevation drop of rivers, and therefore cannot be used in the exercise of market power; (ii) the FERC and NYISO mechanisms that are in place to prevent the exercise of vertical market power; and (iii) the *de minimis* amount of this generation. Moreover, Energy East's retention of these low-cost, renewable energy facilities provides direct benefits to ratepayers that should form the basis of any Commission consideration of whether to divest these facilities.

Exception No. 9: The RD errs in recommending that, as a condition to approval of the Proposed Transaction, Joint Petitioners and their affiliates should be prohibited from owning or operating and should be required to divest any wind generation interconnected with NYSEG's or RG&E's transmission or distribution facilities.

The RD recommends that "if the Commission approves the transaction, it should impose a precondition that petitioners and their affiliates may not own or operate, and must divest, any wind generation interconnected with NYSEG's or RG&E's transmission or distribution facilities" (RD at 61).[48] The RD attempts to justify this condition by claiming that

[48] In its discussion of this proposed condition, the RD refers to "Iberdrola's ownership of wind generation in [NYSEG's and RG&E's] territories" (RD at 61). The relevant inquiry is whether Joint Petitioners and their affiliates would be prevented from owning or operating wind

the ownership or operation of such facilities by Joint Petitioners or their affiliates "would interfere with the provision of economically priced wind energy and would encumber upstate economic growth with the dead weight of excess energy prices" (*Id.*). For the reasons described below, these conclusions are wholly unsupported by the record or Commission precedent and are, in any event, factually incorrect.

As the record amply demonstrates, the intermittent and unpredictable nature of wind generation, with its rapidly variable input levels, "makes wind-powered generating facilities ill-suited to be used in the exercise of vertical market power" (Tr. 842; *see also* Joint Petitioners IB at 57). The RD states that these characteristics are related to horizontal, rather than vertical, market power concerns (RD at 71-72 ("[A]s long as the issue is VMP, it is difficult to see the relevance of arguments by petitioners and other opponents of divestiture that Iberdrola-affiliated wind generators would be price takers, would generate less output than their rated capacity because wind is intermittent, could sell only in real time rather into the day-ahead market, and could not constitute more than a minor percentage of New York's generating capacity.")).

However, this is simply untrue. The fact that wind generation is unpredictable and intermittent does indeed rebut vertical market power concerns. If a transmission owner were to attempt to violate federal law and create or maintain a transmission constraint to increase prices for its affiliated wind generation (which NYSEG and RG&E could not do in any event, for the reasons described below), there would be no assurance that the wind generator would be able to run when requested. Furthermore, wind generators have zero fuel costs. For this reason, wind

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generators that are "interconnected with NYSEG's or RG&E's transmission or distribution facilities."

generators are typically bid into the energy markets as "price-takers," (*i.e.*, they bid into the market at zero price) to ensure that they are dispatched when capable of producing energy.

In addition, Dr. Hieronymus explained that energy from wind generators cannot reasonably be sold into the NYISO's day-ahead market, the market in which the substantial majority of New York electricity is bought and sold. This is because if a wind generator were to sell into the day-ahead energy market, it would have to assume the risk of paying the unpredictable real-time price to cover the financially firm energy that it sold in the day-ahead market in the event that it could not produce the committed energy (*i.e.*, if the wind is not sufficient to run its turbines). Given that wind generation must participate in the NYISO's much smaller real-time market, even if NYSEG and RG&E were able to create or maintain transmission constraints to increase prices for their affiliated generation (which, for the reasons described below, they cannot), Dr. Hieronymus concluded that such actions would have no impact on prices in the larger day-ahead market (Tr. 818).

Dr. Hieronymus also found that the nameplate ratings of wind generators substantially overstate their fossil-equivalent generation capability. Wind power typically has a maximum capacity factor (*i.e.*, average availability) of only about 30% (Tr. 818). Therefore, any theoretical incentive that NYSEG and RG&E may have to manipulate transmission to increase prices for their affiliated wind generation would be far less than that suggested by the nameplate capacity of that generation.

The RD appears to misunderstand the fundamental issue that the VMP Policy Statement was intended to address; namely, that a transmission owner may have an incentive to retain a transmission constraint to keep the market price high on the high-cost side of the constraint. Specifically, the VMP Policy Statement expressed the concern that, if an affiliated "generator is on the high cost side of a transmission constraint and the T&D company has the ability to influence the transmission constraint," then "[t]he T&D company has the incentive to retain the constraint to keep the market price high on the high cost of the constraint" (VMP Policy Statement, at Appx. I, p. 1). However, all of Iberdrola's affiliated wind development projects are located on the *low-cost* side of the major constrained interface in New York State commonly known as the Central-East transmission interface (and not on the high side of the Central-East interface) (Tr. 819-20).[49]

The RD nonetheless claims, without basis, that "energy transmission crosses state boundaries, so that the NYSEG and RG&E territories can be not only the low-cost side relative to the Central-East constraint, but also simultaneously the high-cost side relative to lower cost supplies from PJM or Canada" (RD at 69). The claim that the NYSEG and RG&E territories are on the high-cost side of some unidentified constraint lacks any support in the record or in reality. In fact, no party even attempted to make this argument in the course of this proceeding. Furthermore, the RD's faulty logic turns the VMP Policy Statement on its head – if, as the RD suggests, the low-cost side of a particular transmission constraint is always the high-cost side of some other constraint (which, despite the RD's statement, is simply not true), then the VMP Policy Statement's consideration of a generator's location vis-à-vis an operative constraint would be rendered meaningless.

Furthermore, the record is replete with evidence as to the extensive market rules and other oversight and mitigation mechanisms that have been adopted by the FERC and NYISO since the issuance of the VMP Policy Statement that directly address any vertical market power concerns that could potentially arise from Iberdrola's affiliated wind development activities in

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49 The NYISO Market Monitor recognizes the Central-East constraint as "one of the most important constraints in New York" (*see* Tr. 820).

New York (Tr. 826-835; *see also* Joint Petitioners IB at 52-57). In fact, when FERC approved the Proposed Transaction, it specifically concluded that the Proposed Transaction would not raise any vertical market power concerns given the comprehensive nature of the existing regulatory framework.[50] However, the RD does not attempt to address the comprehensive nature of these rules and mechanisms or their efficacy in terms of preventing the exercise of vertical market power. This is not surprising given that neither Staff, IPPNY nor any other party offered into the record any evidence to support a conclusion that this comprehensive regulatory framework would be insufficient to address the alleged vertical market power issues associated with the Proposed Transaction. Indeed, Staff only pointed to a generalized concern about "subtle" actions that a transmission owner could potentially take to disadvantage non-affiliated generation (Staff IB at 91; 94; 95; and 102), "[n]otwithstanding the nearly decade-long experience with NYISO and FERC since the issuance of the VMP [Policy] Statement" (Staff IB at 91).

The RD suggests, notwithstanding the extensive evidence in the record with respect to the market rules and other mechanisms that have been adopted by FERC and NYISO, that there is no need even to evaluate the ability of such regulatory framework to address the potential for vertical market power because "reliance on regulation instead of divestiture creates the preconditions of this type of mischief [*i.e.*, engaging in discriminatory behavior]" (RD at 68). However, the RD's position that there is effectively no level of regulatory oversight that would be sufficient to eliminate vertical market power concerns is fundamentally at odds with the VMP Policy Statement itself, which specifically provides that any presumption against a transmission owner acquiring or being affiliated with generation in New York can be rebutted, and that there

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50 *Energy East Corp.*, 121 FERC ¶ 61,236 (2007).

is not an absolute prohibition on such affiliated ownership of generation (*see* VMP Policy Statement, at Appx. I, pp. 1-2). There is no reason for the Commission to ignore the comprehensive and ongoing regulatory oversight functions that FERC and the NYISO undertake with respect to vertical market power.

The RD further notes Staff's argument that "some uses of market power [are] too 'subtle' to be detected by regulators" (RD at 67). However, claims of possible, unspecified and speculative "subtle" actions are insufficient to justify placing any restrictions on the ability of Iberdrola's affiliates to own or operate wind generation in the State. This is particularly true given that, as the record evidence demonstrates, NYISO effectively controls all of the functions giving rise to Staff's market power concerns, including transmission system dispatch and generation redispatch, transmission planning and generation interconnection procedures (Tr. 826-27; *see also* Joint Petitioners IB at 53). As a result, NYSEG and RG&E simply do not have the same discretion over those transmission assets that existed when the VMP Policy Statement was issued (*Id.*). Moreover, any hypothetical risks related to discriminatory access and/or actions that could potentially be taken by NYSEG or RG&E could easily be addressed, for example, through increased transparency measures, rather than the extreme prohibitions and divestitures advocated by Staff (*See* Joint Petitioners RB at 25).

Since there is nothing in the record to refute the efficacy of these market rules and oversight and mitigation mechanisms, the RD attempts to justify its proposed restriction on Iberdrola's affiliated wind activities by relying solely on the Commission's *Grid/KeySpan Order* which required the divestiture of KeySpan's Ravenswood Station as a condition to merger approval (RD at 64-65). However, the RD does not address the numerous substantive reasons presented by Joint Petitioners and other parties as to why reliance on the *Grid/KeySpan Order* to support a restriction on Iberdrola's affiliated wind activities in New York would be misplaced. In particular, the Ravenswood Station is a 2,400 MW natural gas-fired facility located in New York City, which presented significantly different issues from those presented by the development by Iberdrola's affiliates of wind projects that would be interconnects to NYSEG's and RG&E's systems (which currently represent only approximately 166 MW), in particular given the intermittent and unpredictable nature of wind-powered generation. In addition:

- The Commission had already determined prior to the KeySpan merger proceeding that the Ravenswood station should be sold to a non-utility generator (Joint Petitioners RB at 25; CPB IB at 10).

- The Commission's decision to require divestiture in the *Grid/KeySpan Order* depended on the specific facts surrounding the Ravenswood Station, which forms a large part of the New York City market, a load pocket with wholly inflexible capacity requirements. The *Grid/KeySpan Order* therefore presents a fundamentally different situation from that presented by Iberdrola's affiliated wind generators in New York (Tr. 855; *see also* Joint Petitioners RB at 25).

- The Ravenswood Station represents approximately 25% of the capacity in New York City, and is pivotal in both the energy and capacity markets. In fact, the Ravenswood Station is *the* marginal unit in the City, setting the locational-based marginal price (Tr. 855-56; *see also* Joint Petitioners RB at 25). By contrast, any Iberdrola affiliated wind generators that would interconnect to NYSEG or RG&E would never be pivotal suppliers. In fact, those generators would be pure "price-takers" that would never be the marginal generator. Moreover, any wind generators interconnected to the NYSEG or RG&E systems would represent only a small share of the NYISO Western market which has excess supply and, significantly, is connected to other Regional Transmission Operators that provide additional supply elasticity in the energy and capacity markets (Tr. 856). Thus, affiliated wind generation would present a fundamentally different situation from that presented by the Ravenswood Station.

- In the *Grid/KeySpan Order*, the Commission appears to have relied on Staff-sponsored evidence that the energy price received by the Ravenswood Station can be, and has been, significantly affected by the operation of National Grid's New York transmission system.[51] This is in stark contrast to wind generation facilities with unpredictable levels of output that bid in at zero as "price-takers". Affiliated wind generation cannot be realistically affected by affiliated transmission operation.

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[51] *See Grid/KeySpan Order* at 34-40; *see also* Joint Petitioners RB at 26.

- In the *Grid/KeySpan Order*, the Commission did not require the divestiture of KeySpan's fossil-fueled generating facilities located on Long Island, thereby undermining Staff's position that the VMP Policy Statement effectively creates an absolute prohibition on the affiliation of transmission and generation owners.[52]

For these reasons, the *Grid/KeySpan Order* does not provide support for the RD's proposed prohibition of the ownership or operation by Iberdrola's affiliates of wind generators interconnected to the NYSEG or RG&E systems.

Exception No. 10: The RD errs in recommending the divestiture of Energy East's existing hydroelectric facilities as a condition to approval of the Proposed Transaction.

The RD recommends that, if the Commission approves the Proposed Transaction, it should require the divestiture of NYSEG's and RG&E's approximately 112 MW of existing hydroelectric generation (RD at 78). The RD attempts to justify this condition based on a general "require[ment] [of] Commission intervention in furtherance of its policies against ownership of generation interconnected with the owner's T&D system," as set out in the VMP Policy Statement (RD at 78). However, for the reasons described above, the extensive market rules and other oversight and mitigation mechanisms adopted by FERC and NYISO since the issuance of the VMP Policy Statement directly address any vertical market power concerns that could potentially arise from the continued ownership of this *de minimis* amount of hydroelectric generation by NYSEG and RG&E (Tr. 826-35; *see also* Joint Petitioners IB at 52-57).

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52 Some parties may seek to distinguish KeySpan's Long Island generating facilities from Iberdrola's affiliated wind generation based upon the fact that the Long Island facilities are subject to long-term, cost-of-service contracts with the Long Island Power Authority, which effectively diminish the vertical market power concerns associated with those facilities. *See Grid/KeySpan Order*, at 36 (noting that, "[a]ccording to DPS Staff, the acquisition of KeySpan's [Long Island] generation facilities is not of immediate concern to the extent their output is the subject of long-term contracts with LIPA based on the cost-of-service."). As described above, the intermittent and unpredictable nature of wind similar "makes wind-powered generating facilities ill-suited to be used in the exercise of vertical market power" (Tr. 842; Joint Petitioners IB at 57). In neither instance could such generation be used to manipulate prices.

Moreover, the RD fails to recognize, much less address, the critical fact raised by Joint Petitioners that these facilities consist only of run-of-the-river hydroelectric generation, "which by its nature is ill-suited to the exercise of vertical market power" (Joint Petitioners RB at 20-21; Tr. 847). As run-of-the river hydroelectric facilities generate electricity only through the natural flow and elevation changes of rivers, it strains credulity for the RD to conclude that Energy East's continued ownership of such intermittent resources would raise any vertical market power concerns, much less any concerns that would warrant their divestiture. As CPB has correctly concluded, the ownership of these facilities by NYSEG and RG&E "[creates] no problems for the continued development of a competitive generation market that any party has been able to identify or quantify" and, therefore, "[t]here is no justification for a Commission order directing the divestiture of these assets" (CPB IP at 9; *see also* Tr. at 716; Joint Petitioners RB at 20).

As CPB also explained, proponents of hydropower divestiture bear the burden of proof because the Commission deliberately chose *not* to require divestiture when it reviewed NYSEG's and RG&E's restructuring proposals in 1998 (CPB IB at 10). When addressing CPB's argument, the RD turns logic on its head and concludes that, because there is nothing in the Commission's 1998 restructuring orders that would indicate that hydroelectric facilities are immune to divestiture, they should now be divested (RD at 79). This argument flies in the face of the fact that the VMP Policy Statement creates only a presumption against the affiliation between generation and transmission, and not an absolute prohibition. Arguments against divestiture should not be dismissed merely because the Commission did not affirmatively state in earlier orders that these facilities should not be divested. Moreover, the RD fails to respond to CPB's argument that, despite the Commission's many previous opportunities to have raised vertical market power concerns with respect to Energy East's existing hydroelectric facilities in New York, "vertical market power disputes [with respect to these facilities] do not appear to have been a problem until now" (CPB IB at 11).

As noted above, the VMP Policy Statement expressly provides for the ability to override the presumption against the affiliation of generation and transmission, essentially on the grounds that any vertical market power issue is *de minimis*. In the VMP Policy Statement, the example of *de minimis* status is shown by reference to a very small transmission utility. As Joint Petitioners' expert witness Dr. Hieronymus has explained: "since it is the combination of generation and transmission that matters, it likely should be the case that the combination of a substantial transmission owner with *de minimis* generation should be permissible" under the VMP Policy Statement (Tr. 851). Given the truly *de minimis* nature of these hydroelectric facilities (approximately 112 MW), it "strain[s] credulity to contend that the continued ownership of this amount of generation by NYSEG and RG&E creates a vertical market power concern, even if such generation were related to the Merger (which it is not)" (Tr. 847).

The only parties that are encouraging the divestiture of Energy East's existing hydroelectric facilities are Staff and IPPNY. As IPPNY's members consist of entities that are incumbent generators in New York State that are commercially opposed to utilities competing in the generation market, and as these members may be interested in bidding on these hydroelectric facilities if they are required to be divested, IPPNY's arguments in support of divestiture and prohibitions on certain development activity should be viewed with skepticism.

Exception No. 11: The RD errs in finding that Energy East's divestiture of its existing hydroelectric facilities would be more beneficial for customers than the retention of those facilities.

As CPB correctly concludes: "[t]he continued ownership and operation of these low-cost, renewable energy facilities [*i.e.*, Energy East's existing hydroelectric facilities] by the utilities provides direct benefits to ratepayers while creating no problems for the continued development of a competitive generation market that any party has been able to identify or quantify" (CPB IP at 9; *see also* Tr. 716). In response, the RD recommends divestiture of the hydroelectric generation, but also invites further input on exceptions as to whether there are customer benefits that merit having Energy East retain ownership of this hydroelectric generation.[53] In response to the RD's request for this information, and on exception to the RD's recommendation for divestiture of hydroelectric generation, Joint Petitioners provide the information below and in Attachment 2.

The RD's recommendation in favor of divestiture of these hydroelectric facilities could result in the very situation that Staff has asserted is problematic with the Asset Sale Gain Account depletion as a result of the market cost of replacing power previously provided from Ginna (Staff IB at 221-23). While ratepayers may receive a short-term gain from the sale of the hydroelectric facilities, the cost to replace the power in the market may ultimately result in increased power costs to customers, particularly as the price paid for the hydroelectric power after divestiture would include a level of unregulated profit for the new owners of these facilities (Joint Petitioners RB at 21, n.33).

Based on current market prices and expected output production, Joint Petitioners estimate that NYSEG and RG&E customers would have to pay on average \$49 - \$55 million more annually for replacement power if these hydroelectric facilities are divested. NYSEG's hydroelectric facilities in Plattsburgh and Mechanicville are expected to produce approximately 300,000 MWh of energy annually, and RG&E's hydroelectric facilities are expected to produce

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53 The RD states "absent further explanation on exceptions, it is not clear that retention [of the hydroelectric assets by NYSEG and RG&E] would be economically more beneficial for customers than divestiture" (RD at 80).

approximately 271,000 MWh of energy annually. Based on current future market prices, the cost associated with replacement power for these hydroelectric facilities ranges between $27 - $30 million for NYSEG electric customers and $22 - $25 million for RG&E electric customers, as illustrated on Attachment 1.

D. FINANCIAL RISKS AND PROTECTIONS

The RD recommends adoption of all but two of the financial conditions proposed by Staff to address purported risks of the transaction (RD at 114-16).[54] Joint Petitioners agree to most of these, including conditions that provide appropriate protection against credit risk, bankruptcy risk at the NYSEG and RG&E level, appropriate dividend policies and ensuring financial transparency and oversight.[55] Most notably, to address bankruptcy risk issues, Joint Petitioners are willing to agree to an Independent Bankruptcy Consent Right, discussed below, that addresses the same elements that were raised by Staff and included in its Condition 19 "Golden Share" proposal. Together with Condition 20's limited purpose entity provision and other conditions agreed to by Joint Petitioners, this condition fully insulates NYSEG and RG&E from upstream affiliate bankruptcy risk.

Joint Petitioners disagree with certain financial restrictions Staff proposes which were based in part on the Grid/KeySpan transaction and other restrictions that even go beyond that transaction. When reviewing the reasonableness of any financial conditions, the

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[54] The RD correctly rejects Staff-proposed conditions that would (i) modify the existing code of conduct of Energy East, NYSEG and RG&E, and (ii) provide that customers would not be responsible for the effect of any downgrade from NYSEG's or RG&E's present debt ratings (RD at 114-16). The RD also partially rejects a condition proposed by MI, to the extent that it would require reduction of NYSEG and RG&E revenues of up to 25% in the event another firm "acquires Iberdrola and its New York subsidiaries" without the Commission's approval under Section 70 (RD at 116).

[55] Attachment 2 hereto lists each of the conditions that Joint Petitioners accept as a condition to the Commission's approval of the Proposed Transaction.

Commission should focus on protections needed to address actual and realistic risks identified in the record. It is inappropriate to project unrealistic "worst-case scenarios" based upon purely hypothetical and unproven risks. In this regard, a fundamental error in the RD's adoption of Staff's proposed conditions is that it fails to tailor mandated financial protections to any actual, present and identifiable risks in this proceeding. Rather, in adopting almost all the proposed conditions of Staff, which in turn were based on those in Grid/KeySpan and other conditions that were created or unprecedented, the RD simplistically relies on a "one-size fits all" approach (*see, e.g.*, Tr. 1405 (stating that Staff's recommended conditions related to credit quality are not any more stringent than those imposed in the Grid/KeySpan merger)).

This case is manifestly different from Grid/KeySpan. Here, unlike the circumstances presented in Grid/KeySpan, Iberdrola has a higher credit quality than Energy East, NYSEG or RG&E (Tr. 506-07; 553; 742; 767; 1058). Iberdrola has "A" level category credit ratings from all major credit ratings agencies while Energy East, NYSEG and RG&E, have "BBB" category ratings with negative outlooks from S&P and Moody's (Tr. 742). This is in contrast to Grid/KeySpan, where KeySpan's standalone "A" rating fell to National Grid's lower "A-" rating as a result of the merger (Tr. 553).[56] Grid/KeySpan is also distinguishable because it was financed entirely with debt, while Iberdrola has financed the Proposed Transaction entirely with equity (Tr. 507).[57] On June 27, 2007, Iberdrola successfully sold 85 million new shares of common stock through an accelerated private placement that was fully subscribed, demonstrating Iberdrola's capacity and ability to raise capital. The result is that the Proposed Transaction will

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[56] Here, affiliation with the "A" category rated Iberdrola might allow Energy East, NYSEG and RG&E to escape their negative outlooks and potentially improve their ratings (Tr. 767-68) or reduce their cost of debt (Tr. 508).

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

not result in any increase in the debt of Energy East or Iberdrola, or any of their affiliates (Tr. 507-08) and ratepayers will be protected from the risks of the debt financing relied upon in Grid/KeySpan (*Id.*).

The Commission should adopt protective financial conditions consistent with the discussion herein. As reflected in Attachment 2, where a financial condition from the RD is not discussed below, Joint Petitioners accept the condition without modification.[58]

Exception No. 12: The RD errs in applying a "burdensome" standard when approving Staff-proposed financial protections that are irrelevant, unnecessary and unreasonable.

The RD incorrectly asserts that the standard for determining whether the Commission should impose Staff's proposed financial protections upon Joint Petitioners is whether a particular protective measure is "burdensome," rather than whether it is necessary to remedy a particular alleged risk of the Proposed Transaction (RD at 114). The RD concludes that "absent a further demonstration on exceptions that the protective measures proposed by the transaction's opponents would be unreasonably burdensome relative to the alleged risks, the recommendation here is that the Commission adopt all the proposed measures except as follows" (*Id.*). The RD then proceeds to identify only two of Staff's proposed measures that it considers burdensome, and recommends the wholesale adoption of the majority of Staff's proposed measures. The RD's use of a "burdensome" standard to evaluate merger conditions is not supported by any evidence in the record or Commission precedent.[59]

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58 Given the extensive scope of these financial conditions, and the fact that it may be in the interests of customers or ratepayers to permit some of these prohibited activities from time-to-time, the Commission should retain the right to grant waivers from the obligations in these conditions as it sees fit.

59 In the discussion of the three conditions that the RD rejected (two proposed by Staff and one by Multiple Intervenors), the RD describes some as "unreasonable" (*e.g.*, RD at 115), which suggests that the RD also believes that reasonableness is a factor that should be considered in

The Commission's analysis of whether to impose a protective measure on a party must logically begin with the identification and quantification of the alleged risk the measure is intended to remedy. As noted, the Commission first assesses alleged risks to determine their reasonableness and likelihood before imposing remedial conditions.[60] Based on that evaluation, the Commission must decide whether the proposed protective measure is necessary to address the alleged risk. The RD, however, fails even to quantify the risks of the Proposed Transaction, claiming instead that "the transaction involves at least some indeterminate degree of risk" (*Id.* at 112). The RD discusses "the difficulty of objectively determining the gravity of a particular risk or the likelihood that it will materialize" (*Id.* at 113). As discussed above in Exception No. 3, the disparity in the RD's evaluation of benefits and risks fails to reflect reasoned decision-making. For these reasons, the Commission should grant Joint Petitioners' exception to the RD's use of this "burdensome" standard.

Exception No. 13: The RD errs in recommending the adoption of Staff's Condition 1, under which no Goodwill from any past transaction may be recorded on the books of NYSEG, RG&E or Energy East.

The RD recommends that the Commission adopt Staff's proposed Conditions 1, 2 and 3, which relate to the treatment of Goodwill and acquisition costs (*see* RD at 94-96, 114). Joint Petitioners object to one aspect of Condition 1, concerning past transactions. That condition provides:

> Condition 1 - The acquisition premium and costs associated with the pending *and all past* transactions will not be recorded on the books of NYSEG and RG&E or Energy East (RD at 94) (emphasis added).

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determining whether financial conditions should be imposed (although that standard does not appear to have been uniformly considered in the RD's analysis).

60 *See, e.g., NIMO/NG Order*, at 62, 71 (evaluating and rejecting concerns raised by intervenors regarding risks of the transaction); *LILCO/BUG Order*, at 28, 30 (same).

As the RD correctly notes, Joint Petitioners have already committed: (1) not to seek recovery of costs incurred to consummate the Proposed Transaction from NYSEG and RG&E ratepayers; (2) that the premium paid for Energy East resulting from the Proposed Transaction will remain on the books of Iberdrola and its wholly-owned affiliates and will not be recorded on the books of Energy East, RGS, RG&E, or NYSEG (Tr. 491-92; *see also* Joint Petitioners RB at 56); and (3) not to seek recovery of costs associated with the past RGS transaction in future rates (Joint Petitioners RB at 57).

The effect of Condition 1, however, would be to require Joint Petitioners to affirmatively remove Goodwill from the books of RGS associated with previous transactions such as the Energy East/RGS transaction. This is contrary to U.S. Generally Accepted Accounting Principles ("U.S. GAAP") and is beyond the jurisdiction of the Commission. U.S. GAAP specifically prohibits the upward transfer of existing Goodwill on the acquired entity's books as part of a subsequent merger or acquisition. In addition, the Commission has no authority to order an unregulated holding company to alter its balance sheet when the specific amounts are not reflected on or allocated to the regulated utility companies.

Niagara Mohawk Power Corporation ("Niagara Mohawk") continues to hold Goodwill on its books from its acquisition by National Grid, where the Goodwill created in the transaction was pushed down to the operating company level as part of the Purchase Accounting used in the transaction. For regulatory reporting and ratemaking purposes, the Niagara Mohawk Goodwill is excluded, but it has not been moved to National Grid USA, let alone to the ultimate National Grid parent. The Energy East/RGS goodwill has already been physically excluded from the NYSEG and RG&E utility books,[61] which has been and should continue to be more than adequate to inform regulators and protect customers.

Accordingly, the Proposed Transaction is not related to the Goodwill that was permitted and placed at the Energy East level as part of the Energy East/RGS transaction, and it is inappropriate and unnecessary to alter that previous Goodwill determination at this time. Joint Petitioners have already committed not to seek recovery in future rates of costs associated with the past RGS transaction. This is sufficient to address any rational NYSEG and RG&E ratepayer concerns. The Commission should revise and narrow Condition 1 as reflected in Attachment 2.

Exception No. 14: The RD errs in recommending the adoption of Staff's Condition 3 that would require Iberdrola to provide the results of Goodwill impairment tests.

Condition 3 provides that Iberdrola will "provide the results of any goodwill impairment test" (RD at 94). Joint Petitioners except to this requirement because it places an unreasonable burden on Iberdrola to report impairment test results at the holding company level, and is wholly unrelated to any legitimate regulatory concern regarding NYSEG and RG&E.

The record shows that Goodwill at the holding company level is the normal state of affairs for utility equity investments since U.S. utility equities normally sell at a premium over book value (Tr. 1054). In addition, the mere fact of Goodwill existing at the Iberdrola level creates no ratepayer harm (such as incentives for reducing service quality or other similar measures at NYSEG and RG&E) (Tr. 1052).

Moreover, with the thorough insulation of NYSEG and RG&E from Iberdrola in the conditions that have been accepted by Joint Petitioners (including the Independent

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[61] The Commission permitted the treatment of Goodwill at the holding company level following Energy East's acquisition of RGS. *See EE/RGS Order* (accepting without modification Section G of the Joint Proposal including the agreement that Goodwill would reside at the "New RGS level" or higher).

Bankruptcy Consent Right in Joint Petitioners' modification to Condition 19 and the limited purpose entity in Condition 20), and the commitments in Conditions 1 and 2 not to seek to recover Goodwill from NYSEG or RG&E customers from the Proposed Transaction or record Goodwill from the Proposed Transaction on the books of Energy East, NYSEG or RG&E, no basis for concern about Goodwill at the Iberdrola level remains. The RD provides no specific justification for requiring an impairment test at the Iberdrola level to be reported to the Commission (*see generally* RD at 111-17) and the Commission should reject it.

Exception No. 15: The RD errs by adopting Condition 6 without appropriate limiting modifications.

The RD recommends adoption of Staff's proposed Conditions 4 through 8 to address purported concerns regarding credit rating risks of Iberdrola (*see* RD at 96-98). Joint Petitioners are willing to accept these proposed conditions, with limited exceptions regarding Condition 6 and 7, noted below. Staff's proposed Condition 6 provides:

> Condition 6 - Copies of presentations made to credit agencies, and backup information, shall be provided to regulators on an ongoing basis (RD at 96).

Joint Petitioners have previously agreed to provide slide presentations to credit agencies and copies of credit reports relating to NYSEG and RG&E (Joint Petitioners IB at 5; Joint Petitioners RB at 50, citing Tr. 554). Joint Petitioners object to Staff's overly broad, unnecessary and irrelevant requirement to provide all backup information, and to provide slide presentations to credit agencies even if they do not relate to NYSEG and RG&E. The requirement to require backup information is an added layer of regulatory oversight that goes beyond what is traditionally required by regulators and what is needed to reasonably review the financial health of NYSEG and RG&E. Ratepayer interests are more than adequately protected by Joint Petitioners' agreement to, among other things, Conditions 1, 2, 4, 5, 9, 19 (as modified by Joint Petitioners) and 20.

Moreover, this additional information bears no relationship to anything Staff needs to maintain effective regulation over NYSEG and RG&E (*see, e.g.*, Tr. 1071 (explaining that any financial risk faced by NYSEG, RG&E and their respective customers is "tied to the regulated capital structures of NYSEG and RG&E . . . . [t]he parent does not affect financial risk, as such; the regulated capital structure does"). The requirement to provide slide presentations with regard to affiliates other than NYSEG and RG&E would be unreasonable and burdensome because Iberdrola would be required to expend personnel resources gathering and submitting such information regarding subsidiaries in South America, Europe or other jurisdictions that have no relevance whatsoever to regulated subsidiaries in New York. The Commission should limit proposed Condition 6 as set forth in Attachment 2 hereto.

Exception No. 16: The RD errs by recommending Staff's Condition 7 without appropriate modifying conditions.

The RD recommends adopting the following condition to address credit quality:

> Condition 7 – A NYSEG or RG&E credit downgrade by S&P or Moody's will require that a plan be filed with the Commission to remedy the downgrade (RD at 96).

The RD's recommendation is overly broad and therefore burdensome because it would require a plan to be filed to remedy a downgrade, even if the downgrade is to a credit rating higher than investment grade. It does not make sense to require that a plan be filed if in the future Energy East or one of its regulated subsidiaries changes from one stable investment grade rating to another stable investment grade rating. To address the credit downgrade concern, Joint Petitioners are willing to agree to a modified condition under which a plan would be required to be filed with the Commission when the least secure unsecured bond rating of such company is downgraded by S&P or Moody's to the non-investment grade category, or is at the lowest investment grade and either S&P or Moody's has issued an outstanding negative watch or review downgrade notice. This is virtually the same as conditions the Commission just recently approved in the merger of Gaz de France and Suez.[62]

Exception No. 17: The RD errs by recommending Staff's Conditions 10 and 11 regarding dividends.

The RD recommends adopting of Staff's five conditions related to dividends paid by NYSEG and RG&E (RD at 97-99). Joint Petitioners are willing to agree to Condition 9, which provides a formula that limits the amount of dividends that NYSEG and RG&E may send upstream, and Conditions 12 and 13, which pertain to restrictions on NYSEG and RG&E in the case where their respective bond ratings are downgraded to non-investment grade (*see* RD at 99). For the reasons set forth below, Joint Petitioners except to the RD's recommendation concerning Conditions 10 and 11. Those Conditions provide:

> Condition 10 – NYSEG and RG&E are each prohibited from paying a dividend at any point in time when their least secure unsecured bond rating is at the lowest investment grade and a rating agency has issued outstanding negative watch or review downgrade notices.
>
> Condition 11 – NYSEG and RG&E are each prohibited from paying a dividend if Iberdrola's least secure senior unsecured debt is rated below an investment grade by a rating agency. (RD at 98-99).

As with many of Staff's other proposed conditions, the proposed dividend conditions, including Conditions 10 and 11, were simply "lifted from the order approving

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62 Specifically, in the order approving the merger, the Commission's condition on this issue stated: "[I]f Suez Environment, United Water Inc., or United Water New Jersey is downgraded below Baa3 by Moody's or BBB- by Standard & Poor's, or if Suez Environment, United Water Inc., or United Water New Jersey are rated BBB- or Baa3 and placed on credit watch, United Water will file with the Commission within sixty (60) days after notification from Moody's or Standard and Poor's a document setting forth the graded entity(s) management's plans to address in a timely manner the credit quality areas of concern set forth in the downgrade notification." *Gaz de France/Suez Order*, at 6.

National Grid's acquisition of KeySpan Corporation" (*Id.* at 99). Conditions 10 and 11 amount to excessive restrictions that were unjustifiably based on the Grid/KeySpan merger even though the financial risks of that transaction were much greater than those of the Proposed Transaction (*see* Joint Petitioners IB at 58-61; Joint Petitioners RB at 66-68). The RD in its recommendations fails to justify proposed Conditions 10 and 11, and they should be rejected.

Condition 10 would prohibit NYSEG and RG&E from paying a dividend, even when their debt remains rated at investment grade level, and a rating agency has issued outstanding negative watch or review downgrade notices. This provision—which would impose an administratively mandated prohibition on dividends even while the utility companies have maintained *investment grade* ratings—is unjustified and unduly restrictive. Staff's apparent speculation that Iberdrola will drain the capital of NYSEG and RG&E is unwarranted, and disregards not only Iberdrola's intentions and historical practice, but also the Commission's ongoing ability to utilize its regulatory powers to ensure that the operating companies provide safe and reliable service.[63] In such a scenario, Joint Petitioners are willing to file a plan with the Commission to address any negative watch, or downgrade notice, similar to that required by Condition 7 (*see* Joint Petitioners IB at 5 (discussing the reporting of a defined "Credit Event")). This is adequate to address concerns relating to a negative watch or review downgrade notice. However, the dividend restriction itself should not begin to apply until the downgrade below investment grade actually occurs.

Condition 11 would prohibit NYSEG and RG&E from paying dividends at any time that *Iberdrola* has unsecured debt rated below investment grade by a rating agency, even if

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

NYSEG and RG&E themselves have maintained investment grade ratings. This condition should not apply at all. Given its financial strength, Iberdrola is unlikely to experience any such downgrade below investment grade.[64] However, even if Iberdrola were to be downgraded to below investment grade, as long as the utility operating companies' finances are sound, any such unlikely downgrade would not impact the abilities of NYSEG and RG&E to continue to pay dividends per their current dividend policies. This is especially true where, as here, other conditions (*e.g.*, Conditions 9, 12, 13, 19 (as modified herein) and 20) ensure that NYSEG and RG&E would be insulated from affiliate bankruptcy risk. NYSEG's and RG&E's ability to continue to pay dividends should be evaluated on their own, pursuant to the other conditions that Joint Petitioners accept, *i.e.*, Conditions 9, 12 and 13.

Finally, the RD recommends that the Commission adopt Multiple Intervenors' proposal that the Commission "reserve the option of enjoining dividend payments from Energy East to Iberdrola" if "another firm acquires Iberdrola and its New York subsidiaries without the Commission's approval under PSL § 70" (RD at 116). This condition should be rejected. It is based on pure conjecture and implies without basis that a future transaction may take place in violation of the PSL. Even if there were a basis to assume such a future violation—which there clearly is not—no condition is necessary because the Commission always retains its full panoply of regulatory compliance and enforcement powers under the PSL.

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64 Moreover, there is no evidence that Iberdrola is likely to experience a downgrade to below investment grade. *See* Tr. 777-78 (noting S&P and Moody's have indicated "comfort with Iberdrola's debt level"); Tr. 760-62 (discussing S&P's "stable" outlook for Iberdrola and positive comments from Moody's regarding Iberdrola's diversification of risks and increased scale); Exh. 70 (Moody's report reaffirming Iberdrola's "A" category rating); *see also* Joint Petitioners RB at 43-49.

Exception No. 18: Joint Petitioners are willing to accept Condition 15, with a limited modification.

Proposed Condition 15 provides that "Iberdrola may participate in a money pool only as a lender" (RD at 100). Although the context and logical intent of this provision is to address money pool transactions involving NYSEG or RG&E as participants, Condition 15 as recommended by the RD is broad enough to be interpreted to purport to prohibit *any* money pool transaction solely involving Iberdrola and its affiliates outside New York. Joint Petitioners agree to the following condition, which addresses the RD's concerns: "If NYSEG or RG&E are participants in a money pool, Iberdrola may only participate in such money pool as a lender."

Exception No. 19: Joint Petitioners agree to a condition to provide an Independent Bankruptcy Consent Right similar to the RD's recommendation to adopt Condition 19.

The RD recommends adoption of a Staff's proposed condition that would impose a "Golden Share" requirement (RD at 101-13). Proposed Condition 19 provides:

> Condition 19 – A golden share is required to prevent a bankruptcy of Iberdrola or any of its affiliates from triggering a voluntary bankruptcy of NYSEG or RG&E.

As clarified below, while there is no support for such a condition, Joint Petitioners nonetheless agree to it, subject to the following clarification. Specifically, Joint Petitioners have concern that the RD's recommended Condition 19 does not provide sufficient detail as to the process for establishing the new class of preferred stock and the rights associated with the independent bankruptcy consent provision, and without such detail there could be unnecessary implementation delay or dispute. Therefore, Joint Petitioners are willing to adopt as a condition to the Proposed Transaction an "Independent Bankruptcy Consent Right" which is, in effect, a bankruptcy veto right controlled by an independent party, as follows:

- As a condition to the Commission's approval of the Proposed Transaction, Joint Petitioners commit to modify corporation by-laws as necessary and establish a voting right in order to prevent a bankruptcy of NYSEG or RG&E to be caused by a bankruptcy of Iberdrola, Energy East, or any other affiliate.

- Within six weeks of closing, of the Proposed Transaction, NYSEG and RG&E will each file a petition with the Commission seeking authority to establish a class of preferred stock having one share, subordinate to any existing preferred stock, and to issue such share of stock to a party to be proposed by NYSEG and RG&E and approved by the Commission who would protect the interests of New York and would be independent of the parent company and its subsidiaries. Such stock shall have voting rights only with respect to limiting NYSEG's and RG&E's right to commence any voluntary bankruptcy, liquidation, receivership, or similar proceedings without the consent of the holder of that share of stock.

- In the event that NYSEG and RG&E are unable to meet this condition despite good faith efforts to do so, NYSEG and RG&E are required to petition for relief from this condition, explaining why it is impossible to meet and how they propose to meet an underlying requirement that a bankruptcy involving Iberdrola, Energy East, or any other affiliate does not necessarily result in the inclusion of NYSEG and RG&E in such a bankruptcy.

This condition fully addresses any relevant concerns regarding the insulation of NYSEG and RG&E from negative effects associated with the bankruptcy of Iberdrola, Energy East or any other affiliate. Joint Petitioners urge the Commission to adopt this Independent Bankruptcy Consent Right as a condition of the Proposed Transaction, given the insufficient details provided in Condition 19, as recommended by the RD.

Exception No. 20: The RD errs in recommending adoption of Staff's proposed Conditions 22, 26, 27 and 28, as these proposed conditions are not justified by any actual risks and would be highly burdensome.

The RD recommends adopting all of Staff's proposed financial protection measures relating to reporting and financial transparency (*see* RD at 114). For the reasons set forth below, Joint Petitioners except (in whole or in part) to the RD's recommendation to adopt Staff's proposed Conditions 22, 26, 27, and 28.

Staff's proposed Condition 22 states as follows:

> Condition 22 - Staff shall have access to the books and records of Iberdrola and its majority-owned affiliates in English. The books and records shall be made available in New York (RD at 103).

Joint Petitioners except in part to the recommended adoption of this condition on the grounds that it is unnecessary and burdensome. As an initial mater, Joint Petitioners have already agreed to provide substantially all of the information Staff requests in Condition 22 (Tr. 549; Joint Petitioners RB at 70). However, to the extent this condition would apply to the books and records of all of Iberdrola's affiliates, even when such books and records are not related to NYSEG and RG&E, it is overbroad and should be rejected. It would be unduly burdensome for Iberdrola to provide such information. Likewise, it would be unnecessary and unhelpful to the Commission, in its ongoing regulation of NYSEG and RG&E, to receive such information. For example, providing the Commission with financial information relating to an Iberdrola wind project in Brazil serves no useful purpose, and involves aspects of Iberdrola's business that are totally unrelated to NYSEG and RG&E, particularly in light of the financial insulation of NYSEG and RG&E from Iberdrola as agreed to in other conditions herein. Therefore, the Commission should grant Joint Petitioners' exception to the RD's recommendation to adopt Condition 22.

Staff's proposed Condition 26 states as follows:

> Iberdrola shall provide annual public financial information, including consolidated balance sheets, income statements, and cash flow statements, and a comprehensive management discussion of its results consistent with Energy East's current SEC 10-K concerning Iberdrola's regulated and unregulated energy companies in the United States. Such filings shall include audited U.S. GAAP financial statements stated in U.S. dollars (RD at 103-04).

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

Joint Petitioners except to the RD's recommended adoption of this condition on the grounds that it is unnecessary, not required, overly burdensome and unreasonable to require Iberdrola to provide audited U.S. GAAP financial statements stated in U.S. dollars. Complying with this condition would impose an enormous administrative and cost burden on Joint Petitioners. Compliance would essentially require a complete duplication of all personnel and efforts to provide audited financial statements under both sets of accounting standards. The SEC has found that differences between GAAP and IFRS are no longer so pronounced (*see* Exh. 48). Furthermore, the SEC has adopted a Final Rule, which became effective on March 4, 2008, to accept financial statements from foreign private issuers prepared in accordance with IFRS without reconciliation to U.S. GAAP (Exh. 48). As observed by the SEC "IFRS as issued by the IASB and U.S. GAAP are both sets of high-quality accounting standards that are similar to one another in many respects, and the convergence efforts to date have progressed in eliminating many differences" (Exh. 48 at 20).[65] In this instance, the Commission should respect the expert judgment of the SEC and summarily reject Staff's burdensome and needless demand that Iberdrola use U.S. GAAP. The Commission can safely accept Joint Petitioners' offered

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

commitments without additional measures and should grant Joint Petitioners' exception to the RD's recommendation to adopt Condition 26.

Staff's proposed Condition 27 states as follows:

> The consolidated financial statements described in Condition 26 shall illustrate how each of Iberdrola's major regulated and non-regulated subsidiaries contribute to the overall consolidated financial statements. This information shall be provided in the same format as the consolidated financial statements made in SEC Form U-5S that registered utilities have filed under the Public Utility Holding Company Act of 1935. The energy utility information shall be fully consistent with the SEC Form U-9C-3 that registered holding companies had to file under PUHCA (RD at 104).

Joint Petitioners except to the RD's recommendation to adopt this condition on the grounds that it is overly burdensome for three reasons. First, its application to all of Iberdrola's major regulated and non-regulated subsidiaries is overly broad (*see* arguments against Condition 22 above). Second, as even Staff acknowledges, it would require Iberdrola to submit reports that are no longer required under PUHCA 2005 (Staff IB at 154; Tr. 1240). Third, this condition would impose an administrative and cost burden on Iberdrola to provide information from affiliates and subsidiaries in a format that Iberdrola has never previously used, simply because Staff is accustomed to it.

Joint Petitioners note, however, that they are willing for Energy East, NYSEG and RG&E to provide to the Commission consolidated financial statements in a format similar to that referenced in Condition 27. Therefore, with this clarification and commitment, the Commission should grant Joint Petitioners' exception to the RD's recommendation to adopt Condition 27.

Staff's proposed Condition 28 states as follows:

> In all future rate cases, Iberdrola shall file consolidated balance sheets, income statements and cash flow statements for Energy East, and its direct subsidiaries, in English using U.S. GAAP. This information shall be provided for the historic test year and be projected into the future rate year. In support of the forecasts, NYSEG and RG&E shall file balance sheets, income statements and cash flow statements for all the Energy East

subsidiaries that are either utility companies or operate in the energy business during the historic test year (RD at 104).

Joint Petitioners have already committed that Iberdrola's consolidated balance sheets, income statements and cash flow statements will be made available to the Commission, in English and in New York, on an annual basis and in a format that is mutually agreeable to Iberdrola and Staff (Tr. 550). These audited financial statements will be in accordance with IFRS, consistent with SEC requirements.

Joint Petitioners except, however, to the RD's recommendation that Condition 28 be adopted on the grounds that it is: (1) unnecessary, (2) inconsistent with the Commission's 1977 Statement of Policy on Test Periods in Major Rate Proceedings (the "1977 Policy Statement"), (3) beyond the Commission's requirements in the Grid/KeySpan merger, and (4) unprecedented.

Condition 28 is not necessary, because Joint Petitioners have agreed to provide the Commission with access to Iberdrola's consolidated balance sheets, income statements and cash flow statements, thus providing the Commission with sufficient financial information.

Further, Section 66 of the PSL, Part 61 of the Commission's regulations, along with the 1977 Policy Statement, set forth specific ground rules for information to be provided in establishing future rates for an electric or gas utility. The information sought by Condition 28 is not included in the data required for rate case filings. It is also not relevant for establishing the cost of service for the New York regulated companies.[66] For ratemaking purposes, there are no PSL or Commission requirements that Iberdrola file the various financial statements and historical test year and projected rate year information for its direct subsidiaries, or Energy East's other subsidiaries, outside of the New York regulated companies (NYSEG and RG&E) sought

[66] It is also not relevant for purposes of evaluating a merger proceeding.

by the RD in Condition 28. NYSEG and RG&E will fully comply with existing Commission ratemaking requirements, consistent with the elements of Condition 21, including providing all appropriate information when filing rate cases. To the extent that there are allocated costs to NYSEG or RG&E from a service or holding company, those costs would be identified and provided to the Commission, as required by the Commission's existing regulatory rules and policy. Thus, adoption of Condition 28 is not necessary for the Commission to have access to affiliate services company information.

Moreover, in the Grid/KeySpan merger, there was no requirement for National Grid to provide projected rate year financial statements for its non-New York regulated subsidiaries when filing future rate cases. There is no reason to insist that Iberdrola be held to a stricter standard than National Grid and all other New York utilities regarding future rate cases.

Joint Petitioners' commitment to provide consolidated financial information, the fact that the additional information sought is not necessary and exceeds existing Commission rate case filing requirements, and the heavy burden it would impose on the companies, mandates that the RD's recommendation be rejected.

E. PROPOSED POSITIVE BENEFIT ADJUSTMENTS

Staff has proposed over $646 million in PBAs as a condition of acceptance of the Proposed Transaction (RD at 124), which the RD recommends that the Commission adopt (*Id.*). The RD provides a lengthy, but internally inconsistent,[67] discussion as to why PBAs are required and why this particular level of PBAs should be accepted—despite the fact that the RD concedes

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[67] The internal inconsistencies in the RD are pervasive. For example, the RD correctly finds that Staff has inappropriately included *$930 million*, representing the acquisition premium for the Proposed Transaction, in its development of $1.6 billion in "benefits" (RD at 126). The RD correctly determined that this amount represents costs to Iberdrola rather than a benefit and, on this issue alone, finds that over 58% of Staff's calculation of benefits is invalid. Inexplicably, the RD states that Joint Petitioners "have made no valid points" to "materially affect" Staff's numbers (RD at 125).

there are significant flaws in two of Staff's benchmarks used to justify PBAs (Staff's estimate of "proxy" benefits, and its comparisons to the benefits-to-revenues percentages in prior mergers) and engages in no discussion of the third (Staff's comparison of the Proposed Transaction to an asset sale). After either discrediting or ignoring each of the three benchmarks, the RD states that those benchmarks are of no consequence and that, without them, other benefits would need to be constructed to reach the same $646 million level: "In each instance, petitioners' argument [discrediting the basis of Staff's PBAs] proves only that PBAs . . . must be funded from some source other than the items mentioned" (RD at 128). Either (a) the benchmarks reflect the RD's bases for the PBAs (which, once discredited, leave the PBAs without any foundation), or (b) the RD is simply trying to justify a pre-designated level of PBAs. The RD's claim that it is not recommending an "entry fee" for Iberdrola to invest in New York (*id.* at 32) is belied by the RD's obvious outcome-determinative approach that does everything to accept Staff's $646 million in PBAs.

According to the RD, it is a "moot" point that Staff has mischaracterized costs as benefits in calculating the basis for its PBAs, and it does not matter that estimating savings in a non-synergy transaction is "highly speculative" (RD at 130). Nor does it appear to matter that the only way to justify the $646 million using Grid/KeySpan is to ignore the Commission's own benefits-to-revenues analysis in that case and arrive at a new calculation that relies upon benefits from LIPA and Niagara Mohawk but excludes their revenues—an approach completely contrary to the RD's own recommended standard for comparing benefits and revenues. The RD then finds that none of this analysis matters because extracting $646 million in PBA concessions is supposedly "salutary" as it "raise[es] the bar" for mergers in the State of New York (*Id.* at 123).

In reaching this recommendation, the RD acknowledges Joint Petitioners' stipulation to provide over $201 million in PBAs if the Proposed Transaction is approved (*id.* at 120) and admits that nothing in the record supports estimating future benefits "beyond" this amount because Staff wrongly characterized many of the purported transaction benefits (*Id.* at 120, 126). Nevertheless, the RD decides that *over $445 million* beyond the $201.6 million offered should be imposed as a condition of the merger. This finding should be rejected.

Below, Joint Petitioners except both to the theoretical bases on which the RD relies to justify imposing PBAs, and to the RD's reasoning for endorsing the specific PBA amount that Staff proposes (*see* RD at 124). The Commission should find that Joint Petitioners' proposed $201.6 million of one-time permanent PBAs meets the public interest standard of Section 70.

Exception No. 21: The RD errs in its finding that PBAs are always required under Section 70 even where there is no expectation that the transaction itself will yield benefits that can be allocated to customers.

The RD states that the primary basis for imposing PBAs is that, under Section 70, PBAs are necessary to provide customers "net benefits which may have to be underwritten by shareholders" when the transaction is a non-synergy merger that "may not produce" "real benefits available for sharing" (RD at 121-23). As discussed, Joint Petitioners take no issue with the view that "positive net benefits" should be demonstrated to meet the public interest test under Section 70. However, the RD's conclusion that Section 70 requires Staff's extraordinarily high PBA levels, which are far in excess of anything supported by the record as benefits *related to this transaction*, is contrary to Commission precedent (RD at 121). Thus, the RD is simply incorrect in baldly asserting that: (a) it is "moot" whether *any* of Staff's purported benefit calculations supporting PBAs even legitimately relate to matters litigated on this record; and (b) in such an event, PBAs must, therefore, be mandated and funded "from some source" (RD at 128).

The flaws in the RD's theory that Staff's PBAs are required under Section 70 are obvious in the RD's cursory discussion of Joint Petitioners' offer of $201.6 million in PBAs (RD at 54-55, 120). The RD provides no justification for finding that Joint Petitioners' PBAs do not provide any benefits, other than simply asserting that "$201.6 million in concessions does not constitute a benefit when offered as an alternative to $646.4 million" (RD at 55). The RD similarly errs by failing to provide any discussion as to why Joint Petitioners' proposal for an immediate, permanent 4.4% reduction in annual delivery rates is not a benefit to customers under the RD's Section 70 rationale for imposing PBAs (*see generally* RD at 117-38).

The RD's Section 70 theory of PBAs is also contrary to precedent. The RD incorrectly suggests that "PBAs are a necessary remedy for the transaction's alleged lack of synergies" (RD at 123). The Commission's non-synergy merger precedent makes it clear that the public interest standard does not mandate *any*, much less a pre-determined arbitrary level of, rate reductions for customers.[68] The Commission has instead based concessions on an analysis of the anticipated synergy savings *that have a nexus to the transaction at issue*.[69] Although Staff attempted to argue that its recommended PBAs serve as a proxy for synergy savings (as discussed below), that is not true, and the RD acknowledges that the record "precludes an estimate that [synergy savings] will reach a specific level, or exceed the revenue impact associated with PBAs beyond $201.6 million" (RD at 120). The RD admits that Staff's benchmarks do not reflect any calculation "linking specific PBAs to specifically estimated benefits of the transaction" (RD at 124), but insists that the Commission should ignore the "imprecision" inherent in Staff's methodology and accept it as an unavoidable consequence of

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68 *See* discussion *supra* note 5 (identifying non-synergy mergers approved by the Commission).

69 *See* discussion *supra* note 6 (identifying cases with synergy savings allocated between shareholders and customers).

circumstances in this case, *i.e.*, the "circumstance" that the Proposed Transaction is a non-synergy merger (RD at 125). The Commission should reject the RD's unprecedented suggestion that Section 70 requires PBAs that are, by the RD's own admission, based on a manufactured and arbitrary amount of assumed synergy savings (rather than the sharing of real, anticipated and identified synergy savings between customers and shareholders).[70]

Exception No. 22: The RD errs by continuing to accept Staff's "proxy theory" as a "secondary justification" for manufacturing and imposing PBAs in a non-synergy merger.

Although the RD correctly marginalizes Staff's "proxy theory" for imposing PBAs, it nonetheless fails to recommend discarding the theory entirely (RD at 120). This failure is erroneous. Under Section 70, there is no justification or requirement for using "proxy" benefits to manufacture PBAs that are mandated as a pre-condition to acceptance of a non-synergy merger.

The RD admits the "weakness" in Staff's proxy benefit theory, correctly noting that under that theory, "one cannot justify *any specific amount* of PBAs and associated rate reductions" as an approximate proxy for future savings (RD at 120) (emphasis added). The RD ultimately finds that "the record...precludes an estimate that [synergy savings] will reach a specific level, or exceed the revenue impact associated with PBAs beyond $201.6 million" (RD at 120).

While Joint Petitioners agree in part with these findings, the RD does not go far enough in its conclusion. After criticizing Staff's proxy theory, the RD refuses to discard it altogether, stating that it "stands only for the proposition that some indeterminate amount of PBAs is appropriate" (RD at 120). This conclusion is incorrect. Because the Proposed

70 Requiring rate concessions that are unrelated to a merger would be bad public policy and would deter future mergers that could be beneficial to New York (*see* Joint Petitioners IB at 33-35).

Transaction is a non-synergy merger, the proxy theory serves no purpose whatsoever. As explained by Joint Petitioners' witness Mr. Meehan, rate concessions should only be required if they are based on "merger benefits that result from utility operational savings" (Tr. 955). In synergy mergers, careful studies are required to ensure that the only rate concessions that are required are those derived from cost reductions that the utility experiences from these operational synergies (*e.g.*, comparing "the utility's costs after a merger with the costs that the utility would have experienced *but for* the merger") (Tr. 934 (emphasis in original)). In this case, however, there are no traditional synergies resulting from the Proposed Transaction.

As the record shows, Staff developed proxy benefits by assembling a list of purported "benefits" to attempt to rationalize its enormous proposed ratepayer concessions (Tr. 1367; 1371-72). However, as explained below, Staff's list of so-called justifications (or "proxy" benefits) does not reflect synergy savings or any other actual benefits to Iberdrola resulting from the Proposed Transaction. Staff admitted "there really isn't any guidance in the precedents we looked at as to how to develop positive benefits to ratepayers" (Tr. 1510). This is not surprising because, by Staff's own admission, it looked only to synergy merger cases for precedent (*see* Exh. 114 (IBER/EE IR. Nos. 2, 10)). The Commission has never relied upon non-existent synergy benefits in a Section 70 merger proceeding in an effort to reach targeted rate concessions and should not do so here.[71] The Commission should reject altogether the "proxy theory" as a wholly invalid justification for Staff's proposed $646 million in PBAs.

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[71] In the synergy merger cases identified by Staff, rate reductions were the result of synergy and/or efficiency savings that were anticipated to result *from the transaction at issue*. *See* discussion *supra* note 6. In non-synergy merger cases like the Proposed Transaction, the Commission has not conditioned its approval on upfront rate concessions or reductions (Tr. 937). *See also Philadelphia/AquaSource Order*, at 6; Tr. 942-43 ("[t]he Commission has recognized synergy savings where they exist and has not attempted to manufacture merger savings where synergies are not present.").

Exception No. 23: The RD errs by failing to reject Staff's flawed calculation of $1.6 billion in purported "benefits" as a valid benchmark to calculate an appropriate amount of PBAs.

The first "benchmark" that Staff uses to justify over $646 million in PBAs is its calculation of various transaction "benefits" that total approximately $1.6 billion (RD at 124). These manufactured "benefits" are entirely without foundation and should be disregarded (Joint Petitioners IB at 33-44; Joint Petitioners RB at 90-101). The RD rightly discredits a large majority of the various components underlying Staff's flawed calculation that the Proposed Transaction would result in $1.6 billion in purported "benefits" (RD at 126-27). However, in another internal inconsistency, the RD fails to reject the $1.6 billion figure and claims Joint Petitioners have not "effectively discredit[ed]" Staff's estimate (RD at 127). This should be rejected as arbitrary and capricious and a failure of reasoned decision-making.

Staff's $1.6 billion figure is comprised of four main components: (1) the $930 million acquisition premium payable by Iberdrola to Energy East shareholders, (2) $124 million in payments by Iberdrola to executives and other third parties facilitating the Proposed Transaction, (3) $150 million in production tax credits ("PTCs"), which Staff incorrectly claims are potentially available to Joint Petitioners in connection with Iberdrola Renewables' wind generation, and (4) $476 million in Spanish tax deferrals, which Staff incorrectly claims will accrue to Iberdrola after the Proposed Transaction (Exh. 106).

The RD makes specific findings that the first two components should be entirely excluded from Staff's calculation. First, the RD finds that the $930 million acquisition premium is "of course, a cost to Iberdrola" (RD at 126), rather than a benefit to Iberdrola. Second, the RD finds that the $124 million in payments to third parties "obviously are another transaction cost rather than a benefit from petitioners' perspective" (*Id.*). These findings alone reduce the value of Staff's purported "benefits" by $1.054 billion.

Third, the RD concedes that "Staff's arguments leave the record unclear whether the $150 million in PTCs is overstated by $50 million related to preexisting projects" (RD at 128). Joint Petitioners assert that the record is not unclear on this point and that there is no basis for any of the $150 million in alleged benefits relating to PTCs (rather than simply eliminating $50 million of the $150 million). The availability of PTCs from Iberdrola Renewables' wind projects is completely unrelated to the Proposed Transaction and, in any event is highly speculative.[72] These PTCs will exist for all Iberdrola Renewables wind projects, regardless of whether the Proposed Transaction is consummated and regardless of Energy East's tax liability (Tr. 528; Joint Petitioners IB at 41).[73] All (or virtually all) wind developers in the United States utilize PTCs without any needed affiliation with any transmission and distribution utility. The arguments for their inclusion as a so-called "benefit" attributable to the Proposed Transaction are unsupported by the record, based on inherently flawed calculations and are contrary to the public policy supporting tax incentives to encourage the development of wind generation (*see* Tr. 527-32; 622-24; 626; *see also* Joint Petitioners IB at 38-42; Joint Petitioners RB at 94-97).

While the RD makes no finding with respect to the inclusion of Staff's calculation of $476 million associated with Spanish tax deferrals (*see* RD at 127), the Commission should also exclude the entire amount of these tax deferrals/amortizations. Iberdrola is highly unlikely

72 Contrary to suggestions by the RD, Staff and MI (RD at 129; Staff IB at 119; MI IB at 18), certain early statements by Iberdrola related to the potential utilization of PTCs from Iberdrola Renewables' wind projects are of no consequence to the issues raised in this proceeding. These early statements were made when Iberdrola had not fully evaluated the potential availability of Iberdrola Renewables' PTCs. Since then, Joint Petitioners have explained, including through the testimony of Mr. Azagra, that Iberdrola did not include any potential PTC benefits in its valuation of Energy East as part of its decision to move forward with the Proposed Transaction (Joint Petitioners IB at 32; Tr. 652-53). No PTC benefits were quantified and relied upon in the decision of the Iberdrola Board of Directors to acquire Energy East (Joint Petitioners RB at 95).

73 CPB argues that Iberdrola may be able to obtain "greater value" for its PTCs by utilizing them to offset Energy East's tax liability (CPB IB at 22). There is no evidence in the record to support this claim, much less any evidence to quantify any such "greater value."

ever to realize this "tax benefit"[74] because of certain restrictions under Spanish law (Tr. 536; 657-58; *see also* Joint Petitioners IB at 42-44). No party challenges, much less rebuts, the speculative nature of this supposed tax "benefit" under Spanish law (Joint Petitioners RB at 97). Instead, certain parties have argued that the mere fact that Iberdrola may pursue such tax deferral/amortization after the closing of the Proposed Transaction somehow makes any potential "benefit" less speculative (Staff IB at 118-19; MI IB at 18). This argument is without merit. It would be imprudent for Iberdrola not to pursue favorable tax treatment, just as any other utility holding companies would pursue potential tax saving options from time to time. The ability of Iberdrola (or any other utility holding company) to pursue favorable tax treatment does not make such treatment any less speculative.[75]

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

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

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

Despite the fact that the RD specifically finds that well over $1 billion of Staff's calculated amount of transaction "benefits" should be excluded, and despite the fact that Joint Petitioners have clearly demonstrated that the Commission should also eliminate any transaction "benefit" assigned to PTCs and Spanish tax deferrals, the RD fails to reject the validity of using Staff's $1.6 billion figure to justify its proposed $646 million in PBAs. The RD instead tries to brush away Joint Petitioners' evidence by finding it irrelevant since PBAs, if required, must be funded from "some source other than the items mentioned" (RD at 128). The RD never specifies or even suggests what other possible sources could be used to fund the PBAs, or more importantly, why it would be reasonable to calculated PBAs based on fabricated "benefits" that have nothing to do with demonstrated savings associated with the Proposed Transaction. The absurdity of continuing to rely on this benchmark, which the RD itself largely discredits, illustrates the RD's outcome-determinative desire to reach a "sufficient" level of PBAs, contrary to what the "positive net benefits" test under Section 70 requires.

Exception No. 24: The RD errs by failing to reject Staff's asset sale comparison as a valid benchmark to calculate an appropriate amount of PBAs.

The RD also cites, and does not reject, Staff's second benchmark based on a comparison of the Proposed Transaction to an asset sale (RD at 124). Other than a brief citation to this benchmark (*see id.*), the RD provides no explanation as to why such a comparison is reasonable.

In an attempt to support Staff's argument that the acquisition premium paid to Energy East shareholders justifies its proposed PBAs, Staff has argued that the Proposed Transaction is comparable to RG&E's recent sale of its Ginna facility "in that Energy East is essentially selling all of its assets to Iberdrola[,]" and further states that in RG&E's recent sale of its Ginna facility, "customers received over 95% of the gain on that sale" (Tr. 1369). This comparison has no merit.

A sale of a regulated asset out of rate base of a utility is not the same as a sale of the stock of a parent corporation of a utility. In the case of the ConEd/O&R merger, the Commission rejected precisely the same argument, and found that stock sales should not be treated as analogous to an asset sale.[76] In that case, contrary to Staff's position here, Staff made the following principled points in support of the settlement at issue:

> [The] argument that ratepayers have a claim on a portion of the stock premium proposed to be paid by CEI shareholders to O&R shareholders is not borne out by the authorities cited. . . . What Rockland [County] proposes is in essence a tax on the stock transfer even though the regulated entity has not given up a single asset. Staff knows of no precedent for such a proposal and sees no regulatory principle that would justify such a proposal as the ratepayer interest in the assets remains unaffected by the merger and stock transfer.[77]

Staff's prior analysis in that case remains correct. The Commission should disregard and reject the asset sale comparison as a benchmark for the reasonableness of Staff's proposed PBAs.

Exception No. 25: Recent Commission precedent does not support the imposition of the level of PBAs proposed by Staff and recommended by the RD.

The RD inappropriately justifies its acceptance of Staff's proposed $646.4 million of PBAs based on an incorrect analysis of the benefit-to-revenue ratios in the Grid/KeySpan merger and the Energy East/RGS merger (the third benchmark in the RD). With respect to the Grid/KeySpan merger, the RD improperly accepts Staff's artificially inflated 10% benefit-to-

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[76] *See ConEd/O&R Order*, at 21 (distinguishing asset transfer cases from those involving stock acquisitions and mergers).

[77] Exh. 113 at 9-10 (Case 98-M-0961 - *Staff's Reply Statement*); *see also* Tr. 1517-18 (discussion of same).

revenue ratio instead of the 1.89% benefit-to-revenue ratio that is clearly stated in the *Grid/KeySpan Order*.[78] The RD also improperly adopts Staff's distorted Energy East/RGS merger benefit-to-revenue ratio of 6% rather than the actual benefit-to-revenue ratio of 1.26% that results when 50% of the $164.3 million synergy savings found by the Commission[79] are divided by revenues ($6,504.5 million).

Joint Petitioners strongly except to the RD's use of synergy mergers such as Grid/KeySpan and Energy East/RGS as a basis for justifying the level of PBAs recommended in the RD. However, if a comparison of benefits of the Proposed Transaction with these benefits in these two synergy mergers is nonetheless utilized, the Commission must not rely on the RD's erroneous benefit-to-revenue ratio calculations. The RD and Staff have mismatched benefits and revenues. Table A below sets forth a correct "apples to apples" comparison and demonstrates that Joint Petitioners' $201.6 million of PBAs clearly provide customer benefits that are comparable to these two merger transactions, both of which were previously approved as in the public interest.

Table A

Merger	Term	NPV/Nominal	Benefits	Revenues	Ratio
			(US $ Millions)	(US $ Millions)	
National Grid/KeySpan	5-Year	Nominal	$407.9	$23,742.0	1.72%
National Grid/KeySpan	10-Year	NPV	$686.5	$36,318.0	1.89%
Energy East/RGS	5-Year	Nominal	$82.2	$6,504.5	1.26%
Partial Acceptance	5-Year	Nominal	$201.6	$6,504.5	3.10%
RD / Staff	**5-Year**	**Nominal**	**$646.4**	**$6,504.5**	**9.94%**

78 *Grid/KeySpan Order*, at 121.

79 *EE/RGS Order*, at 4 (noting the merger will provide $164.3 million in savings through 2006).

a. **National Grid / KeySpan Merger Comparison**

The RD attempts to justify its proposed $646.4 million of PBAs based on the benefit-to-revenue ratio of the Grid/KeySpan merger. The RD asserts that the benefit-to-revenue ratio for Grid/KeySpan is 10% (RD at 131, 132), which the RD alleges provides justification for the Staff-proposed benefit-to-revenue ratio of 11%[80] in this proceeding. However, the RD's stated 10% benefit-to-revenue ratio for Grid/KeySpan is directly contrary to the Commission's own finding that this should be a 1.89% ratio.[81] The RD's misstatements about the benefit-to-revenue ratio in the Grid/KeySpan decision are either inadvertent error or a collateral attack on the Commission's findings. In either case, they must be rejected.

In arriving at a 10% benefit-to-revenue ratio for Grid/KeySpan, the RD appears to have relied solely upon Staff's analysis of the Grid/KeySpan case, rather than the Commission's own findings in Grid/KeySpan. However, Staff made two mistakes in calculating an inflated benefit-to-revenue ratio. First, Staff erroneously relied on its own estimate of savings in the Grid/KeySpan merger rather than the savings amount actually relied upon by the Commission. Second, Staff attributed all of the savings in the merger to KeySpan, thus excluding LIPA and Niagara Mohawk revenues from the benefit ratio calculation (RD at 32; *see also* Tr. 962-63; Joint Petitioners IB at 48). The RD recognizes the first error on the part of Staff but not the second. The RD notes that "petitioners are correct to remove $194.9 million ... from the Grid/KeySpan benefits on the ground that the Commission found they were not benefits of the transaction" (RD at 132). But the RD then seeks to find other benefits in the Grid/KeySpan

80 Staff's 11% ratio is drawn from its Exhibit 121 and is not based on the $646.4 million PBA level, but rather on some higher amount.

81 *Grid/KeySpan Order*, at 121 (finding that the benefit-to-revenue ratio is 1.89% using a 10-year net present value ("NPV") basis).

order[82] and modifies Staff's analysis from a five-year nominal basis to some unspecified type of ten-year analysis.

In doing so, the RD errs by failing to rely upon the same benefits and associated methodology that the Commission utilized in Grid/KeySpan. Specifically, in the Grid/KeySpan proceeding, it is clear the Commission divided the merger transaction benefits by a delivery revenue value (denominator) that included LIPA and Niagara Mohawk revenues, because the Commission had included LIPA and Niagara Mohawk's share of overall merger benefits in the numerator.[83] Here, although the RD articulates the correct rationale for the benefit-to-revenue comparison—which is to "compare the magnitude of the benefits in various mergers *on a consistent basis* relative to the size of the companies whose customers benefit" (RD at 134) (emphasis added)—the RD then fails to follow this metric and therefore reaches the wrong conclusion.

Specifically, the RD includes benefits attributable to Niagara Mohawk and LIPA in the numerator, but summarily rejects the inclusion of Niagara Mohawk and LIPA revenues from the denominator in deriving the RD's own benefit-to-revenue ratio (RD at 134). The RD claims it does so for two reasons, each of which is without basis: first, on its finding that the benefits of the merger flowed "primarily" to customers of KeySpan, and second, that including Niagara Mohawk and LIPA benefits would require the inclusion of Iberdrola's revenues.[84]

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82 The RD reasons that the "end result" is a sum of $686.5 million NPV in benefits, "more than compensating for the Commission's $194.9 million nominal ($112.8 million NPV) disallowance" (RD at 133).

83 *See Grid/KeySpan Order*, at 121 & n.307.

84 The RD states that "...petitioners' inclusion of Niagara Mohawk and LIPA revenues in the revenue base ignores the rationale for calculating a benefits/revenues ratio, which is that the ratio makes it possible to compare the magnitude of the benefits in various mergers on a consistent basis relative to the size of the companies whose customers benefit. In the Grid/KeySpan case,

Under the RD's own formulation of the rationale for a benefit-to-revenue comparison, which requires precise parity to compare benefits to the size of the companies, the RD's claims are seriously flawed. In Grid/KeySpan, the benefits of the merger did *not* flow primarily to KeySpan. The Commission specifically found $264.21 million of benefits flowed to Niagara Mohawk and LIPA (10-year, NPV).[85] The $264.21 million figure represents 38% of the claimed total benefits of $686.5 million. In addition, the amount attributed to Niagara Mohawk and LIPA for the second five-year period is 72% of the second five-year savings ($264.2 million/ $366.4 million).[86] Obviously, the RD's conclusion that benefits were "primarily" for KeySpan is wrong. More significantly, the RD's clear departure from the methodology used in Grid/KeySpan, and the Commission's specific finding of a 1.89% benefit-to-revenue ratio,[87] is an inappropriate collateral attack on the *Grid/KeySpan Order* that the Commission should reject.

The RD's second justification for excluding Niagara Mohawk and LIPA revenues in the benefit-to-revenue calculation is based on the incorrect presumption that inclusion of these revenues would, in the ratio calculation in this case, mandate inclusion of Iberdrola's global revenues (RD at 135). Again, the RD errs by departing from the methodology that the

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Staff says, the benefits flowed primarily to customers of the acquired company, KeySpan, just as the PBAs here would benefit only NYSEG and RG&E customers" (RD at 134).

85 *See Grid/KeySpan Order*, at 119.

86 The $366.4 million used to derive the 72% figure appears on page 132 of the RD. The second five-year adjustments made by the RD—which fail to include revenues of LIPA and Niagara Mohawk—appear to have been used by the RD to mitigate the impact of Staff's benefit calculation error. Other than a blanket assertion that the Grid/KeySpan benefits would continue to accrue each year (RD at 134), the RD provides no rationale for the switch from a five-year to a ten-year period. In fact, the RD acknowledges that the record does not support its proposed new ten-year benefit approach, conceding that "[t]he parties do not seem to have discussed that question directly, or explained why they have quantified the benefits of the various merger cases primarily on the basis of a five-year estimate" (RD at 136). Although reaching a far different result than the RD's proposed ten-year methodology, the Commission did utilize a ten-year NPV amount to evaluate the level of benefits being provided. *Grid/KeySpan Order*, at 121.

87 *Id.* at 121.

Commission itself applied in Grid/KeySpan. Without explanation, the RD ignores the simple fact the Commission did *not* include National Grid's worldwide operation revenues in calculating the Grid/KeySpan benefit ratio. Like National Grid's international operations, Iberdrola's global operations do not provide synergy savings in New York, and thus, no Iberdrola benefits are included in the numerator and no revenues are in the denominator.[88] The RD's logic is flawed and must be rejected.

In sum, the RD cannot explain away that the Commission itself unequivocally calculated and held that a 1.89% ratio of benefits-to-revenues on a ten-year net present value basis was sufficient to find the Grid/KeySpan merger in the public interest.[89] This 1.89% figure stands in stark contrast to the 10% benefit ratio for the Grid/KeySpan merger claimed by Staff and recommended by the RD as a benchmark for comparison purposes. The $201.6 million of benefits proposed by Joint Petitioners calculated on a five-year basis produces a 3.10% benefit-to-revenue ratio, well within the reasonable range of benefits actually used by the Commission in the Grid/KeySpan proceeding.[90]

b. <u>Energy East / RGS Merger Comparison</u>

Staff also seeks to justify its proposed PBAs by comparing them to the benefit levels in the synergy-driven Energy East/RGS merger. Staff's numerous calculation errors have significantly overstated the level of customer benefits from the Energy East/RGS merger (Tr.

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88 Although the RD's logic on this point is flawed, it reaches the proper result that including Iberdrola's global revenues would be improper for comparison purposes (RD at 135).

89 *Grid/KeySpan Order*, at 121. Joint Petitioners' expert testimony demonstrates that this ratio, when calculated correctly on a five-year nominal basis, results in a benefits ratio of 1.34% of delivery revenues, even lower than the Commission's determination (Tr. 963; Exh. 79; *see also* Joint Petitioners IB at 49).

90 While some of the benefits from the Partial Acceptance extend beyond year 5, the majority occur in years 1-5. However, those benefits will permanently accrue to ratepayers when, for example, a write-off is taken that customers will never again be responsible for.

570-71; *see also* Joint Petitioners RB at 109). Staff initially alleged that customers of NYSEG and RG&E received almost $822 million in cumulative reductions over five years, representing approximately 12.6% of five-year delivery revenues. This extreme result occurred because Staff incorrectly multiplied total five-year synergy benefits by an additional five years to arrive at its original estimate. This estimate was fully discredited (*see* Tr. 570-71; *see also* Joint Petitioners RB at 109-10).

Staff subsequently recalculated the Energy East/RGS benefits and reduced its claimed savings figure down to a total of $383.4 million over five years. Staff's recalculation utilizes only the "Year 5" benefit amount of $76.67 million and then, with no justification, multiplies that year's benefit amount by five years, which leads to an exaggerated result (*see* Tr. 571).

Staff's recalculated benefit figure for the Energy East/RGS transaction remains in error because it is inconsistent with the ratepayer portion of the five-year amount set forth in the Joint Proposal Appendix A that was relied upon by the Commission in approving the Energy East/RGS merger (Tr. 571).[91] In addition, there is no justification for extending "Year 5" synergy savings out an additional five years given that the parties and the Commission did not rely on the benefits from that period in approving the Energy East RGS/ merger as in the public interest.

Staff's calculation is artificially inflated further because it fails to reflect the 50/50 sharing between customers and shareholders approved by the Commission in the Energy East/RGS proceeding. With little or no analysis of Staff's actual methodology, the RD accepts Staff's claim that benefits represented 6% of revenues in the Energy East/RGS merger

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91 *EE/RGS Order*.

proceeding. The RD thus errs in accepting Staff's flawed benefit calculations and incorrectly ignores Joint Petitioners' demonstration that the Energy East merger resulted in a five-year nominal benefit ratio of 1.26%.[92]

Instead of the five years of benefits (which included 50/50 sharing between shareholders and ratepayers) relied upon by the parties and the Commission in the Energy East/RGS merger proceeding, the RD suggests instead using a ten-year period for recalculating the Energy East/RGS benefit ratio. Compounding its error, the ten-year analysis proposed by the RD is not an analysis of years 1 through 10, but rather a manufactured approach of taking the "Year 5" savings level multiplied by 10, thus not recognizing any sharing of benefits in the first five years. The RD erroneously concludes, with no record basis, that "Staff's use of ten years, disregarding the average synergy level and 50% sharing associated with the initial five years of the Energy East acquisition is more valid than reliance on the initial five years' benefits" (RD at 136). The RD also concludes with no meaningful analysis or record basis that the "ten year horizon better accounts for the fact that the initial five years in the Energy East case were atypical of the permanent results in that case" (RD at 136). The RD fails to specify or even address in passing why the five years of results, relied upon by the Commission in approving the merger, were in any way "atypical."

In its order approving the Energy East/RGS merger, the Commission focused only on the first five years as part of its merger review. In other words, the benefits in years 1-5 are the basis on which the Commission determined that the Energy East/RGS merger was in the public interest. The Commission relied upon the schedule of synergies for the first five years

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92 This represents a five-year synergy benefit number of $164.3 million. This amount is multiplied by 50% to reflect the 50/50 sharing between ratepayers and shareholders to equal $82.16 million in benefits. That number is then divided by revenues of $6,504.5 million, resulting in a ratio of 1.26%.

alone, as set forth in Appendix A to the Joint Proposal, in finding that the Energy East/RGS transaction provided adequate benefits and was in the public interest. In reviewing the five-year merger synergy data provided by the parties, the Commission concluded that the "level and percentage of savings shared between customers and shareholders are consistent with other merger approvals."[93] The benefit-to-revenue ratio for that period was 1.26%, as noted above.

The synergies, if any, from the second five-year term were not known by the parties and as a result were not in the record before the Commission. Accordingly, they could not have formed any part of the Commission's benefit determination. The Joint Proposal states that "[f]or purposes of this Joint Proposal ... the Parties accept the year-by-year net synergy savings, as well as the gross savings and costs-to-achieve, shown in Appendix A to this Joint Proposal."[94] The Joint Proposal also makes it clear that the amount of savings and the sharing of those savings beyond the first five years was unknown, stating that "shareholders shall have a reasonable opportunity to retain a reasonable percentage, *if any*, not to exceed 50%, of the net synergy savings resulting from the merger."[95] Similarly, the Joint Proposal called for the parties to meet after the initial five years had expired to negotiate with the "objective of identifying the level of synergy savings, *if any*, and specifying a retention percentage, *if any*, upon expiration of the sharing percentages applicable in the initial period."[96] Indeed, Staff in its Statement in Support of the Energy East/RGS merger recognized that any future synergies were uncertain and

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93 *EE/RGS Order*, at 10.

94 Cases 01-E-0359 and 01-M-0404 - *Petition of New York State Electric and Gas Corporation for Approval of its Electric Price Protection Plan, Joint Petition of Energy East Corporation, RGS Energy Group, Inc., New York State Electric & Gas Corporation, Rochester Gas and Electric Corporation and Eagle Merger Corp. for Approval of Merger and Stock Acquisition*, Joint Proposal at 5.

95 *Id.* at 7 (emphasis added).

96 *Id.* (emphasis added).

noted that "[a]fter the five-year term ends, NYSEG and RG&E are afforded the opportunity to demonstrate that merger synergies are still producing benefits that should be shared with shareholders for years six through ten following consummation of the merger."[97]

In summary, the RD's conclusion that a manufactured ten-year period should now be used to recalculate the Energy East/RGS merger benefit-to-revenue ratio must be rejected as completely inconsistent with the facts considered by the Commission in that proceeding. In the Energy East/RGS, merger the synergies, if any, for years 6-10 were not contemplated by the parties, were not capable of calculation at the time of the Commission's merger approval and were not part of the record relied upon by the Commission in approving the transaction as in the public interest.[98] Rejecting a ten-year approach is also consistent with the fact that all other facets of the Energy East/RGS proceeding, such as the rate plans and recovery of merger costs, were based on five rather than ten years.[99]

Even adopting *arguendo* a ten-year, nominal benefits analysis and accepting Staff's values for years 6-10, divided by ten-year delivery revenues, the result is a benefit-to-revenue ratio of 3.58%, placing Joint Petitioners' agreement to provide $201.6 million in benefits via the Partial Acceptance still well within the range of reasonableness.

c. **Summary of merger benefit ratio comparisons**

The record clearly demonstrates that the Proposed Transaction with Joint Petitioners' Partial Acceptance of $201.6 million in PBAs provides on a five-year nominal basis

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97 Cases 01-E-0359 and 01-M-0404 - *Petition of New York State Electric and Gas Corporation for Approval of its Electric Price Protection Plan, Joint Petition of Energy East Corporation, RGS Energy Group, Inc., New York State Electric & Gas Corporation, Rochester Gas and Electric Corporation and Eagle Merger Corp. for Approval of Merger and Stock Acquisition, Staff Statement in Support of Joint Proposal*, at 10 (emphasis added).

98 Cases 01-E-0359 and 01-M-0404 - *Joint Proposal*, at 6-8.

99 *EE/RGS Order*, at 7, 14; *see also* Appendix A to the Energy East/RGS Merger Joint Proposal.

a 3.10% ratio between merger benefits for ratepayers and revenues. This 3.10% ratio compares favorably with the Commission's own determination of a 1.89% ratio in the Grid/KeySpan merger (on a ten-year NPV basis), a precedent Staff has held up to be the paradigm in this case. The 3.10% ratio also compares favorably with the Energy East/RGS ratio of 1.26% on a five-year nominal basis. Thus, contrary to the RD's suggestion, the $201.6 million in PBAs provided by Joint Petitioners in the Partial Acceptance is fully consistent with the benefit ratios previously required by the Commission, whether calculated on a five-year nominal basis or on a ten-year basis. In marked contrast, the RD's proposal of $646.4 million in PBAs must be rejected by the Commission since it produces a benefit-to-revenue ratio of 9.94% that exceeds by five times the ratio from the Grid/KeySpan case.

F. RATE MATTERS

Exception No. 26: The RD errs in recommending immediate rate proceedings.

If the Commission decides to approve the Proposed Transaction, the RD recommends that the Commission: (1) rule upon the contested PBA amounts; (2) immediately implement the 4.4% overall rate reductions associated with the $201.6 million of PBAs in Petitioners' Partial Acceptance, by means of an equal across-the-board decrease for all classes in each company after allocating PBAs of about $81 million and $121 million to NYSEG and RG&E, respectively; (3) declare the resulting rates temporary to the extent of any other, contested PBAs adopted by the Commission; and (4) institute a plenary Phase 2 rate proceeding to consider other regulatory adjustments and establish permanent rates on a conventional eleven-month schedule (RD at 144-45). This recommendation is flawed in many respects.

First, as discussed above, the $201.6 million of PBAs offered by Joint Petitioners is more than adequate to meet the Section 70 public interest standard and, thus, the RD errs in recommending that the Commission consider, let alone adopt, Staff's additional level of PBAs (*see also* Joint Petitioners RB at 84-87). For all of the reasons set forth herein and Joint Petitioners' testimony and post-hearing briefs, the Commission should reject any level of PBAs above the $201.6 million contained in Joint Petitioners' Partial Acceptance.

Second, while Joint Petitioners agree with the RD's recommendation that the 4.4% overall delivery rate reductions can, and should, be implemented immediately, the resulting rates should be permanent, rather than temporary. There is no reason for and no support in the evidentiary record for temporary rates.

Third, implicit in the RD's recommendation is the requirement to conduct four contemporaneous rate proceedings to reset both the electric and gas rates for NYSEG and RG&E. As the RD properly concludes in denying Staff's request to further expedite any future rate cases, even a conventional eleven-month schedule would "substantially burden the parties' resources" (RD at 143). The RD errs, however, by failing to address this burden. To minimize the practical resource burden on all parties, any subsequent rate proceedings should be conducted only on a staggered schedule in order to ensure due process for all interested parties.

In particular, any subsequent NYSEG electric and gas rate proceedings and RG&E electric and gas rate proceedings should progress on a schedule that reflects the timing of the issuance of the Commission's order in this proceeding. Given the resource constraints acknowledged in the RD, the statutory and regulatory requirements for rate cases, and the Commission's policies related to test years for major rate proceedings, it would be logical to stagger any rate filings ordered as a result of the approval of the Proposed Transaction.[100]

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[100] *See* Case 07-M-0906 - *Reply Brief of Nucor Steel Auburn, Inc.*, at 3 (Apr. 25, 2008) (noting that litigations of the rate cases need not be done immediately after closing).

Further, given the opportunity for the Commission to rule before the end of 2008 on the RG&E (electric and gas) Rate Plan Continuation filing of February 1, 2008, there is no need to initiate any RG&E rate proceeding immediately. RG&E's electric and gas rates would continue until reset after a full rate case. Similarly, the NYSEG gas rate plan provides for continuation of current rates "as the default mode if no new rates are adopted by the end of the plan's prescribed rate period" (RD at 144). As the RD further correctly notes, NYSEG's present electric rates were set using a single rate year which ordinarily creates no implicit expiration date. Thus, there is no calendar-driven imperative that rate cases proceed on an expedited basis (*Id.*).

In light of the Commission's policies on test periods for major rate proceedings, NYSEG could plan to file electric and gas rate cases within the prescribed 150-day period following the close of the quarter that follows the issuance of the Commission's order in this proceeding.

If the Commission requires RG&E to auction various fossil generating facilities as a condition of approval in this proceeding (as proposed by Joint Petitioners in the Partial Acceptance), RG&E could plan to file electric and gas rate cases within the prescribed 150-day period following the close of the quarter that follows the closing of the sale of the generating facilities. Given that the auction process, including setting appropriate protocols, could take a year or longer, this approach would minimize, or even eliminate, any overlap between the NYSEG electric and gas rate proceedings and the RG&E electric and gas rate proceedings and would provide RG&E an opportunity to build the results of the auction(s) into the rate proceedings.

G. ESCO COLLABORATIVE

Exception No. 27: The Commission should specifically find that ESCO referral programs are best addressed in any subsequent rate proceeding.

The RD correctly concludes that the ESCO Referral Programs suggested by Staff "are not listed as a condition ameliorating any harm from the merger, nor are they cited as benefits flowing from the merger" and, thus, the Commission should address the ESCO Referral Programs elsewhere (RD at 149). The RD also correctly notes that there are several open dockets in which "the relevant proposals are under consideration, and the matters [could] be decided there" (*Id.*). However, the RD also states, alternatively, that the issues surrounding the ESCO Referral Program proposals could be resolved in the context of future rate proceedings for NYSEG and RG&E. As discussed in Joint Petitioners' briefs, there is no evidence in the record to support Staff's proposed ESCO Referral Program collaborative and Staff's proposals should be rejected outright by the Commission (*see* Tr. 177-81; Joint Petitioners IB at 112-13; Joint Petitioners RB at 152-53). If the Commission decides not to do so, it should find that the matters raised by Staff relative to ESCO Referral Programs are best addressed in any subsequent rate proceeding.

H. REVENUE DECOUPLING MECHANISM

The RD correctly concludes that revenue decoupling mechanisms ("RDM") should not be considered in this merger proceeding but, instead, should be considered as part of NYSEG's and RG&E's next rate cases. Joint Petitioners accept the RD's recommendation. Accordingly, NYSEG and RG&E will not make an RDM filing later this year as discussed in Joint Petitioners' briefs (Joint Petitioners IB at 112-13; Joint Petitioners RB at 143-44).

III. CONCLUSION

For the foregoing reasons, Joint Petitioners respectfully request that the Commission approve the Proposed Transaction, consistent with the discussion herein. The record has demonstrated that the Proposed Transaction will bring extensive benefits to NYSEG's and RG&E's ratepayers and to the State of New York. These benefits meet and exceed the "public interest" standard of Section 70.

Respectfully submitted,

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ATTACHMENTS

Iberdrola / Energy East Merger Proceeding
NYSEG and RG&E Hydro
Replacement Power Cost Forecast

Attachment 1

		Energy Cost		Capacity Cost				
	MWh Output	Avg. LBMP Energy Price	Replacement Energy Cost	$/kw-mo	MW / mo (Nov - Apr)	MW / mo (May - Oct)	Capacity Cost	Projected Replacement Power Cost
NYSEG Hydro								
2009	299,149	$95.48	$28,562,104	$3.00	51.7	41.2	$1,672,200	$30,234,304
2010	299,149	$85.18	$25,483,039	$3.00	51.7	41.2	$1,672,200	$27,155,239
2011	299,149	$83.15	$24,874,836	$3.00	51.7	41.2	$1,672,200	$26,547,036
Average			**$26,306,660**		***	***	**$1,672,200**	**$27,978,860**
RG&E Hydro								
2009	271,405	$87.48	$23,741,965	$3.00	35.9	33.8	$1,254,600	$24,996,565
2010	271,405	$78.11	$21,198,306	$3.00	35.9	33.8	$1,254,600	$22,452,906
2011	271,405	$76.20	$20,680,574	$3.00	35.9	33.8	$1,254,600	$21,935,174
Average			**$21,873,615**		***	***	**$1,254,600**	**$23,128,215**
Total NY Hydro								
2009	570,554	$91.67	$52,304,069	$3.00	87.6	75.0	$2,926,800	$55,230,869
2010	570,554	$81.82	$46,681,345	$3.00	87.6	75.0	$2,926,800	$49,608,145
2011	570,554	$79.84	$45,555,411	$3.00	87.6	75.0	$2,926,800	$48,482,211
Average			**$48,180,275**		***	***	**$2,926,800**	**$51,107,075**

*** Calculated based on UCAP requirements. The MW Ratings for NYSEG and RG&E Hydroelectric facilities are 60.1 MW and 52.5 MW, respectively.

ATTACHMENT 2 – FINANCIAL CONDITIONS

Joint Petitioners set forth below the list of financial conditions that they are willing to agree to as conditions to the Commission's approval of the Proposed Transaction. For ease of reference, the numbers of the Conditions correspond to the Conditions recommended in the RD. Joint Petitioners have indicated with an asterisk below when they have offered to accept a condition recommended in the RD with no modifications.

Condition 1.

The acquisition premium and costs associated with the pending transaction will not be recorded on the books of NYSEG and RG&E or Energy East. Joint Petitioners commit that they will not seek recovery of the acquisition premium or costs associated with the Energy East/RGS merger in future rate proceedings.

Condition 2.

The acquisition premium and related costs associated with the transaction will not affect rates.

* *No change from Staff's proposed Condition 2 (RD at 94)*

Condition 4.

NYSEG, RG&E and Iberdrola shall maintain S&P and Moody's credit ratings on their securities.

* *No change from Staff's proposed Condition 4 (RD at 96)*

Condition 5.

Iberdrola, Energy East, NYSEG and RG&E shall have a stated goal to maintain the investment grade ratings of their securities.

* *No change from Staff's proposed Condition 5 (RD at 96)*

Condition 6.

Iberdrola, Energy East, NYSEG or RG&E, as applicable, will provide the Commission on a confidential basis with copies of all slide presentations to credit ratings agencies relating to Energy East, NYSEG or RG&E, as well as all rating agency reports relating to Energy East or any Energy East subsidiaries, on an ongoing basis.

Condition 7.

NYSEG, RG&E or Energy East, as applicable, will file a plan with the Commission when the least secure unsecured bond rating of such company is downgraded by S&P or Moody's to the non-investment grade category, or is at the lowest investment grade and either S&P or Moody's has issued an outstanding negative watch or review downgrade notices.

Condition 9.

For each company, the amount of dividends it can send upstream to Iberdrola is limited during a year to no more than the sum of the income available for common equity, plus the cumulative amount of retained earnings since the acquisition was consummated, plus the portion of additional "paid in capital" that is recorded on the books of NYSEG and RG&E as unappropriated retained earnings and unappropriated undistributed earnings less accumulated other comprehensive income existing immediately prior to the consummation of the acquisition, to the extent such earnings had not already been paid out as a dividend.

* *No change from Staff's proposed Condition 9 (RD at 98)*

Condition 12.

NYSEG and RG&E are each prohibited from paying a dividend if their respective bond ratings are immediately downgraded to the non-investment grade category.

* *No change from Staff's proposed Condition 12 (RD at 99)*

Condition 13.

When under a dividend restriction, NYSEG and RG&E are not permitted to transfer, lend or lease any items of value to any affiliate without prior Commission approval.

* *No change from Staff's proposed Condition 13 (RD at 99)*

Condition 14.

NYSEG, RG&E, and any future domestic regulated entities may participate in money pool arrangements as either a borrower or lender.

* *No change from Staff's proposed Condition 14 (RD at 100)*

Condition 15.

If NYSEG or RG&E are participants in a money pool, Iberdrola may only participate in such money pool as a lender.

Condition 16.

Non-regulated and foreign entities may not participate in a money pool with NYSEG or RG&E.

* *No change from Staff's proposed Condition 16 (RD at 100)*

Condition 17.

No cross-default provisions for any affiliate of Iberdrola are to affect NYSEG and RG&E. Iberdrola and its affiliates promise that they will not enter into such arrangements in the future.

* *No change from Staff's proposed Condition 17 (RD at 100)*

Condition 18.

Indirect loans from NYSEG and RG&E to any affiliate are prohibited.

* *No change from Staff's proposed Condition 18 (RD at 100)*

Condition 19.

As a condition to the Commission's approval of the Proposed Transaction, the Joint Petitioners commit to modify corporation by-laws as necessary and establish a voting right in order to prevent a bankruptcy of NYSEG or RG&E to be caused by a bankruptcy of Iberdrola, Energy East, or any other affiliate.

Within six weeks of closing, NYSEG and RG&E will each file a petition seeking authority to establish a class of preferred stock having one share, subordinate to any existing preferred stock, and to issue such share of stock to a party to be proposed by NYSEG and RG&E and approved by the Commission who would protect the interests of New York and would be independent of the parent company and its subsidiaries. Such stock shall have voting rights only with respect to limiting NYSEG's and RG&E's right to commence any voluntary bankruptcy, liquidation, receivership, or similar proceedings without the consent of the holder of that share of stock.

In the event that NYSEG and RG&E are unable to meet this condition despite good faith efforts to do so, NYSEG and RG&E are required to petition for relief from this condition, explaining why it is impossible to meet and how they propose to meet an underlying requirement that a bankruptcy involving Iberdrola, Energy East, or any other affiliate does not necessarily result in the inclusion of NYSEG and RG&E in such a bankruptcy.

Condition 20.

A limited purpose entity is required to ensure compliance with dividend and money pool restrictions.

* *No change from Staff's proposed Condition 20 (RD at 100)*

Condition 21.

Energy East shall continue to use U.S. Generally Accepted Accounting Principles (GAAP) for all financial reporting purposes.

* *No change from Staff's proposed Condition 21 (RD at 100)*

Condition 22.

The Commission will have access, in English and in New York, to (1) the books/records of NYSEG and RG&E, and (2) any books/records of Iberdrola or any Iberdrola affiliates to the extent such books/records are related to NYSEG or RG&E. The Commission will have access, in English and in New York, to any minutes of the Iberdrola Board of Directors, and any sub-committee thereof, to the extent that such minutes discuss Energy East, NYSEG or RG&E. Iberdrola also shall translate such other documents as the Commission determines to be reasonably necessary to fulfill its statutory duties.

Condition 23.

NYSEG and RG&E shall continue to satisfy the current reporting requirements that apply to them.

* *No change from Staff's proposed Condition 23 (RD at 100)*

Condition 24.

Energy East shall continue to be subject to the existing, applicable legal requirements of the Sarbanes-Oxley Act (SOX). Its periodic, statutory financial reports should include certifications provided by Energy East officers concerning the six SOX requirements.

* *No change from Staff's proposed Condition 24 (RD at 100)*

Condition 25.

Energy East, NYSEG and RG&E shall remain subject to annual attestation audits by independent auditors.

* *No change from Staff's proposed Condition 25 (RD at 100)*

Condition 26.

Iberdrola's consolidated balance sheets, income statements and cash flow statements will be made available to the Commission, in English and in New York, on an annual basis and in a format that is mutually agreed to between Iberdrola and the Commission Staff. Audited financial statements will be in accordance with the International Financial Reporting Standards ("IFRS"), as issued by the International Accounting Standards Board, consistent with Securities and Exchange Commission ("SEC") requirements.

Additionally, Iberdrola agrees to provide specific answers to particular questions raised by the Commission and its Staff with respect to IFRS.

Condition 27.

Energy East, NYSEG and RG&E will provide consolidated financial statements to the Commission. This information shall be provided for Energy East and its subsidiaries in the same format as the consolidated financial statements made in SEC Form U-5S that registered utilities have filed under the Public Utility Holding Company Act of 1935. The energy utility information for Energy East and its subsidiaries shall be fully consistent with the SEC Form U-9C-3 that registered holding companies had to file under PUHCA.