

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.  
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Case 07-M-0906

**REBUTTAL TESTIMONY OF  
JOINT PETITIONERS' POLICY PANEL**

**Pedro Azagra Blazquez  
James P. Laurito  
Robert E. Rude**

January 31, 2008

**JOINT PETITIONERS' POLICY PANEL**

**I. INTRODUCTION**

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Q. Please state the names of the members of this Policy Panel for the record.

A. Our names are Pedro Azagra Blazquez, James P. Laurito and Robert E. Rude.

Q. Are you the same Pedro Azagra Blazquez, James P. Laurito and Robert E. Rude who submitted Direct Testimony in this proceeding on August 1, 2007 (the "Joint Petitioners' Direct Testimony")?

A. Yes.

Q. Have your positions or business addresses changed since the Joint Petitioners' Direct Testimony was submitted?

A. No, they have not.

Q. What is the overall purpose of your testimony?

A. The purpose of this testimony is to respond to portions of the direct testimony of the Department of Public Service Staff ("Staff") Policy Panel ("Staff Policy Panel"), which is comprised of the testimony of Thomas A. D'Ambrosia, Patrick J. Barry, Maynard Bowman, Michael Salony and Stephen A. Berger. Other witnesses also rebut portions of the Staff Policy Panel on behalf of the Joint Petitioners, including Steven Fetter, William Hieronymus, Eugene Meehan, Jeff Makhholm and the Rate Adjustment Panel. We refer to those witnesses as appropriate. In the time available since receipt of the Staff Policy Panel's 317 pages of testimony and an even greater volume of accompanying exhibits, we have attempted to be as thorough as time permits in our review of that proposed evidence for matters requiring response. It is possible, however, that one or more

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1 such matters may have escaped our notice. Accordingly, to the extent that a  
2 particular matter raised in the testimony or exhibits of the Staff Policy Panel is not  
3 expressly accepted or rebutted herein, any such matter is rejected by this Panel.

4 In addition, we respond to testimony filed by various intervenors.

5 Q. Mr. Azagra, please identify those areas of testimony for which you have primary  
6 responsibility.

7 A. While we are collectively sponsoring this Panel testimony with respect to the  
8 proposed transaction, my primary areas of responsibility are issues relating to: (1)  
9 the benefits of the proposed transaction; (2) the matters raised by the Staff Policy  
10 Panel regarding the U.S. Production Tax Credit (“PTC”), Spanish tax issues, and  
11 alleged benefits to current employees, stakeholders and others; and (3) the  
12 reporting, financial and affiliate risks identified by the Staff Policy Panel. Both  
13 Mr. Rude and I address issues relating to (1) the consolidation of information  
14 technology (“IT”) systems, and (2) goodwill. Mr. Rude and Mr. Laurito will  
15 address the remainder of the Panel’s rebuttal to the testimony of the Staff Policy  
16 Panel and intervenors.

17 Q. Does the Panel testimony address Staff’s responses to information requests  
18 submitted by the Joint Petitioners that are related to the Staff Policy Panel’s direct  
19 testimony?

20 A. Yes. We have reviewed several such responses by Staff and have specifically  
21 addressed some of the responses in our rebuttal testimony. However, additional  
22 analysis will be required as there was insufficient time to complete our review of  
23 these responses in the time provided to submit this Panel testimony. We further

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1 note that in certain responses, Staff has indicated that it intends to revise certain  
2 exhibits and we reserve the right to modify this Panel testimony at hearing to  
3 address any changes to Staff's exhibits.

4 Q. Is this Panel sponsoring any exhibits?

5 A. Yes. Exhibit \_\_ (JPP-1) contains a copy of the interrogatory responses and  
6 workpapers referenced in this Panel's testimony. Exhibit \_\_ (JPP-2) is a  
7 transcript from former Chairwoman (and current Commissioner) Acampora's  
8 November 13, 2007 remarks to Lehman Brothers. Exhibit \_\_ (JPP-3) consists of  
9 an S&P report showing removal of "Watch Negative" and replacing it with a  
10 "Stable" outlook for Iberdrola, S.A. ("Iberdrola"). Exhibit \_\_ (JPP-4) consists of  
11 a Moody's report showing "Stable" outlook and "A3" rating for Iberdrola.  
12 Exhibit \_\_ (JPP-5) demonstrates that Iberdrola's gross and net operating profits  
13 were up well over 20% in the first nine months of 2007 as compared to the same  
14 period of the previous year. Exhibit \_\_ (JPP-6) includes a stock price  
15 comparison. Exhibit \_\_ (JPP-7) is a U.S. Securities and Exchange Commission  
16 ("SEC") issuance regarding financial reporting requirements. Exhibit \_\_ (JPP-8)  
17 is the Synergy Appendix A from the Joint Proposal in Case No. 01-M-0404 –  
18 Energy East/RGS Merger.

19 **II. EXECUTIVE SUMMARY**

20 Q. Please summarize your testimony.

21 A. The acquisition of Energy East Corporation ("Energy East") by Iberdrola  
22 ("Proposed Transaction") presents New York with a unique opportunity to

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1 advance the State's energy and economic development policies. Iberdrola not  
2 only possesses immense financial strength (including credit ratings significantly  
3 higher than that of Energy East) but also global utility expertise, a demonstrated  
4 commitment to service quality, sustainable development and infrastructure  
5 investment, and expertise as the largest producer of renewable wind energy in the  
6 world. These attributes uniquely position Iberdrola to assist the State in meeting  
7 its Renewable Portfolio Standard and the Governor's "15 by 15" clean energy  
8 goal. Consummation of the Proposed Transaction will benefit New York by  
9 advancing the State's renewable energy policies, a fact recognized by several  
10 intervenors. In addition, the Proposed Transaction supports economic  
11 development by maintaining existing utility jobs in upstate New York while  
12 ensuring that New York ratepayers will bear none of the costs associated with the  
13 Proposed Transaction.

14 Despite the benefits of the Proposed Transaction and a lack of public  
15 opposition, Staff treats the Proposed Transaction as if it were a repeat of the  
16 National Grid/KeySpan merger. As explained by the Rebuttal Testimony of Mr.  
17 Meehan in further detail, the Proposed Transaction is significantly different than  
18 many of the transactions that have been presented to the Commission, including  
19 the National Grid/KeySpan merger. Rather, in many important respects, the  
20 Proposed Transaction is similar to certain other "first mover" transactions in the  
21 State. A comparison of the Iberdrola/Energy East merger to transactions that  
22 involved a combination of operating companies or other potential synergies, is  
23 therefore inappropriate. As Dr. Makhholm explains in his testimony, Staff also

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1 mischaracterizes the Proposed Transaction as it relates to the public interest  
2 standard in New York.

3 Staff inappropriately seeks to modify existing rate plans and orders in this  
4 Section 70 merger proceeding. This proceeding should not be turned into a rate  
5 case, and Staff's rate case issues are more appropriately addressed in a subsequent  
6 rate proceeding designed to deal with those matters. As discussed in detail in the  
7 Rate Adjustment Panel testimony, Staff's proposal to impose onerous conditions  
8 on the Proposed Transaction, including write-offs, reserve increases, earnings  
9 sharing changes, and rate plan modifications, is inequitable and inadvisable,  
10 particularly in light of the many and substantial positive impacts of the Proposed  
11 Transaction on NYSEG and RG&E customers and the State as a whole. Staff's  
12 proposed rate plan modifications are inappropriate and, in the event they are  
13 nonetheless deemed relevant to the proceeding, they suffer from serious flaws.  
14 While the Joint Petitioners' Rate Adjustment Panel rebuts Staff's calculations  
15 regarding various Proposed adjustments to rates, the focus of this proceeding is  
16 and must remain on the Proposed Transaction, not on issues that should be raised,  
17 if at all, by Staff in future rate proceedings.

18 Staff also alleges various theoretical risks and speculates about potential  
19 harms, including imagined vertical market power concerns and a non-existent  
20 negative reaction by the credit rating agencies to the merger. Dr. Hieronymus  
21 testifies that the Proposed Transaction does not raise vertical or horizontal market  
22 power concerns. Dr. Makholm and Mr. Fetter demonstrate that Staff's concerns  
23 about credit quality are misplaced.

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1           At their core, Staff's positions themselves do not appear to be consistent  
2           with the public interest. They reflect a strong aversion to large holding companies  
3           and the emerging global nature of the utility business (in particular, gas and  
4           electric utilities), despite the fact that a number of New York utilities already are  
5           owned by non-U.S. entities. Staff's concerns are not shared by other  
6           governmental and regulatory bodies that have jurisdiction over the Proposed  
7           Transaction, including other states and federal agencies that have approved the  
8           Proposed Transaction (Connecticut, Maine, New Hampshire, and the Federal  
9           Energy Regulatory Commission) and other New York State and public interest  
10          organizations that have intervened in this proceeding (*e.g.*, New York State  
11          Department of Environmental Conservation, Empire State Development, Greater  
12          Rochester Enterprise, and the Natural Resources Defense Council).

### 13           **III.    BENEFITS OF THE PROPOSED TRANSACTION**

14    Q.    Mr. Azagra, the testimony submitted by Staff, as well as certain other intervenors  
15          in this proceeding, suggests there are no benefits associated with the Proposed  
16          Transaction (*see, e.g.*, Staff Policy Panel at 16-17). Can you summarize the  
17          benefits New York customers will realize from the Proposed Transaction?

18    A.    As I explained in the Joint Petitioners' Direct Testimony, it is true that the  
19          Proposed Transaction does not provide immediate, measurable benefits in the  
20          form of merger synergies because the Proposed Transaction is an upstream  
21          transfer of control rather than a consolidation of operating companies. Since  
22          Iberdrola does not have any other regulated utility interests in the region or

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1 elsewhere in the U.S. (*i.e.*, this is a “first mover” transaction), the Proposed  
2 Transaction is not anticipated to result in any tangible and quantifiable synergistic  
3 benefits.

4 Q. Although the Proposed Transaction will not result in any synergy savings, will the  
5 Proposed Transaction nonetheless provide benefits to the State of New York?

6 A. Yes. The Proposed Transaction will benefit customers of NYSEG and RG&E, as  
7 well as the economy of the State of New York, in several important respects.  
8 These benefits are sufficient to satisfy the public interest standard, in particular  
9 given that the Proposed Transaction does not raise any of the potential risks that  
10 the Commission has been faced with in other transactions. Specifically:

- 11 • Financial Stability – Customers of NYSEG and RG&E will benefit from  
12 Iberdrola’s financial stability. Iberdrola’s market capitalization is  
13 approximately \$67 billion (utilizing a currency exchange rate of  
14 \$1.35/Euro), and Iberdrola has long-term “A” category credit ratings that  
15 are and have been higher than the credit ratings of Energy East. NYSEG  
16 and RG&E will obtain the financial stability and other benefits associated  
17 with becoming subsidiaries of a well-capitalized, multi-national, widely  
18 diversified energy holding company with a higher credit rating. For  
19 example, assuming no changes in market conditions, it is likely that the  
20 borrowing costs for NYSEG and RG&E should be lower as subsidiaries of  
21 Iberdrola (with 1-3 notches higher “A” category credit ratings) than the  
22 borrowing costs would be if NYSEG and RG&E did not become affiliates  
23 of Iberdrola (with a lower “BBB” level credit rating). The financial

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1 strength and stability associated with NYSEG and RG&E becoming  
2 subsidiaries of an “A” category rated company and the associated benefits  
3 to New York customers are discussed further below.

4 • Global Energy Experience and Best Practices – Customers of NYSEG and  
5 RG&E will benefit from Iberdrola’s extensive global utility expertise,  
6 which the Commission has recognized as a benefit in water utility “first  
7 mover” transactions within the State. Iberdrola has been in the utility  
8 business for 100 years and is a world leader with high-quality, reliable and  
9 environmentally friendly electric distribution service to 22 million electric  
10 points of supply and 2 million gas points of supply in Europe and the  
11 Americas. Iberdrola is committed to sharing information about best  
12 practices among its operating utility subsidiaries, including NYSEG and  
13 RG&E. As discussed further below, such sharing of information has  
14 produced benefits for other utility subsidiaries acquired by Iberdrola.

15 • Focus on Renewable Development and the Environment – Customers of  
16 NYSEG and RG&E, as well as the State of New York, will benefit from  
17 Iberdrola’s significant presence in New York because of Iberdrola’s  
18 corporate philosophy, which incorporates a significant focus on energy  
19 efficiency, clean technology and the environment. Iberdrola is the world’s  
20 leading producer of electricity from wind energy, with approximately  
21 7,000 MW of wind capacity installed, and nearly 50% of Iberdrola’s  
22 approximately 41,000 MW of total installed capacity is emissions-free. A  
23 number of states in the U.S. recognize the environmental benefits of

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1 renewable resources as well as the economic benefits that communities  
2 derive from the development of such resources, and there is competition  
3 among the states in terms of attracting investment in wind projects within  
4 their borders. Iberdrola is willing to work with the State of New York to  
5 further the State's renewable energy goals, including meeting its  
6 aggressive RPS goals. Iberdrola has substantial expertise, capacity and  
7 resources at its disposal, and is uniquely positioned to assist the State in  
8 meeting these goals.

- 9 • Economic Development and Jobs – The Proposed Transaction will  
10 reinforce ongoing efforts to maintain and revitalize the economy of upstate  
11 New York. While many horizontal utility mergers and acquisitions  
12 eliminate jobs, the Proposed Transaction includes no job reduction  
13 proposal, which helps to sustain economic development in the State of  
14 New York. Moreover, under the Agreement and Plan of Merger between  
15 Iberdrola and Energy East, employee compensation and benefits will  
16 remain substantially unchanged for a period of at least 18 months after the  
17 Proposed Transaction becomes effective. These aspects of the Proposed  
18 Transaction should be viewed as providing benefits to upstate New York.

19 **A. Benefits of Iberdrola's Financial Strength**

20 Q. Mr. Azagra, please explain how Iberdrola's financial strength can be expected to  
21 benefit customers of NYSEG and RG&E.

22 A. Customers of NYSEG and RG&E should realize a variety of benefits from the  
23 Proposed Transaction because Iberdrola is a larger, stronger holding company

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1 than Energy East. As I have previously explained, Iberdrola is a \$67 billion  
2 company and is currently rated “A3” by Moody’s and “A-” by S&P, both with  
3 stable outlooks. Iberdrola is currently rated “A” by Fitch with a negative outlook.  
4 By contrast, Energy East is rated “BBB” by Fitch, “Baa2” by Moody’s and  
5 “BBB+” by S&, all with negative outlooks. The Proposed Transaction should  
6 provide NYSEG and RG&E with greater access to capital at a lower cost than  
7 they would have on a stand-alone basis as subsidiaries of Energy East, thereby  
8 allowing NYSEG and RG&E to continue providing high-quality, safe, and  
9 reliable service.

10 As I explained in the Joint Petitioners’ Direct Testimony, Iberdrola’s  
11 successful issuance of \$4.5 billion of equity to fund the acquisition of Energy East  
12 is a good example of Iberdrola’s level of access to the capital markets.  
13 Iberdrola’s issuance of equity to fund the Proposed Transaction protects  
14 ratepayers from the risks of debt financing utilized in other transactions, such as  
15 the risks that former Chairwoman (and current Commissioner) Acampora recently  
16 explained accompanied the financing of the National Grid/KeySpan merger (*e.g.*,  
17 negative credit rating differential and use of debt financing). *See* Exhibit \_\_ (JPP-  
18 2). From the perspective of stable commercial dealings and cost of credit, it will  
19 be more favorable for NYSEG and RG&E to be subsidiaries of Iberdrola than  
20 Energy East (which has a lower credit rating and a negative outlook from all three  
21 ratings agencies, as compared to Iberdrola).

22 Q. The Staff Policy Panel has suggested that Iberdrola’s financial strength “is of no  
23 consequence to the New York utilities” (at 62). Can you describe more

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1 specifically the benefits to NYSEG and RG&E that could be realized due to  
2 Iberdrola's higher credit ratings?

3 A. The credit rating of a parent company can affect the credit rating of its  
4 subsidiaries. Therefore, while it is not possible to quantify with precision the  
5 direct benefits associated with Iberdrola's stronger credit rating, it is reasonable to  
6 assume that the cost of debt capital for NYSEG and RG&E should be lower if  
7 they are subsidiaries of Iberdrola given that Iberdrola maintains a stronger credit  
8 rating than Energy East. For example, it is my understanding that S&P has a  
9 consolidated ratings approach. As such, the ratings for NYSEG and RG&E are  
10 currently linked to those of Energy East. Correspondingly, after the Proposed  
11 Transaction occurs, S&P may also consolidate Energy East's rating with that of  
12 its new parent, Iberdrola, thereby also enhancing the view of NYSEG and RG&E  
13 by the applicable credit rating agencies, and providing even greater financial  
14 stability to NYSEG and RG&E. There are generally known basis point spreads  
15 associated with different credit ratings, and, over time, the differential between  
16 Iberdrola and Energy East's credit ratings may translate into measurable cost  
17 savings for NYSEG and RG&E's respective regulated services, assuming other  
18 factors remain constant. The differential between Iberdrola's and Energy East's  
19 respective credit ratings could result in a measurable reduction in NYSEG's and  
20 RG&E's capital costs, and thereby provide a direct benefit to their ratepayers.

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1 Q. What impacts do the recent events in the global capital markets have on your  
2 conclusion that Iberdrola's higher credit rating will provide benefits to NYSEG  
3 and RG&E?

4 A. These recent events make it even more difficult for lower-rated companies, such  
5 as Energy East, NYSEG and RG&E, to raise debt and equity on favorable terms.  
6 Iberdrola's stronger "A" category credit ratings is therefore even more significant  
7 in terms of providing superior access to the capital markets. This is demonstrated  
8 by the increase in average basis point spreads on bonds for "BBB" rated utility  
9 companies to approximately 205 basis points from 103 basis points one year ago.  
10 The spread of "A" rated utilities has widened to a much lesser extent.  
11 Additionally, the difference in spreads between "A" and "BBB" rated companies  
12 has increased from 17 basis points to 35 basis points for the same period. Thus,  
13 today's volatile capital markets create an even greater opportunity for NYSEG  
14 and RG&E ratepayers to benefit from Iberdrola's stronger "A" category credit  
15 ratings.

16 Q. The Staff Policy Panel points out that Iberdrola was recently downgraded by S&P  
17 and Moody's (at 62). Can you address this issue?

18 A. Iberdrola was recently downgraded by S&P from "A" to "A-," and placed on  
19 negative watch pending the completion of the initial public offering of 20% of the  
20 equity of Iberdrola Renovables, S.A. ("Iberdrola Renewables"), a subsidiary of  
21 Iberdrola (the "Iberdrola Renewables IPO"). After the successful completion of  
22 the Iberdrola Renewables IPO, however, S&P removed the "Watch Negative" and  
23 replaced it with a "Stable" outlook for Iberdrola. See Exhibit \_\_ (JPP- 3). The

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1 downgrade from “A2” to “A3” by Moody’s was the result of Iberdrola’s  
2 acquisition of ScottishPower, plc (“ScottishPower”), the Iberdrola Renewables  
3 IPO and Iberdrola’s growth strategy. However, Moody’s has made it clear that  
4 Iberdrola has a “Stable” outlook and that the “A3” rating is a forward-looking  
5 rating that already takes into consideration Iberdrola’s Strategic Plan 2008-2010  
6 (see IBER-0137S, Exhibit \_\_ (JPP-1)) and the effect of the Proposed Transaction.  
7 See Exhibit \_\_ (JPP-4).

8 Q. Are you concerned that there could be future downgrades of Iberdrola’s credit  
9 rating to a “B” category rating?

10 A. No. The current ratings are forward-looking ratings and are either mid-level “A”  
11 category ratings with stable outlooks, or a mid-to-high level “A” category rating  
12 with a negative outlook. While there is no way of predicting future events that  
13 could impact Iberdrola’s credit rating, Iberdrola is unquestionably committed to  
14 undertaking all reasonable efforts to maintain its current “A” category ratings.  
15 Quite simply, doing so is good for Iberdrola’s business, and for its customers and  
16 shareholders.

17 The Staff Policy Panel apparently believes that there are a variety of  
18 factors, including concerns regarding the Proposed Transaction, that could lead to  
19 further downgrades (see, e.g., at 151-58). I, and more importantly the capital  
20 markets, do not believe that this is probable. Iberdrola’s most recent financial  
21 results demonstrate that it is on track to maintain its current, strong “A” category  
22 credit ratings. For example, in the first nine months of 2007, Iberdrola’s gross  
23 and net operating profits were up well over 20% as compared to the same period

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1 of the previous year. *See* Exhibit \_\_ (JPP-5). In addition, the equity markets have  
2 reacted favorably to Iberdrola's growth strategy. Iberdrola had a market  
3 capitalization of approximately €13 billion at the end of 2001. As of December  
4 31, 2007, the market capitalization of Iberdrola reached €52 billion, making it the  
5 fifth largest utility in the world by that measure. A comparison of the stock prices  
6 of Iberdrola and Energy East from January 2004 through January 2008 illustrates  
7 that the equity markets have viewed Iberdrola, even after the close of the  
8 ScottishPower acquisition and the announcement of the Proposed Transaction,  
9 much more favorably than Energy East. *See* Exhibit \_\_ (JPP-6). Additionally, I  
10 note that Staff has not identified any analyst report, communication or other  
11 document that has placed Iberdrola on credit watch for a downgrade other than for  
12 the one reason already resolved by the Iberdrola Renewables IPO. *See* IBER/EE  
13 IR No. 27, Exhibit \_\_ (JPP-1).

14 Finally, there is no basis to presume that, even in the unlikely event that  
15 Iberdrola's credit ratings were downgraded, such downgrade would result in any  
16 direct harm to NYSEG or RG&E. Iberdrola's "A" category ratings are one to  
17 three notches above that of Energy East (rated "BBB"/"BBB+"). As such, even if  
18 Iberdrola were downgraded (which I believe to be improbable), there is no  
19 credible suggestion that Iberdrola's credit rating would fall below that of Energy  
20 East.

21 Q. Mr. Rude, the Staff Policy Panel alleges that S&P put NYSEG and RG&E "on  
22 watch for a downgrade" in part as a result of the announcement of the Proposed  
23 Transaction (at 167). Do you agree with Staff's suggestion that the Proposed

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1 Transaction caused this negative outlook?

2 A. Absolutely not. As discussed in further detail in the Rebuttal Testimony of Mr.  
3 Fetter, the ratings agencies placed Energy East, NYSEG and RG&E on negative  
4 outlook in September 2006, shortly after the Commission issued its August 2006  
5 rate order in the NYSEG electric proceeding, and approximately 9 months prior to  
6 the announcement of the Proposed Transaction. Accordingly, NYSEG's and  
7 RG&E's negative outlooks are completely unrelated to the Proposed Transaction.

8 Q. Do you agree with the Staff Policy Panel's claim that the Proposed Transaction  
9 had a negative impact on NYSEG's recent financing (*e.g.*, at 175-176)?

10 A. No, I emphatically disagree. As discussed in further detail in the Rate Adjustment  
11 Panel, the 30 basis point differential that Staff noted between NYSEG's debt  
12 issuance and those of its peers was caused by several factors, including ratings  
13 differences in Staff's proxy group and the relative size and frequency of NYSEG  
14 offerings compared to the proxy group, and was wholly unrelated to the Proposed  
15 Transaction. For the reasons described above, I agree with Mr. Azagra that the  
16 Proposed Transaction offers significant opportunities for NYSEG and RG&E to  
17 benefit from Iberdrola's stronger, "A" category credit ratings.

18 **B. Iberdrola's Global Utility Expertise**

19 Q. Mr. Azagra, can you please explain how Iberdrola's expertise will benefit New  
20 York ratepayers?

21 A. As I discussed in the Joint Petitioners' Direct Testimony, Iberdrola has 100 years  
22 of experience in the utility business and is a world leader that provides high-  
23 quality, reliable and environmentally friendly distribution service to 22 million

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1 electric points of supply and 2 million gas points of supply in Europe and the  
2 Americas. Iberdrola is an innovative and diversified holder and manager of utility  
3 and other energy assets with a well-demonstrated commitment to infrastructure  
4 investment, service quality and sustainable development. As I noted in the Joint  
5 Petitioners' Direct Testimony, Iberdrola's focus on service quality and operational  
6 excellence is evident in its superior performance as measured by the Customer  
7 Average Interruption Index (CAIDI) and the System Average Interruption  
8 Frequency Index (SAIFI). Relative to U.S. benchmarks, Iberdrola over the last  
9 three years has delivered results that would rank in either the first or second  
10 quartile of U.S. utilities. Moreover, Iberdrola has always been committed to  
11 sharing information about best practices among its operating utility subsidiaries,  
12 and will do so with Energy East, NYSEG and RG&E. *See* IBER-0030, Exhibit  
13 \_\_ (JPP-1). It is my understanding that the Commission has valued such global  
14 expertise in other utility mergers (*e.g.*, the Thames/Long Island Water Company  
15 merger).

16 Finally, the Joint Petitioners wish to emphasize that reliability, safety and  
17 customer service will remain top priorities for both NYSEG and RG&E after the  
18 consummation of the Proposed Transaction.

19 Q. The Staff Policy Panel has suggested that the Proposed Transaction will not  
20 benefit New York ratepayers because Iberdrola has stated it will continue to rely  
21 on Energy East's, NYSEG's and RG&E's existing management (*see, e.g.*, at 74).  
22 Can you respond?

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1 A. Iberdrola values Energy East's, NYSEG's and RG&E's local management, and  
2 anticipates enhancing this existing management with leading local and national  
3 professionals after the closing of the Proposed Transaction. Iberdrola's reliance  
4 on local management does not, however, mean that Iberdrola will not be able to  
5 help improve the operations of Energy East, NYSEG and RG&E for the benefit of  
6 their customers. Rather, Iberdrola will be in a position to share information  
7 regarding best practices. Indeed, while Iberdrola has traditionally relied on local  
8 management for the operations of other, non-Spanish entities that it has acquired,  
9 Iberdrola has nonetheless had a measurable and positive influence on these  
10 operations. For example, even though Iberdrola has continued to rely on local  
11 management for its utility subsidiaries in Brazil and Guatemala, local  
12 management at those utilities instituted various programs and upgrades as a result  
13 of Iberdrola's practice of sharing information about best practices among its  
14 operating subsidiaries.

**C. Renewable Benefits**

16 Q. Mr. Azagra, please explain Iberdrola's expertise in developing renewable  
17 resources, such as wind farms.

18 A. As I described in the Joint Petitioners' Direct Testimony, Iberdrola is the largest  
19 producer of wind energy in the world with 7,000 MW of wind capacity.<sup>1</sup> In 2006  
20 alone, Iberdrola invested over \$1.32 billion in renewable technologies and  
21 currently has over 41,000 MW of new renewable resources in the pipeline,

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<sup>1</sup> Capacity numbers are as of September 30, 2007.

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1 including over 21,000 MW in the United States.<sup>2</sup> With this expertise, Iberdrola is  
2 uniquely positioned to assist the State in meeting its renewable energy goals.

3 Q. What are the State's renewable energy goals?

4 A. It is my understanding, based on information on the Commission's website and  
5 other publicly-available information, that New York's 2002 State Energy Plan  
6 warned of the possible consequences of New York's heavy dependence on fossil  
7 fuel. Therefore, at the request of Governor Pataki and after a study period, the  
8 Commission on September 24, 2004 adopted an RPS. The RPS establishes the  
9 State's goal of increasing the proportion of renewable electricity used by New  
10 York consumers to at least 25% by 2013. The Commission designated the New  
11 York State Energy Research and Development Authority as the central  
12 procurement administrator of the State's RPS program. Under this program, the  
13 major investor-owned utilities collect revenues from ratepayers for the purpose of  
14 achieving a mandatory RPS target set at 24% of retail electricity consumption.  
15 The remaining 1% of the overall 25% goal comes from voluntary purchases made  
16 by retail customers. The Commission itself noted that the primary benefits  
17 expected from implementing the RPS Program were in (1) diversifying the  
18 generation resource mix to improve energy security and independence; (2)  
19 attracting the economic benefits from renewable resource generators,  
20 manufacturers, and installers to the state; and (3) improving New York's  
21 environment by reducing air emissions and other adverse environmental impacts  
22 of electricity generation. In addition to the State's RPS, Governor Spitzer

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<sup>2</sup> Capacity numbers are as of September 30, 2007.

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1 announced the “15 x 15” clean energy strategy in April 2007 to reduce the State’s  
2 electricity consumption by 15% from forecasted levels by 2015. As part of this  
3 strategy, Governor Spitzer recognized the need to phase out less secure and dirtier  
4 power plants, and outlined a plan to make New York an ideal environment for  
5 investment in renewable energy projects.

6 Q. Please respond to the Staff Policy Panel’s argument (at 29) that, given Iberdrola’s  
7 affiliated wind projects and development activities in New York, the Proposed  
8 Transaction would actually prevent the State from meeting its RPS goals.

9 A. The Staff Policy Panel’s argument that the Proposed Transaction would prevent  
10 the State from meeting its RPS goals is not only counterintuitive, it is illogical.

11 As I have described, given Iberdrola’s expertise in the development of renewable  
12 resources, it is uniquely positioned to assist the State in meeting its renewable  
13 energy goals. The Staff Policy Panel’s position is based entirely on the  
14 unsupported allegation that, if Energy East becomes affiliated with Iberdrola’s  
15 affiliated wind projects, other wind developers will not invest in New York,  
16 despite all of the economic incentives for them to do so. In fact, Staff recognizes  
17 the very extensive wind projects already in the New York Independent System  
18 Operator (“NYISO”) interconnection queue (*see* IBER/EE IR No. 1, Exhibit \_\_  
19 (JPP\_1)), and the announcement of the Proposed Transaction does not appear to  
20 have had any impact on such activities.

21 Despite the Staff Policy Panel’s stated concerns on this point, there has  
22 been no suggestion by Staff or any other party in this proceeding that any  
23 developer has in fact scaled back its projects or withdrawn from the State as a

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1 result of the Proposed Transaction. No wind developer has even intervened in  
2 this proceeding, much less suggested that Iberdrola's acquisition of Energy East  
3 would adversely impact wind development in New York. In fact, neither the  
4 Independent Power Producers of New York ("IPPNY") nor any generation  
5 developer has raised any concerns in this proceeding with respect to potential  
6 vertical market power issues associated with the operating and planned wind  
7 projects in New York owned by Iberdrola's affiliates. It is worth emphasizing  
8 that a number of parties in this proceeding that have direct interests in increasing  
9 wind development in New York State – including the New York State  
10 Department of Environmental Conservation, the Natural Resources Defense  
11 Council and the Greater Rochester Enterprise – are on record as stating that the  
12 Commission should treat Iberdrola's renewables expertise as a benefit when  
13 evaluating the Proposed Transaction. Dr. Hieronymus provides further support in  
14 his rebuttal testimony for the conclusion that the Proposed Transaction will have  
15 no adverse effect on wind development activities in New York. Finally, I note  
16 that in Iberdrola's extensive and global wind experience, it has not witnessed any  
17 adverse impact on the level of wind development activities in the regions where  
18 Iberdrola owns both transmission/distribution businesses and wind generation.

19 Q. Do you have any comments with respect to the Staff Policy Panel's conclusion  
20 that, given Iberdrola's wind development activities in New York, the Proposed  
21 Transaction will create the potential for the Joint Petitioners to exercise vertical  
22 market power (*see, e.g.*, at 124-25)?

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1 A. The Rebuttal Testimony of Dr. Hieronymus explains in detail why the Proposed  
2 Transaction does not raise any vertical market power concerns. I would also like  
3 to provide some comments with respect to the factual parts of this discussion. As  
4 an initial matter, in response to concerns raised by the Staff Policy Panel (at 45-  
5 46), I note that the existence of antitrust claims against Iberdrola's  
6 transmission/distribution subsidiaries in other parts of the world is not relevant to  
7 the Commission's review of the Proposed Transaction, much less suggestive of  
8 any potential vertical market power issues associated with the Proposed  
9 Transaction. In fact, Staff admits that it has not compared the number of claims  
10 against Iberdrola with those of other domestic or foreign public utilities or public  
11 utility holding companies. *See* IBER/EE IR No. 12, Exhibit \_\_ (JPP-1).

12 Q. Do you agree with the Staff Policy Panel's recommendation that, if the  
13 Commission approves the Proposed Transaction, it should require the divestiture  
14 of Iberdrola's affiliated wind projects in New York (at 288)?

15 A. Not at all. Dr. Hieronymus explains why Iberdrola's affiliated wind projects in  
16 New York could not be used in the exercise of vertical market power. I would  
17 like to add that the Staff Policy Panel's position on these projects does not make  
18 any sense in light of the State's aggressive renewable energy goals, and  
19 Iberdrola's ability to help the State meet those goals. Staff is the only party in this  
20 proceeding that is recommending the divestiture of these affiliated wind projects.

21 Q. Do you have any other comments on the Staff Policy Panel's recommendation  
22 that Iberdrola's affiliated wind projects in New York be divested as a condition to  
23 approval of the Proposed Transaction?

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1 A. The Staff Policy Panel believes that there is a contradiction inherent in Iberdrola's  
2 claim that it will be able to provide substantial benefits toward meeting the State's  
3 RPS targets, although its current operational and planned wind projects in New  
4 York are relatively *de minimis* (at 141-42). Staff fails to recognize that the State's  
5 renewable energy goals are very aggressive, and it is unlikely that those goals  
6 could be met through investment by a reduced number of developers. Rather, it is  
7 more likely that the State will need to rely on all available renewable developers  
8 to meet its goals. Given Iberdrola's expertise with the development of renewable  
9 projects, it is uniquely positioned to help the State meet those goals. Thus, the  
10 Commission should not discount the contribution that the Iberdrola group of  
11 companies could make to this effort.

12 Q. How is the Proposed Transaction related to meeting the State's renewable energy  
13 goals? Wouldn't Iberdrola and its affiliates continue to develop wind projects in  
14 New York regardless of the Proposed Transaction?

15 A. Certainly, the decision as to whether to develop a particular wind project is based  
16 on the economics of the project. That being said, a number of states in the U.S.,  
17 in recognition of the environmental benefits of renewable resources as well as the  
18 economic benefits that communities derive from the development of such  
19 resources, are encouraging wind development activities within their borders.  
20 Iberdrola and its affiliates simply cannot invest in each state that is trying to  
21 attract renewable developers. Rather, renewable investment will be targeted to  
22 those states where there is a familiarity with the market opportunities, the RPS  
23 standards, and other applicable regulatory frameworks, as well as the general

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1           receptiveness within the state to such development. Logically, if Iberdrola has a  
2           significant presence in New York (such as through its affiliation with Energy  
3           East) and has made a positive determination with respect to these considerations  
4           in New York, then it and its affiliates may be more likely to target New York sites  
5           for additional wind development. I would also like to point out that, while there  
6           are a number of wind developers that are currently evaluating options in New  
7           York, Iberdrola's affiliates have a most impressive track record with respect to the  
8           completion of such projects. In fact, Iberdrola is one of only a handful of  
9           developers that has successfully completed and placed in service wind projects in  
10          New York. Any suggestion that Iberdrola and its affiliates should somehow be  
11          excluded from this effort is simply contrary to the State's renewable energy  
12          policies.

13   Q.    Do you have any comments on the Staff Policy Panel's conclusion that Horizon  
14          and Gamesa should be included in any discussion of Iberdrola's wind  
15          development activities (at 129-30) and its suggestion that Iberdrola could  
16          influence the production and sale of wind generation equipment through its  
17          affiliation with Gamesa (at 142-43)?

18   A.    The Staff Policy Panel misunderstands the nature of Iberdrola's limited  
19          relationships with Horizon and Wind Gamesa. Let me clarify this.

20                 With respect to Horizon Wind, although Iberdrola holds a 9.5% equity  
21                 interest in Energías de Portugal, S.A. ("EDP"), which holds a 70% ownership  
22                 interest in Horizon Wind, Iberdrola may not exercise voting rights that represent  
23                 more than 5% of EDP's voting share capital and does not have any seats on the

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1 EDP board. Iberdrola has no access to non-public information on Horizon  
2 Wind's development activities, and is not involved in the decision-making with  
3 respect to those activities.

4 With respect to Gamesa, Iberdrola holds an approximate 23.9% interest in  
5 Gamesa Corporación Tecnológica, S.A., a publicly-traded entity. However, there  
6 are structural protections in place to prevent Iberdrola and its affiliates from  
7 obtaining any competitive information on Gamesa's operations and, as such, the  
8 only information available to Iberdrola with respect to Gamesa's U.S. operations  
9 is information that is publicly available. In addition, there are structural  
10 protections in place to prevent Iberdrola from voting on matters related to  
11 Gamesa's development activities in the U.S. Thus, there is no commonality of  
12 control or access to non-public information as between the Iberdrola's affiliated  
13 projects, on the one hand, and the Gamesa or Horizon Wind projects, on the other.

14 Q. You mentioned earlier that IPPNY has not raised any concerns in this proceeding  
15 with respect to potential vertical market power issues associated with Iberdrola's  
16 currently operating and planned affiliated wind projects in New York. Do you  
17 have any comments on IPPNY's testimony in this proceeding?

18 A. Yes. While IPPNY does not recommend the divestiture of these projects, it does  
19 request (at 25) that the Commission require the Joint Applicants to "commit to not  
20 construct or otherwise acquire any ownership interests in other electric generating  
21 facilities located in RG&E's and NYSEG's respective service territories." I  
22 presume that what IPPNY is seeking here is a prohibition against the  
23 interconnection of affiliated generation projects to NYSEG or RG&E

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1 transmission facilities. Dr. Hieronymus explains in detail why such a  
2 commitment is simply not necessary.

3 Q. Do you have any suggestions as to how to address IPPNY's concern?

4 A. As Dr. Hieronymus describes in his testimony, the Commission already has  
5 certain regulatory oversight of the development and acquisition of generation in  
6 New York, including in the NYSEG and RG&E service territories. Additionally,  
7 neither NYSEG nor RG&E will develop additional utility-owned generation to be  
8 included in rate base unless authorized.

9 Q. The Staff Policy Panel expresses some concerns with the number of Iberdrola's  
10 U.S. affiliates and the use of Special Purpose Entities ("SPEs") for these  
11 businesses (at 216-18). Can you address this issue?

12 A. An SPE is a corporate entity, usually a limited liability company or a limited  
13 partnership, that is created to fulfill a specific objective, such as isolating financial  
14 risk, such as bankruptcy, taxation or regulatory risk. An SPE's debt is generally  
15 non-recourse, which means that, in the event of a default, the lender's recovery is  
16 limited to the collateral (typically the SPE's assets). Thus, by definition, the  
17 liabilities within Iberdrola's SPE subsidiaries would not flow upstream to  
18 Iberdrola or any of its affiliates. As such, the fact that many of Iberdrola's  
19 subsidiaries are structured as SPEs should be reassuring to the Commission, rather  
20 than a concern.

21 Moreover, all of Iberdrola's existing affiliates in the U.S. are unregulated  
22 entities involved in wholesale electricity generation and natural gas storage  
23 development and operation, as well as energy trading – and the use of SPEs is

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1 standard with respect to these types of businesses throughout the country. It is my  
2 understanding that virtually all, if not all, of the competitive wholesale generators  
3 located in New York are also structured as SPEs, which facilitates their use of  
4 traditional project financing structures. It is also my understanding that  
5 competitive wholesale generators that are affiliated with transmission owners in  
6 other states (such as FPL Energy, Constellation Energy, Duke, Exelon and many  
7 others) are often structured as SPEs. In fact, it would be unusual if individual  
8 energy project companies were financed and constructed without utilizing SPEs.  
9 These traditional structures are not complicated or unusual; rather, they reflect  
10 prudent practice for entities involved in the generation business.

11 Q. Can you address the Staff Policy Panel's concerns with respect to transactions  
12 between NYSEG and RG&E and their unregulated affiliates (at 222-23)?

13 A. Later in my testimony I will explain the specific structures that will be in place to  
14 govern these types of transactions and ensure that no affiliate abuse occurs. At  
15 this point, I would like to address the Staff Policy Panel's misstatements about the  
16 nature of the marketing contracts between Community Energy, Inc. ("CEI"), a  
17 partially-owned subsidiary of Iberdrola, and NYSEG and RG&E (at 230-32).  
18 These contracts were executed well before Iberdrola and Energy East began  
19 discussing a potential merger and, as such, represent arm's length transactions  
20 that were negotiated significantly before these entities had become affiliates. The  
21 affiliate rules that are already in place will help maintain the arm's-length nature  
22 of these contracts after the Proposed Transaction occurs. I would also like to  
23 point out that the Staff Policy Panel incorrectly states CEI sells power to NYSEG

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1 and RG&E customers under these agreements, and that NYSEG and RG&E are  
2 restricted from marketing any non-CEI energy to customers in their respective  
3 service territories. In fact, CEI only markets renewable energy certificates, and  
4 does not make any power sales under these contracts or otherwise.

5 **D. Economic Development and Job Retention**

6 Q. Mr. Azagra, the Staff Policy Panel states that the Proposed Transaction may  
7 cause, among other things, job losses (at 316). Does Iberdrola anticipate that the  
8 Proposed Transaction will result in any job losses?

9 A. No. In addition, Iberdrola has committed that existing employee compensation  
10 and benefits will remain substantially unchanged for a period of at least eighteen  
11 months after consummation of the Proposed Transaction.

12 Q. Why do you anticipate that the Proposed Transaction will not result in any job  
13 losses?

14 A. Typically, when a merger results in synergistic savings, a component of those  
15 savings stems from the elimination of jobs. By contrast, Iberdrola does not own  
16 any regulated utilities in the U.S., and therefore the Proposed Transaction does  
17 not involve the combination or elimination of corporate or utility operating  
18 functions, which are necessary to produce such savings (and often result in job  
19 losses).

20 Q. What impact will the Proposed Transaction have on the New York economy?

21 A. The Proposed Transaction will have a positive economic impact on the  
22 revitalization of the upstate New York economy, and this benefit is recognized by  
23 other parties to this proceeding. In particular, the Greater Rochester Enterprise

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1 notes that Iberdrola's position as a global energy leader will help upstate New  
2 York to compete on the global stage for jobs and investment, recruit new  
3 companies to the region, and provide the financial ability for continued  
4 investments in infrastructure (at 7-9). Additionally, Empire State Development  
5 states that potential investment in NYSEG and RG&E by a leading international  
6 energy company is a "key opportunity to assist the State in the implementation of  
7 upstate economic development objectives" (at 1). I agree with these parties that  
8 have acknowledged Iberdrola's positive impact on economic development in  
9 upstate New York as a benefit of the Proposed Transaction, and I believe that the  
10 State of New York would want to attract transactions of this nature.

11 **IV. NO SYNERGIES/IMPUTED BENEFITS**

12 Q. Does the Staff Policy Panel claim that the Proposed Transaction will result in any  
13 synergistic benefits?

14 A. Yes. The Staff Policy Panel claims that Iberdrola will obtain significant tax  
15 benefits as a result of the Proposed Transaction in the form of PTCs for wind  
16 energy projects, as well as Spanish tax credits (*see, e.g.*, 78-79). The Staff Policy  
17 Panel also suggests that there are synergy benefits related to IT consolidation (at  
18 97) and certain alleged benefits to current employees, stakeholders and others  
19 resulting from the Proposed Transaction.

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1 Q. Does the Panel agree with the Staff Policy Panel's claim that these synergistic  
2 benefits exist?

3 A. No. The Joint Petitioners have not identified any synergistic benefits resulting  
4 from the Proposed Transaction. This is consistent with other "first mover"  
5 transactions, in which a non-U.S. entity undertakes its first acquisition of a  
6 regulated utility business in the U.S. While the Commission's treatment of  
7 synergy versus non-synergy transactions is discussed primarily in the Rebuttal  
8 Testimony of Mr. Meehan, it is the Joint Petitioners' understanding that the  
9 Commission has historically not required a sharing of imputed synergies in these  
10 "first mover" cases, because such cases do not result in any actual synergies or  
11 cost savings resulting from a combination of utility operations at the utility or  
12 holding company level. Thus, as the Proposed Transaction is a "first mover"  
13 transaction, the Joint Petitioners do not believe it would be appropriate for the  
14 Commission to impute synergies here. The Commission will have the  
15 opportunity to review any long-term benefits that may arise from the Proposed  
16 Transaction in future rate proceedings.

17 Moreover, although affiliates of Iberdrola have existing wind and thermal  
18 generation and gas storage businesses in the U.S., these unregulated entities are  
19 all owned by a separate parent company, Iberdrola Renewables, which is only  
20 80% owned by Iberdrola and 20% publicly traded on the Spanish stock  
21 exchanges. These existing unregulated entities have a different business focus  
22 than Energy East and their day-to-day operations would continue to be separately  
23 managed after the consummation of the Proposed Transaction. Accordingly,

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1 Iberdrola's current U.S. affiliates do not offer any potential for synergistic savings  
2 with respect to Energy East, and Staff should not invent synergies that do not  
3 exist.

4 **A. Production Tax Credits**

5 Q. Mr. Azagra, what is Staff's argument with respect to PTCs?

6 A. Staff believes that Iberdrola does not pay enough U.S. income taxes to be able to  
7 utilize the full value of the PTCs associated with its affiliated wind projects and  
8 that, through the acquisition of Energy East, "it will acquire taxable income  
9 sufficient to enable it to utilize at least some and perhaps all of the PTCs that it  
10 has generated" (at 82). Staff estimates that Iberdrola could obtain up to \$50  
11 million of PTCs per year based on the existing level of its ownership interests in  
12 wind power facilities, assuming that each of these facilities qualifies for PTCs.  
13 Staff also estimates that if Iberdrola constructs all of its planned generation for  
14 2007-2008, assuming that all of such projects are available for PTCs, it could  
15 generate up to \$150 million in PTCs per year by 2008. Staff does not provide any  
16 basis for these estimates, other than very rough estimates that are based upon a  
17 calculation of Staff's estimate of 100% of the value of existing and future PTCs,  
18 regardless of how they are and would be otherwise utilized.

19 Q. For background, can you explain what PTCs are?

20 A. The PTC mechanism was created by federal legislation (the Energy Policy Act of  
21 1992) as a subsidy to encourage power developers to expand renewable  
22 generation development in the U.S. The amount of the federal PTC for qualifying  
23 wind facilities is currently 2.0 cents per kWh of electricity produced in the U.S.

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1 from wind and sold to an unaffiliated third party. Because PTCs result in a  
2 reduction of U.S. federal tax liability, the entity (or consolidated tax group of  
3 entities) claiming such benefit must have sufficient offsetting U.S. federal tax  
4 liability in order to fully utilize the PTCs from affiliated wind projects. The PTC  
5 mechanism will expire at the end of 2008 (*i.e.*, 11 months from now), unless  
6 extended by Congress.

7 Q. Are there any synergistic PTC-related benefits resulting from the Proposed  
8 Transaction?

9 A. No. There simply are no PTC-related benefits of the Proposed Transaction. Let  
10 me start off by describing the ownership structure for Iberdrola's affiliated wind  
11 projects in the U.S. that have, or in the future may be, eligible for PTCs. Each of  
12 these projects is a wholly- or partially-owned, indirect subsidiary of Iberdrola  
13 Renewables, which, as I noted above, is owned 80% by Iberdrola, with the  
14 remaining shares traded on the Spanish stock exchanges. Any PTCs that may be  
15 available with respect to Iberdrola Renewables' wind projects in the U.S. are  
16 wholly unrelated to the Proposed Transaction: those PTCs exist regardless of  
17 whether the Proposed Transaction is consummated and regardless of Energy  
18 East's tax liability. In addition, PTCs associated with Iberdrola Renewables'  
19 operating wind projects have already been utilized sufficiently to develop and  
20 finance these existing projects. Furthermore, the availability of PTCs for any  
21 wind projects that Iberdrola Renewables may develop in the future is uncertain,  
22 and any such future PTCs would likely be utilized using investment structures  
23 similar to those in place for its wind projects that are already in operation.

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1 Q. Can you explain why there are no PTC-related benefits resulting from the  
2 Proposed Transaction?

3 A. Yes. The PTCs associated with Iberdrola Renewables' wind projects have  
4 already been utilized by third-party equity investors sufficient to develop and  
5 finance these existing projects.

6 Q. Please explain what you mean when you say that these PTCs have been "utilized"  
7 by third-party equity investors.

8 A. Iberdrola Renewables' affiliates have entered into a number of structured  
9 institutional partnership investment transactions related to their operational wind  
10 farms. Under these so-called "tax equity" structures, a non-affiliated equity  
11 investor that is a partial owner of the project can utilize the PTCs to offset its own  
12 U.S. federal taxable income. These structures facilitate Iberdrola Renewables'  
13 wind growth beyond its own tax capacity.

14 Q. Can you explain how these "tax equity" structures work?

15 A. Assume for the sake of this discussion that a wind farm is an indirect, wholly-  
16 owned subsidiary of Iberdrola Renewables. Once that project becomes  
17 operational (or close to becoming operational), it is transferred to a holding  
18 company that is also an indirect, wholly-owned subsidiary of Iberdrola  
19 Renewables. A percentage of that holding company is then sold to an unaffiliated  
20 equity investor that has the capacity to utilize the project's PTCs to offset its tax  
21 liability. The investor makes an up-front cash payment and subsequent payments  
22 over time, based on the project's forecasted energy production. The tax benefits,  
23 along with the project's income and cash flows, are allocated to the investor and

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1 Iberdrola Renewables, disproportionately in favor of the investor. Once the  
2 investor has received an agreed-upon after-tax return or some other objective  
3 standard has been met, the sharing ratios may “flip” so that the investor would  
4 receive a smaller portion of the PTCs and income, and Iberdrola Renewables  
5 would receive a larger portion. Iberdrola Renewables, through its affiliates,  
6 maintains operational and management control over the project, and provides  
7 O&M services.

8 Q. Are these tax equity structures standard in the wind industry?

9 A. Yes, there is a strong demand for tax-advantaged investments in the U.S. market,  
10 and numerous entities in the financial community are involved in providing tax  
11 equity investment for renewable projects. Such investors include commercial  
12 banks, insurance companies and investment funds that are primarily interested in  
13 the available tax benefits, and not the long-term ownership of the wind projects.  
14 In fact, tax equity structures are so common in the wind industry that the U.S.  
15 Internal Revenue Service recently issued special rules for these structures.

16 Q. Will Iberdrola Renewables' subsidiaries be eligible for PTCs for wind farms that  
17 they may develop in the future?

18 A. Determining the availability of PTCs for future wind projects is a speculative  
19 exercise for a number of reasons. First, the completion of any wind development  
20 project depends upon a variety of development risks and other factors. As the  
21 completion and operation of development projects are not certain, the availability  
22 of any PTCs associated with those projects is also uncertain. Second, the  
23 availability of any PTCs for those future projects is uncertain given that the PTC

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1 mechanism is currently scheduled to expire on December 31, 2008. As I noted  
2 above, while we anticipate that Congress may extend the PTC mechanism beyond  
3 2008, there is no guarantee that this will happen. Third, the amount of the PTC is  
4 based on the amount (in kWh) of electricity actually generated by a project.  
5 Given the intermittent and unpredictable nature of wind, the amount of PTCs  
6 available to any future project (assuming that the project is actually constructed is  
7 eligible for PTCs under a Congressional extension of the PTC mechanism) would  
8 also be uncertain.

9 Furthermore, the decision as to how to utilize any future PTCs that may  
10 become available will be made by Iberdrola Renewables, taking into  
11 consideration its tax liability and the tax liability of those entities with which it is  
12 consolidated for tax purposes.

13 Q. How important is the availability of PTCs for a particular development project?

14 A. The decision to develop a particular wind project is determined by the economics  
15 of that project, including the potential availability of any associated PTCs. In  
16 other words, the unavailability of PTCs would certainly have an adverse impact  
17 on Iberdrola Renewables' decision as to whether to invest in a particular  
18 development project. Again, I would like to emphasize that these PTCs are  
19 wholly unrelated to the Proposed Transaction or to the rates and operations of  
20 NYSEG and RG&E.

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1 Q. Do you believe that it would make for good public policy if the Commission were  
2 to find that the Proposed Transaction results in PTC-related synergistic benefits?

3 A. Absolutely not. As I described above, PTCs were created by federal legislation to  
4 put wind projects on a competitively level playing field with non-renewable  
5 generation resources and thereby encourage power developers to expand wind  
6 generation development in the U.S. Since the Energy Policy Act of 1992 was  
7 enacted, the PTC mechanism has been extended five times, with only two of these  
8 extensions occurring prior to the expiration of the then-current PTC provisions.  
9 The significance of the PTC mechanism as an incentive to the U.S. wind industry  
10 is demonstrated by the “boom and bust” cycles that it has experienced during  
11 those periods when the mechanism was allowed to lapse or its extension was  
12 uncertain. For a state regulator to effectively eliminate or even dilute this  
13 incentive, in particular in the context of a wholly-unrelated transaction, would  
14 clearly subvert the Congressional goal of encouraging the development of wind  
15 generation. The Rebuttal Testimony of Mr. Meehan also addresses this issue and  
16 explains that it would be improper as a policy matter for the Commission to  
17 interfere with the incentives provided by Congress for the development of  
18 renewable resources. The Rebuttal Testimony of Dr. Makholm further explains  
19 why any PTCs associated with Iberdrola’s affiliated wind projects are not a  
20 relevant issue to ratepayers of NYSEG and RG&E.

21 Q. Do you have any comments on the Staff Policy Panel’s specific calculations that  
22 Iberdrola could obtain up to \$50 million of PTCs per year based on the existing

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1 level of its ownership interests in wind power facilities, and up to \$150 million in  
2 PTCs per year by 2008?

3 A. The Staff Policy Panel doesn't provide any proper basis for its calculations. It  
4 appears that the Staff Policy Panel has simply provided an estimate of existing  
5 and future Iberdrola Renewables' wind capacity multiplied by 100% of the  
6 estimated PTC value. As explained above, because existing projects already have  
7 already utilized their PTCs, and because any PTCs for future projects are  
8 speculative at best, the expected value of PTCs to potentially offset against any  
9 Energy East tax liability should be zero.

10 **B. Spanish Tax Benefits**

11 Q. Mr. Azagra, the Staff Policy Panel has concluded that Iberdrola will receive  
12 certain tax benefits under Spanish law in connection with the Proposed  
13 Transaction and that these benefits should be treated as synergies in this  
14 proceeding (at 78-80). Please respond.

15 A. It would not be appropriate to consider these speculative Spanish tax "benefits" as  
16 synergies in this proceeding, because there is no certainty that Iberdrola will ever  
17 be able to obtain any tax offset or goodwill amortization associated with the  
18 Proposed Transaction under Spanish law. First, the Staff Policy Panel refers to  
19 Article 12(5) of the Spanish Corporate Income Tax Law (the "CIT Law"), which  
20 provides that financial goodwill related to the acquisition of shares in qualifying  
21 foreign subsidiaries may be amortized for tax purposes at a maximum yearly rate  
22 of 5% over 20 years. I note as an initial matter that Article 12(5) may operate as a  
23 tax deferral, rather than as a straight deduction. If and when an acquired company

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1 is sold, the amount of the financial goodwill which has been amortized pursuant  
2 to Article 12(5) may be recaptured in the taxable base of the seller. Moreover, the  
3 amortization of goodwill pursuant to Article 12(5) is subject to significant legal  
4 restrictions imposed by tax authorities in Spain. In particular, recent rulings by  
5 these authorities have questioned whether the acquisition of a holding company  
6 (*i.e.*, where the top tier entity is not the operating utility company, as is the case  
7 with Energy East) may actually generate goodwill eligible for amortization. *See*  
8 IBER-0148, Exhibit \_\_ (PP-2).

9 Q. Are there any other reasons why it is speculative to assume that Iberdrola will  
10 receive any tax benefit under Article 12(5) in connection with the Proposed  
11 Transaction?

12 A. Yes. For the reasons described above, it is uncertain whether any or all of the  
13 goodwill associated with the Proposed Transaction will be eligible for  
14 amortization under Article 12(5). By way of example, Iberdrola has not yet been  
15 able to determine whether any or all goodwill from its ScottishPower acquisition,  
16 which closed in April 2007, will be eligible for amortization under Article 12(5).

17 Q. Does the Staff Policy Panel identify any other potential tax benefits under the CIT  
18 Law?

19 A. Yes. The Staff Policy Panel also references Article 37 of the CIT Law (at 80),  
20 which provides a tax offset for companies purchasing shares in foreign companies  
21 to the extent the purchase leads to increased export activities. The European  
22 Competition Commission has declared offsets under Article 37 incompatible with  
23 the common market and requested that Spain gradually repeal Article 37 by 2010.



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1 when it acquired the last of its various operating companies, RG&E, and ending  
2 in 2004 with the implementation of the SAP system to support financial and work  
3 management functions. In addition, there are currently no plans to consolidate IT  
4 operations among Energy East, NYSEG, RG&E and Iberdrola's unregulated  
5 generation and natural gas affiliates in the U.S. due to the significant challenges  
6 associated with combining the IT functions of regulated and non-regulated  
7 operations.

8 Q. Mr. Rude, did Energy East elect to consolidate its regulated and unregulated  
9 operations on a single IT platform when it engaged in its most recent IT  
10 consolidation?

11 A. No. Energy East made the decision in 2002 to create a new shared service  
12 organization to support just its regulated utility operating companies.  
13 Consolidating these IT functions in Rochester, New York, was part of the plan.  
14 Prior to this consolidation, each Energy East utility had its own IT department.  
15 Detailed planning and work supporting the IT consolidation began late in 2002  
16 and continued through the end of 2005. IT consolidation was successful because  
17 the basic requirements the Energy East utilities have for IT services are relatively  
18 consistent across those utilities. This allows IT work processes to be standardized  
19 and leveraged across the utilities. It is unlikely that non-regulated entities would  
20 have the same IT service requirements as Energy East's regulated utility  
21 subsidiaries.

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1 Q. Mr. Rude, what were the main steps required for IT consolidation among Energy  
2 East's utilities?

3 A. One of the first steps in the IT consolidation effort was to define the new  
4 organization, develop new functional responsibilities, and develop a single set of  
5 processes to support multiple utilities. The majority of the organizational changes  
6 took effect in May 2003. The new organization included a centralized IT Help  
7 Desk, a centralized Network Operations Center, and a centralized Data Center.  
8 Additionally, the Network, Technical and IT Support Service teams were  
9 consolidated in Rochester, New York, where they standardized operations and  
10 worked under the direction of a single management team.

11 Q. What were the next steps for IT consolidation?

12 A. The second step was contract consolidation. The consolidated IT entity sought to  
13 re-bid and/or renegotiate several of its largest contracts with better pricing and  
14 terms. Over the consolidation period, new contracts were negotiated in the areas  
15 of telecommunications, mainframe hardware and software, disaster recovery and  
16 help desk services. The third step was technical consolidation. While the  
17 organizational changes were being made work was being done to consolidate the  
18 physical technology IT supports. Data Centers were consolidated to Rochester,  
19 resulting in data center closures in Hartford, Connecticut, Bridgeport,  
20 Connecticut, and Ithaca, New York. Additionally, the technology in the Augusta,  
21 Maine, data center was converted from a primary location to a back up location  
22 for the Rochester facility. A new network design was implemented to connect the  
23 Energy East utilities to one another and the Rochester Data Center. Additionally,

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1 network infrastructure standards were developed and implemented to reduce the  
2 complexity and cost of operating the network. A corporate desktop was  
3 developed to standardize the desktop operating systems, office productivity tools  
4 (e.g., email, word processing, spreadsheets, etc), remote connectivity tools and  
5 collaboration tools. In the process, corporate PCs were refreshed and  
6 standardized in 2005.

7 Q. Please explain why the fourth step related to applications makes it difficult to  
8 obtain the type of synergies Staff alludes to in the combination of regulated and  
9 non-regulated entities.

10 A. IT Application consolidation was driven by the implementation of SAP. In 2004,  
11 Energy East implemented a suite of applications in SAP including, HR, Payroll,  
12 Finance, Accounting and Materials management. This allowed those areas of the  
13 business to consolidate under the shared service umbrella. Upon completion of  
14 the Back Office implementation, the utility-specific Application teams that  
15 supported those applications were consolidated onto a single central team. A  
16 similar process took place in 2005, when the work management applications at  
17 the Energy East utilities were replaced with SAP. After the SAP implementation,  
18 support for work management applications was consolidated on a central team.  
19 Each of these applications share considerable community of interest for regulated  
20 entities but would be markedly different for unregulated entities that require  
21 different services.

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1 Q. What were the guiding principles of the integration work undertaken by Energy  
2 East in the IT area?

3 A. The integration focus was limited to the regulated T&D businesses. These  
4 businesses were the common denominator for investments that fostered additional  
5 commonality that could yield material merger related synergies. Branching IT  
6 consolidation into other areas including unregulated activities would have diluted  
7 the returns for the integration efforts. In part this dilution would have occurred  
8 because of the unique nature of the regulated businesses versus all other  
9 businesses. The need to segregate regulated utility shared service company  
10 activities from unregulated subsidiary activities must also be recognized.

11 Q. Mr. Azagra, did any IT consolidation savings result from Iberdrola's acquisition  
12 of ScottishPower and, if so, why wouldn't Iberdrola anticipate similar savings  
13 with respect to Energy East?

14 A. Prior to Iberdrola's acquisition of ScottishPower, ScottishPower had a uniquely  
15 high IT cost base arising from the fact that it obtained its IT services from a large  
16 number of suppliers, at high costs and without disciplined procurement budgeting  
17 and control at a central level. There were approximately 400 service level  
18 agreements and over 400 applications being used in ScottishPower. In addition,  
19 ScottishPower had not moved to the industry standard SAP application. By  
20 contrast, as discussed above and as the Staff Policy Panel has acknowledged (at  
21 97), Energy East's utility subsidiaries, including NYSEG and RG&E, already  
22 have implemented the SAP system. In addition, given the IT consolidation that  
23 has already occurred, Energy East and its subsidiaries do not have the same IT

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1 supplier management issues that were faced by ScottishPower. As such, a similar  
2 opportunity for IT consolidation savings does not exist with respect to the merger  
3 between Iberdrola and Energy East. For these same reasons, the Proposed  
4 Transaction will also not create any stranded costs with respect to NYSEG's and  
5 RG&E's SAP system, as the Staff Policy Panel suggests (at 97).

6 Additionally, the regulated T&D business represented only €3 million per  
7 annum of the announced expected synergies in Iberdrola's acquisition of  
8 ScottishPower. This amount was made up of some relatively limited expected  
9 savings in joint procurement of capital investments, and is consistent with the  
10 very limited nature of operational synergies in cross-border combinations  
11 involving a regulated T&D utility. Finally, I note that there has been no IT  
12 consolidation between ScottishPower's U.S. operations and Iberdrola's U.S.  
13 operations since Iberdrola's acquisition of ScottishPower last year.

14 Q. Is it likely that there could be synergies in combining United States and Spanish  
15 IT systems?

16 A. Iberdrola has not undertaken an evaluation of whether any cost savings could be  
17 achieved by integrating common IT platforms between Energy East and Iberdrola.  
18 *See* IBER-0095, Exhibit \_\_ (PP-2). A variety of factors (including among other  
19 things, geographic separation, time-zone differences and accounting standards)  
20 would make such integration difficult, even to the extent that there were IT  
21 platforms in common between Energy East and Iberdrola.

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1 Q. Please summarize the Panel's view of the potential IT integration synergies  
2 suggested by Staff.

3 A. The Panel believes that material IT synergies have already been achieved by the  
4 integration of the Energy East utilities' IT systems. Any alleged additional  
5 synergies created by seeking to integrate unregulated affiliates would be  
6 inconsistent with our efforts to avoid cross-subsidization between regulated and  
7 unregulated operations.

8 **D. Alleged "Benefits" To Current Employees, Stakeholders And Others**

9 Q. The Staff Policy Panel states that the Proposed Transaction will result in  
10 substantial benefits to Energy East shareholders, executives and other third parties  
11 (for example, investment bankers, advisors and attorneys) that should be shared  
12 with ratepayers (at 87-89). Can the Panel respond to this assertion?

13 A. This Staff argument is difficult to understand from a practical or logical  
14 perspective. These are costs to consummate a transaction that is in the best  
15 interests of the State. Put simply, the payments identified by the Staff Policy  
16 Panel are just the cost of doing business, and would be similarly incurred by any  
17 other potential acquirer of utilities in New York. In this case, these costs will  
18 have no effect on customers of NYSEG and RG&E. As the Panel has previously  
19 explained and as discussed in greater detail below, Iberdrola has committed that  
20 its shareholders will bear the costs of the Proposed Transaction and that NYSEG  
21 and RG&E will not seek recovery in rates of any such costs. To somehow claim  
22 that these transaction costs are "benefits" to anyone defies logic. As discussed in  
23 detail in the Rebuttal Testimony of Mr. Meehan, the Staff Policy Panel's assertion

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1 that these “benefits” should be shared with ratepayers would be a bad policy for  
2 the Commission to adopt as it attempts to impose additional costs on parties  
3 interested in investing in New York utilities without regard to whether such  
4 purposed “benefits” are attributable to effects on New York utility operations.

5 **V. WRITE-OFFS, WRITE-DOWNS, RESERVES, AND RATE PLAN**  
6 **MODIFICATIONS**

7 Q. Is the Panel generally addressing the Staff Policy Panel’s and Staff’s  
8 recommendations regarding write-offs, write-downs, reserves and rate plan  
9 modifications in your rebuttal testimony?

10 A. No. These topics are primarily being addressed in the Rate Adjustment Panel and  
11 the Rebuttal Testimony of Mr. Meehan. However, the Panel would like to  
12 address certain issues raised by the Staff Policy Panel with respect to goodwill.

13 Q. Does the Panel agree with Staff’s definition of goodwill for regulatory purposes as  
14 “the excess of the purchase price over original cost”?

15 A. Yes. It provides a workable definition of goodwill in this context.

16 Q. What are the three categories of goodwill that are discussed by the Staff Policy  
17 Panel?

18 A. These three categories are the goodwill associated with the Energy East/RGS  
19 transaction (“RGS Goodwill”), the goodwill associated with Iberdrola’s purchase  
20 of Energy East (“New Goodwill”), and existing goodwill on Iberdrola’s books.

21 While the Rebuttal Testimony of Dr. Makhholm addresses the overall treatment of  
22 goodwill, this Panel will briefly address Staff’s proposed treatment of these three

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1 categories of goodwill.

2 Q. Mr. Rude, was the transaction that resulted in the RGS Goodwill approved by the  
3 Commission?

4 A. Yes. In its *Order Adopting Provisions of Joint Proposal with Modifications*,  
5 issued February 27, 2002 in Cases 01-E-0359 and 01-M-0404, the Commission  
6 approved the merger that created the RGS Goodwill as in the public interest.

7 Q. Is the RGS Goodwill included on Energy East's books or on RG&E's books?

8 A. The RGS Goodwill resides on the books of RGS. The RGS Goodwill was not  
9 “pushed-down” to NYSEG or RG&E. The RGS Merger Joint Proposal approved  
10 by the Commission states that “the cost of such business combination [i.e. the  
11 merger] shall not be ‘pushed’ down below the New RGS level, and the goodwill  
12 created in this transaction shall not appear on the books of either RG&E or  
13 NYSEG.” *See* Section III.G of the Energy East / RGS Merger Joint Proposal  
14 approved in Case 01-M-0404.

15 Q. Does the RGS Goodwill increase or decrease as a result of the Proposed  
16 Transaction?

17 A. Neither. The RGS Goodwill is not changed by the Proposed Transaction.

18 Q. Have New York ratepayers paid for the RGS acquisition premium?

19 A. No. The premium was not recovered from New York ratepayers.

20 Q. Staff notes that Iberdrola has made no commitments concerning the existing  
21 goodwill associated with the Energy East/RGS transaction that is currently  
22 recorded on Energy East’s books. Is this correct?

23 A. Yes. The Joint Petitioners’ have not proposed to take any steps with the pre-

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1 existing RGS Goodwill.

2 Q. How has Staff proposed to treat the RGS Goodwill?

3 A. The Staff Policy Panel recommends that Iberdrola remove the RGS Goodwill  
4 from Energy East's books (at 92-93).

5 Q. Do you support this recommendation?

6 A. No. First, the RGS Goodwill currently resides on the books of RGS, not Energy  
7 East. In any event, it would be unprecedented for an unregulated entity (in this  
8 case RGS or Energy East) to be required by the Commission to move goodwill  
9 upstream to another unregulated entity. The RGS Goodwill was placed on the  
10 books of RGS prior to the Proposed Transaction and is unrelated to and  
11 unaffected by the Proposed Transaction, and it would therefore be inappropriate  
12 to require Iberdrola to remove the RGS Goodwill from Energy East's books as a  
13 condition to the Proposed Transaction.

14 Q. What rationale, if any, does Staff offer to support its recommendation?

15 A. Staff states that "the acquisition of Energy East involves the purchase of Energy  
16 East's assets; among those assets is the goodwill on Energy East's books." Staff,  
17 however, mischaracterizes the nature of the Proposed Transaction, which involves  
18 the purchase of Energy East's stock and not its individual assets.

19 Q. Staff also argues that the "push up" of RGS Goodwill will improve financial  
20 transparency by avoiding the fact that existing goodwill has been a continuing  
21 source of controversy in the utilities' rate cases because it allegedly "clouds the  
22 true picture of Energy East's financial health." Do you agree with this argument?

23 A. No. The RGS Goodwill has not in any way "clouded" the picture of Energy

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1 East's financial health. The RGS goodwill is clearly recorded on RGS's books  
2 and is therefore clearly separate from RG&E's and NYSEG's books. In fact,  
3 even where goodwill is recorded on the books of other Energy East utility  
4 companies in other jurisdictions, no regulatory body with jurisdiction has  
5 struggled with transparency or alleged the existence of any "cloud." This concern  
6 is clearly without merit.

7 Q. What, if anything, should happen to the RGS Goodwill as a result of the Proposed  
8 Transaction?

9 A. Nothing should happen to the RGS Goodwill. It is unrelated to, and unaffected  
10 by, the Proposed Transaction and should therefore remain on the books of RGS.  
11 The placement of the RGS Goodwill on RGS' books was approved by the  
12 Commission when it approved the RGS transaction and Staff has failed to justify  
13 its unprecedented request to move goodwill from one unregulated holding  
14 company to another unregulated entity.

15 Q. Mr. Azagra, has the Staff Policy Panel raised any concerns regarding the goodwill  
16 on Iberdrola's books?

17 A. Yes. The Staff Policy Panel has raised a number of concerns regarding the  
18 amount of goodwill on the books of Iberdrola and the potential impairment of that  
19 goodwill. There is no basis for the Staff Policy Panel's concerns on this issue. As  
20 an initial matter, goodwill is not a primary indicator of the risk profile of a  
21 company, as described in further detail in the Rebuttal Testimony of Mr. Fetter,  
22 and the Staff has been unable to point to any credit report about Iberdrola that  
23 even mentions goodwill. *See* IBER/EE IR No. 51, Exhibit \_\_ (JPP-1).

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1                   Furthermore, the goodwill on Iberdrola's balance sheet is a result of  
2                   historical transactions, and has been estimated based on the fair value of those  
3                   historic transactions, based on the expected cash flows generated through each  
4                   historic acquisition. Under both the International Financial Reporting Standards  
5                   ("IFRS") and U.S. Generally Accepted Accounting Principles ("U.S. GAAP"),  
6                   goodwill is recorded at a cost generating unit ("CGU") level. Thus, Iberdrola's  
7                   goodwill only would be impaired if its expected future cash flows were no longer  
8                   sufficient to support the amount of goodwill on a CGU level. Given Iberdrola's  
9                   strong cash flow and earnings growth, and the high opinion of Iberdrola by the  
10                  capital markets (as reflected in its ratings by the credit ratings agencies, and both  
11                  its successful capital increase to finance the Proposed Transaction and the  
12                  successful Iberdrola Renewables IPO) it is completely unrealistic and unfounded  
13                  to assume that any significant portion, much less all, of the goodwill recorded  
14                  across all of its various CGU levels could suddenly become impaired as suggested  
15                  by the Staff Policy Panel. Finally, it is important to note that Iberdrola has  
16                  consistently committed that no goodwill in connection with the Proposed  
17                  Transaction will be recorded on the books of NYSEG or RG&E. The Rebuttal  
18                  Testimony of Dr. Makhholm explains that because Goodwill will not be pushed  
19                  down to the books of Energy East, NYSEG or RG&E, it will have no affect on  
20                  rates, or ratepayer interests.

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1 **VI. REPORTING, FINANCIAL AND AFFILIATE RISKS IDENTIFIED BY**  
2 **THE STAFF POLICY PANEL**

3 **A. Diminished Transparency and Reporting**

4 Q. Mr. Azagra, do you agree with the Staff Policy Panel's suggestion that the  
5 Proposed Transaction will result in diminished financial transparency and  
6 reporting?

7 A. No. The Staff Policy Panel states that “[d]ifferences in accounting standards and  
8 language, coupled with a complex organizational structure, and the unfamiliarity  
9 of Iberdrola with New York regulators and their policies all pose a risk for the  
10 customers of NYSEG and RG&E” (at 24-25). These risks are without foundation,  
11 and they unfairly disregard the track record of other stable and successful foreign  
12 utility investments in the United States. In particular, it is my understanding that  
13 there are a number of utilities within the State of New York that are successfully  
14 operated by foreign companies, including United Water, American Water,  
15 Niagara Mohawk and KeySpan.

16 Moreover, Iberdrola will continue to comply with all U.S. laws and  
17 regulations regarding financial reporting. As made clear by the SEC, both U.S.  
18 GAAP and the IFRS under which Iberdrola prepares and reports its financial  
19 statements are high-quality accounting standards that are similar to one another in  
20 many respects and rapidly converging. See Exhibit \_\_ (JPP-7). Iberdrola also  
21 will make appropriate persons available to respond to specific inquiries regarding  
22 the differences in these two accounting standards. Additionally, Energy East will

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1 continue to use U.S. GAAP for all financial reporting and will comply with  
2 existing and any applicable requirements of the Sarbanes-Oxley Act.

3 Nonetheless, the Joint Petitioners wish to acknowledge the Staff Policy  
4 Panel's financial transparency and reporting concerns. While we believe that no  
5 further commitments are required here in order for this Proposed Transaction to  
6 be found to be in the public interest, the Joint Petitioners are willing to commit to  
7 the following additional financial transparency and reporting measures to further  
8 ensure that the Commission and the public will have robust access, in English and  
9 in New York, to the following information related to Iberdrola, Energy East,  
10 NYSEG, and RG&E:

- 11 • **Books & Records** - The Commission will have access, in English and in New  
12 York, to (1) the books/records of NYSEG and RG&E, and (2) any  
13 books/records of Iberdrola or any Iberdrola affiliates that are related to  
14 NYSEG or RG&E. The Commission will have access, in English and in New  
15 York, to any minutes of the Iberdrola Board of Directors, and any sub-  
16 committee thereof, to the extent that such minutes discuss Energy East,  
17 NYSEG or RG&E. Iberdrola also shall translate such other documents as the  
18 Commission determines to be reasonably necessary to fulfill its statutory  
19 duties.
- 20 • **Audit Reports** - The Commission will have access, in English and in New  
21 York, to all internal and external audit reports and recommendations for  
22 NYSEG and RG&E, and for any Iberdrola affiliate with respect to the  
23 provision of goods and services for compensation to NYSEG or RG&E.

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- 1 • **Financial Statements** - Iberdrola's consolidated balance sheets, income  
2 statements and cash flow statements will be made available to the  
3 Commission, in English and in New York, on an annual basis and in a format  
4 that is mutually agreed to between Iberdrola and the Commission Staff.  
5 Audited financial statements will be in accordance with IFRS as, as issued by  
6 the International Accounting Standards Board, consistent with SEC  
7 requirements. Additionally, Iberdrola agrees to provide specific answers to  
8 particular questions raised by the Commission and its Staff with respect to  
9 IFRS.

10 The commitments should adequately address any concerns regarding financial  
11 transparency and reporting issues.

12 Q. Mr. Azagra, do you believe that the translation of documents should be a major  
13 issue in connection with the Proposed Transaction?

14 A. No. As a global company with significant existing operations in the U.S. and the  
15 United Kingdom, and given its numerous U.S. investors, Iberdrola already  
16 translates key documents into English in the ordinary course of business. Indeed,  
17 a substantial amount of information, including all key financial information, is  
18 already routinely made available publicly in English on Iberdrola's website.  
19 Moreover, Iberdrola will need to communicate with Energy East, NYSEG and  
20 RG&E in English and documents related to the management of these entities will  
21 be prepared in and/or translated into English accordingly.

22 Additionally, the concerns raised by the Staff Policy Panel regarding the  
23 translation of documents in the Maine Public Utilities Commission's review of

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1 the Proposed Transaction (at 47) were based solely upon the onerous number of  
2 document translations requested by one party to that proceeding on issues that  
3 were unrelated to the Proposed Transaction and that proceeding. That party has  
4 subsequently signed a comprehensive settlement agreement that resolves all  
5 issues raised in that proceeding, including translation issues, and the Maine  
6 Commission has voted to approve that settlement. Iberdrola translated all  
7 documents requested by the Maine Advisory Staff in that proceeding. Thus, the  
8 Staff Policy Panel should not be concerned about translation issues in connection  
9 with the Proposed Transaction, particularly in light of the reporting commitments  
10 that I discussed above.

**B. Data Security**

11  
12 Q. Mr. Azagra, do you agree with the Staff Policy Panel's data security concerns  
13 regarding vulnerabilities in the New York electric grid, as well as sensitive  
14 personal customer data, and "the possibility that this information could wind up in  
15 the wrong hands" after the Proposed Transaction (at 292)?

16 A. No. Iberdrola has put robust protections in place to protect its information  
17 systems against unwanted access, either by authorized or unauthorized personnel,  
18 with the aim of ensuring the confidentiality and integrity of the information  
19 processed by those systems. Access to Iberdrola's information systems from the  
20 outside may only be made through safe, encrypted channels. These measures  
21 apply to all office information systems, as well as to systems related to power  
22 production and gas and electric distribution. Iberdrola's information systems  
23 follow the most demanding practices in the world, including those in the United

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1 States. In fact, Iberdrola participates with other U.S. electrical utilities in the  
2 Electric Power Research Institute's Cybersecurity Assessment Program, which  
3 focuses on North American Electric Reliability Corporation security standards.  
4 Finally, I note that Iberdrola has no intention to merge its information control  
5 systems with those of Energy East.

6 Nonetheless, the Joint Petitioners want to acknowledge the Staff Policy  
7 Panel's data security concerns and are willing to commit to the following  
8 measures to ensure further that critical energy infrastructure information, as well  
9 as sensitive personal data of NYSEG and RG&E customers, remains secure:

- 10 • **Data Security** – The Joint Petitioners commit that information about  
11 vulnerabilities in the New York electric grid and the gas pipeline network, in  
12 all media formats, shall remain within the headquarters of NYSEG and  
13 RG&E. The Joint Petitioners also commit that customer data (*e.g.*, names,  
14 addresses, telephone numbers, social security numbers, credit reports) shall  
15 remain, in all media formats, within the headquarters or customer service  
16 centers of NYSEG and RG&E.

17 **C. Credit Quality Risks**

18 Q. Mr. Azagra, do you agree with the Staff Policy Panel's concerns about Iberdrola's  
19 financial status and credit downgrade?

20 A. No. The Staff Policy Panel incorrectly states that Iberdrola's capital investment  
21 program "has caused concern at the credit agencies" and that the credit agencies  
22 are also concerned "about the high degree of leverage Iberdrola plans to deploy  
23 and how its large investment program will be financed" (at 23). The Staff Policy

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1 Panel also suggests that declines in Iberdrola's credit quality could have a  
2 negative impact on the credit ratings of NYSEG and RG&E, as well as their  
3 ability to raise capital. As described more fully in the Rebuttal Testimony of Mr.  
4 Fetter, these concerns have no foundation. As the third largest "investor-owned"  
5 utility in Europe with an impeccable track record and stable "A" category credit  
6 ratings, Iberdrola's access to the capital markets at terms and pricing that are  
7 consistent with its "A" category credit ratings is not in question. Additionally,  
8 Iberdrola's current strong "A" category credit ratings already take into account  
9 Iberdrola's capital structure and its future investment program, including the  
10 information described in Iberdrola's Strategic Plan 2008-2010.

11 The Proposed Transaction does not raise any of the credit issues raised in  
12 the National Grid/KeySpan transaction, in which the parent company had a lower  
13 credit rating than the target utility and utilized significant debt to finance the  
14 transaction. As a result of that transaction, KeySpan's standalone "A" rating fell  
15 to National Grid's lower "A-" rating. If the Proposed Transaction were to have a  
16 similar impact, then Energy East's credit rating would actually improve 1-2  
17 notches, which would amount to a substantial improvement in its credit quality.

18 Finally, the Joint Petitioners are willing to commit to the following credit  
19 quality measures to ensure further that this Commission receives all relevant  
20 information related to the credit ratings of Iberdrola, Energy East, NYSEG and  
21 RG&E, and that the customers of NYSEG and RG&E are protected in the  
22 unlikely event that Iberdrola experiences a credit downgrade:

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- 1       • **Credit Ratings** - Iberdrola, Energy East, NYSEG and RG&E will maintain  
2       credit ratings with at least two generally accepted ratings agencies (*e.g.*, S&P  
3       and Moody's).
- 4       • **Reporting of Credit Events** - If there is a "Credit Event" (defined as the  
5       downgrade of Iberdrola's, Energy East's, NYSEG's or RG&E's credit rating  
6       below "BBB"/"Baa3", or credit rating of "BBB-"/"Baa3" with a "Watch  
7       Negative", by at least two major credit reporting agencies (*e.g.*, S&P and  
8       Moody's)), NYSEG and RG&E will make a timely filing notifying the  
9       Commission of any such Credit Event, and subsequent filings with the  
10      Commission every three months, identifying (1) the current credit rating  
11      during such Credit Event and (2) a plan to remedy such Credit Event, until  
12      such Credit Event is eliminated.
- 13     • **Ratings Agency Presentations and Reports** - Iberdrola, Energy East,  
14      NYSEG or RG&E, as applicable, will provide the Commission on a  
15      confidential basis with copies of all slide presentations to credit ratings  
16      agencies relating to Energy East, as well as all rating agency reports relating  
17      to Energy East or any Energy East subsidiaries, on an on-going basis.
- 18     • **Cost of Debt** - NYSEG and RG&E ratepayers shall not be responsible for any  
19      increase in NYSEG's or RG&E's cost of debt caused by Iberdrola's financial  
20      status. For ratemaking purposes, the Commission may impute a reasonable  
21      cost of debt that is based on NYSEG's and RG&E's stand-alone risk profile.

22      Although the likelihood of a Credit Event occurring is extremely remote, the  
23      above measures, along with Iberdrola's commitment to maintain its current strong

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1 "A" category credit ratings, should address the Staff Policy Panel's concerns on  
2 these issues.

3 **D. Capital Structure Risks**

4 Q. Mr. Azagra, do agree with the Staff Policy Panel's concerns regarding Iberdrola's  
5 capital structure?

6 A. No. The Staff Policy Panel raises a number of concerns regarding Iberdrola's  
7 "leveraged capital structure" (at 179) and the "amount of dividends that NYSEG  
8 and RG&E will have to upstream to Iberdrola once the merger is consummated"  
9 (at 179). As discussed in the Rebuttal Testimony of Dr. Makhholm and Mr. Fetter,  
10 these concerns are without merit and are largely irrelevant to the Commission's  
11 protection of the customers of NYSEG and RG&E. In particular, the recent  
12 Iberdrola Renewables IPO raised \$6.5 billion in equity to support Iberdrola's  
13 renewable capital expenditure program, and fully addressed the leverage concerns  
14 of the ratings agencies. Additionally, Iberdrola clearly states in its Strategic Plan  
15 2008-2010 that up to 72% of its capital expenditure program will be financed by  
16 means of the Iberdrola Renewables IPO, operational cash flow, and divestments  
17 of over three billion euros. *See* IBER-0137S, Exhibit \_\_ (JPP-1). The remaining  
18 28% of Iberdrola's capital expenditure program will be financed by means of  
19 debt, thus resulting in a net reduction of Iberdrola's debt/capital ratio.

20 On the issue of dividend restrictions, it should be noted that Iberdrola's  
21 dividend policy is an integral part of its Strategic Plan 2008-2010 that has been  
22 assessed by the credit agencies as part of the larger credit analysis that led to  
23 Iberdrola's "A" category credit ratings. It is also my understanding that the

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1 Commission has not required dividend restrictions of the kind proposed by the  
2 Staff Policy Panel (*see, e.g.*, at 273-276) in any non-synergy transaction in New  
3 York in the past 11 years.

4 Nonetheless, Joint Petitioners are willing to commit to the following  
5 additional (and in Joint Petitioners' view, unnecessary) measures to ensure further  
6 that the customers of NYSEG and RG&E are protected from any remote  
7 theoretical risks that might be raised by Iberdrola's capital structure:

- 8 • **Minimum Common Equity Ratio** - NYSEG and RG&E will at all times  
9 maintain common equity capital at levels equal to or greater than 38% of total  
10 adjusted capital (including common equity, preferred equity, long-term debt,  
11 short term debt, capitalized leases, Current Maturities of Long-Term Debt  
12 and Current Maturities of Capitalized Long-Term Leases). Notwithstanding  
13 the foregoing, NYSEG and RG&E shall maintain the right to petition the  
14 Commission for an exception to this condition. One-time events, such as  
15 mandated changes in accounting, that temporarily affect equity will be  
16 reported to the Commission and excluded from the common equity ratio  
17 calculation.
- 18 • **No Cross Default** - There will be no cross default provisions in any joint  
19 credit arrangements among NYSEG and RG&E, on the one hand, and  
20 Iberdrola and its affiliates, on the other hand, unless otherwise authorized by  
21 the Commission.
- 22 • **Money Pool Participation** - NYSEG and RG&E may participate in Iberdrola  
23 money pools provided the other participants in such money pools are limited

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1 to regulated utility affiliates of Iberdrola in the U.S., unless otherwise  
2 authorized by the Commission. Iberdrola shall not borrow from money pools  
3 in which NYSEG and RG&E are participants.

- 4 • **Dividend Policy** - NYSEG and RG&E will maintain their respective dividend  
5 policies with due regard for the financial performance and needs of NYSEG  
6 and RG&E, irrespective of the financial performance and needs of Iberdrola.  
7 Iberdrola will report to the Commission in the event that the dividend payout  
8 for any year is more than 100% of income available for dividends calculated  
9 on a two-year rolling (eight calendar quarter) average basis.

10 **E. Ring Fencing**

11 Q. Mr. Azagra, do you agree with the Staff Policy Panel's recommendation that  
12 "substantial ring fencing covenants" are necessary "to protect the interests of New  
13 Yorkers by assuring that both NYSEG and RG&E are in a position to provide safe  
14 and adequate service at a reasonable price to the public" (at 242).

15 A. No. Ring fencing covenants are intended to insulate utility customers from the  
16 potential credit issues of a parent company. As I have discussed above, Iberdrola  
17 is a stronger, more financially stable parent company than Energy East, and  
18 NYSEG and RG&E are therefore poised to benefit financially from the Proposed  
19 Transaction. Accordingly, ring fencing provisions are not necessary in  
20 connection with the Proposed Transaction. I also note that the National  
21 Grid/KeySpan merger, in which ring fencing covenants were required, is not  
22 analogous to the Proposed Transaction since National Grid was a lower-rated  
23 company and used debt to finance its merger with KeySpan.

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1 For these same reasons, other extreme measures that have been proposed  
2 by the Staff Policy Panel, such as a “golden share” to provide a veto right with  
3 respect to voluntary bankruptcy petitions, are not appropriate for the Proposed  
4 Transaction. It is my understanding that the National Grid/KeySpan merger is the  
5 only instance in which the Commission has required the “golden share,” a  
6 mechanism that former Chairwoman (and current Commissioner) Acampora has  
7 described as “unusual.” *See* Exhibit \_\_ (JPP-2). The Rebuttal Testimony of Dr.  
8 Makhholm addresses further why a “golden share” is an unnecessary and  
9 inadvisable measure. I do note, however, that certain commitments made by the  
10 Joint Petitioners in this Panel testimony may serve as ring fencing protections,  
11 including commitments regarding separate accounting and financial statements  
12 for NYSEG and RG&E, limitations on NYSEG and RG&E assets transfers,  
13 dividend restrictions, and prohibitions against guarantees, pledges or other credit  
14 support by NYSEG and RG&E in favor of Iberdrola or its affiliates.

**F. Affiliate Transaction Risks**

15  
16 Q. Mr. Azagra, do you agree with the Staff Policy Panel’s suggestion that the  
17 Proposed Transaction will create incentives for cross-subsidization and raise other  
18 affiliate transaction issues (at 26-27)?

19 A. No. The Staff Policy Panel suggests that the magnitude of Iberdrola’s  
20 unregulated operations “creates an incentive to misallocate costs” and that the  
21 “complexity of its corporate structure would make it difficult to follow audit trails  
22 for its complex transactions” (at 27). The Staff Policy Panel also expresses  
23 concern about Staff’s ability to effectively monitor affiliate transactions “which

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1 may take place overseas, be recorded in a foreign currency (Euros), may be  
2 treated on an international accounting basis, and may be in a foreign language” (at  
3 26-27). The Staff Policy Panel also proposes a number of revisions to the existing  
4 safeguards that are in place for affiliate transactions, which Staff claims will be  
5 “inadequate since they may not be able to capture the nuances and unknowns  
6 related to the future dealings between Iberdrola, Energy East, and the utilities” (at  
7 294).

8 As more fully described in the Rebuttal Testimony of Dr. Makhholm, the  
9 Staff Policy Panel’s concerns with respect to affiliate transactions are without  
10 merit. Iberdrola’s organizational structure is not particularly complex; it is similar  
11 to that of any organization with a variety of operating utilities and an unregulated  
12 entity that holds separately financed generation projects. In fact, it is my  
13 understanding that there are already utility holding companies with operations in  
14 New York with significantly more complex organizational structures than  
15 Iberdrola (*e.g.*, Suez). Moreover, Iberdrola has significant experience in the  
16 ownership of both regulated and unregulated operating companies, and will fully  
17 comply with the Commission’s, and the FERC’s, standards, regulations and  
18 policies with respect to the relationship between its regulated and unregulated  
19 affiliates (*e.g.*, Standards of Conduct, Codes of Conduct, etc.). Nonetheless, the  
20 Joint Petitioners are willing to commit to the following measures to ensure further  
21 that there are no potential incentives for cross-subsidization among NYSEG,  
22 RG&E and Iberdrola’s unregulated affiliates:

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- 1           • **Cost Allocations** – NYSEG and RG&E will continue to utilize Energy East’s  
2           cost allocation methodologies and Energy East will allocate centralized costs  
3           from Iberdrola to NYSEG or RG&E only to the extent that such costs are  
4           properly chargeable to utility operations and accepted by the Commission.  
5           Costs charged by Iberdrola or its affiliates to Energy East and any of its U.S.  
6           affiliates that either directly or indirectly affect NYSEG’s or RG&E’s costs of  
7           service shall be based on Energy East’s approved cost allocation  
8           methodology, unless otherwise permitted by the Commission.
- 9           • **Separate Accounting and Financial Statements** - NYSEG and RG&E will  
10          maintain separate and independent accounting records and financial  
11          statements from that of Iberdrola and all other affiliates.
- 12          • **Asset Transfers** - NYSEG and RG&E will not transfer or sell material assets  
13          or facilities to Iberdrola or any affiliate without prior approval of the  
14          Commission. All asset sales to these entities will be on an arm’s-length basis,  
15          and be subject to market vs. book value tests.
- 16          • **No Lending** - NYSEG and RG&E will not loan funds to Iberdrola or any  
17          unregulated affiliate, either through a money pool or otherwise, unless  
18          otherwise authorized by the Commission..
- 19          • **No Credit Support** - NYSEG and RG&E will not provide guarantees,  
20          collateral, or pledge or provide any other type of credit support for the benefit  
21          of Iberdrola or any affiliate.

22          These commitments should fully resolve any potential concerns regarding  
23          chaining transactions, costs allocation or other affiliate transaction issues.

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1 Q. Staff has proposed in Exhibit \_\_ (PP-25) modifications to the Standards  
2 Pertaining to Affiliates and the Provision of Information, which were set forth as  
3 Appendix B to NYSEG's 2002 Merger Joint Proposal. The document is  
4 commonly referred to as the Code of Conduct. Does the Panel believe that Staff's  
5 proposed changes are necessary or appropriate?

6 A. No. As Staff acknowledges, the existing affiliated transaction rules are adequate  
7 to govern the relationship between Energy East holding and services companies,  
8 NYSEG, and RG&E. Staff's primary justification for seeking to change the Code  
9 of Conduct is that it, "may not be able to capture the nuances and unknowns  
10 related to the future dealings between Iberdrola, Energy East and the utilities" (at  
11 294).

12 Q. What is the Panel's overall view of Staff's proposed changes?

13 A. We disagree with the unilateral nature of the changes and believe that they should  
14 be rejected. The existing Code of Conduct, which has already been approved by  
15 the Commission, should remain in place, except for those provisions discussed  
16 elsewhere in this Panel testimony.

17 **G. Other Commitments**

18 Q. Are there any other commitments that the Joint Petitioners are willing to make to  
19 ensure that the ratepayers of NYSEG and RG&E are not adversely affected by the  
20 Proposed Transaction?

21 A. Yes. The Joint Petitioners continue to make the following commitments, both of  
22 which were included in the Joint Petitioners' Direct Testimony:

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- 1       • **Acquisition Premium** - NYSEG and RG&E will not seek recovery of the  
2       acquisition premium being paid by Iberdrola in the Proposed Transaction,  
3       either directly or indirectly, from customers in any proceeding.
  
- 4       • **Transaction Costs** - NYSEG and RG&E will not seek recovery in rates of  
5       any transaction costs for the Proposed Transaction in any proceeding.  
6       Transaction costs include investment bank fees, legal fees, transfer or other  
7       taxes, severance or change of control related payments, incremental costs for  
8       stock options and restricted stock and any other costs incurred either to  
9       complete or as a result of the Proposed Transaction.

10       While the Staff Policy Panel has suggested that this final commitment not to seek  
11       recovery from New York ratepayers of any costs incurred to consummate the  
12       Proposed Transaction is insufficient to prevent those costs from improper  
13       allocation at some time in the future (at 95), this concern is without foundation.  
14       The Commission clearly has the means to ensure the Joint Petitioners remain in  
15       compliance with this explicit commitment, and the Joint Petitioners have all the  
16       proper incentives to comply with a merger condition of this nature.

17       **VII. EXISTING RG&E AND NYSEG GENERATION**

18       Q.     Mr. Rude, the Staff Policy Panel asserts that there are indications that RG&E does  
19       not intend to fulfill its commitment to sell the Russell Station to a non-affiliated  
20       company after the completion of the Rochester Transmission Project (“RTP”) (at  
21       131-132). How do you respond to Staff's assertion?

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1 A. Staff is incorrect. RG&E will comply with Commission orders and meet RG&E's  
2 existing obligations unless the Commission otherwise so determines. To be clear,  
3 the Commission has ordered RG&E to auction the Russell Station after  
4 completion of the RTP. As explained below, there are certain facts that have  
5 changed since the Commissions' determination on this issue, and RG&E believes  
6 it is important for the Commission to be aware of these changes. If the  
7 Commission makes no determination that alters the Commission order to auction  
8 Russell Station to an unaffiliated third party, then RG&E will proceed to develop  
9 protocols to conduct the auction after RTP begins operation.

10 Q. When would RG&E present its repowering scenario to the Commission?

11 A. In the absence of the consummation of the Proposed Transaction, RG&E had  
12 planned to make a filing with the Commission in June 2008 demonstrating the  
13 need for repowering, an assessment of alternatives to the re-powering of Russell  
14 Station, the expected costs and in-service date of its proposed re-powering  
15 project, and proposed ratemaking treatment. RG&E requests that the Commission  
16 provide an opportunity for RG&E, Staff, and any other interested parties to  
17 evaluate thoroughly the possibility of Russell Station being re-powered as a  
18 regulated project owned by RG&E. Since RG&E (like all other electric utilities  
19 in New York) remains a provider of last resort under the Public Service Law, it is  
20 incumbent upon RG&E to examine all options to meet this responsibility,  
21 including utility-owned generation. Any auction of the Russell Station should not  
22 commence until the Commission has a chance to review and rule on RG&E's  
23 repowering proposal.

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1 Q. Please provide background information on this issue.

2 A. In December 2004, the Commission granted RG&E a certificate of environmental  
3 compatibility and public need for the RTP based on a Joint Settlement Agreement  
4 reached among the parties. The Joint Settlement Agreement approved in that  
5 proceeding called for an auction of the Russell Station after completion of the  
6 RTP but did not contemplate the changes in the Rochester system that have  
7 subsequently taken place. The Joint Proposal, which was signed by RG&E, the  
8 Department of Public Service, the Department of Environmental Conservation  
9 and the Department of Agriculture and Markets, at page 30 states that “[t]he RTP  
10 would also be in the public interest because it would allow RG&E to fulfill its  
11 commitment (made on the record in RTP-0051) to follow an appropriate  
12 competitive auction process with the goal of the sale of the Russell Station site to  
13 a non-affiliated entity.” The Rochester system has experienced additional growth  
14 since that time and RG&E has identified a localized reliability need within the  
15 system that cannot, and was not designed to, be met by the RTP. Based on a  
16 preliminary analysis, RG&E believes it can meet the reliability need through the  
17 repowering of Russell Station at its current site.

18 Q. In addition to the Russell Station, Staff has recommended the divestiture of all  
19 existing generation owned by NYSEG & RG&E. Do you agree with this  
20 recommendation?

21 A. No. If the goal is to avoid vertical market power, the sale of the Carthage Plant,  
22 which is a market-based unit owned by an unregulated affiliate, and certain hydro  
23 and gas peaking facilities will not impact that goal. Staff appears to want to force

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1 the utilities to sell any and all generation, without any meaningful analysis of  
2 ratepayer impacts. The Rebuttal Testimony of Dr. Hieronymus shows that there  
3 are no market power concerns associated with this generation.

4 Q. You testified that Staff is seeking the sale of the hydro units. Is there any harm to  
5 ratepayers if hydro assets must be sold?

6 A. Yes. The hydro facilities provide benefits to consumers. They are renewable  
7 resources, which New York is seeking to encourage. Hydro also provides a hedge  
8 against the volatility of market prices. Significantly, NYSEG and RG&E have  
9 owned these hydro facilities for decades and have never been required by the  
10 Commission to divest them.

11 **VIII. Attempt to Compare Other Offers to the Proposed Transaction**

12 Q. Mr. Rude, did Energy East entertain other offers or review certain strategic  
13 initiatives prior to its acceptance of Iberdrola's offer?

14 A. Yes. However, those strategic initiatives did not involve the acquisition of  
15 Energy East and are not comparable to the Proposed Transaction. As described in  
16 Energy East's Schedule 14A Proxy Statement filed September 26, 2007, Energy  
17 East was approached towards the end of the first quarter of 2007 about the  
18 possible sale of certain of its operating subsidiaries. In April, management and  
19 the Board of Directors also began to consider, on a preliminary basis, the possible  
20 acquisition of a small electric utility company.

21 Q. What was the result of the proposed acquisition of a small electric company and  
22 the sale of certain of Energy East's operating subsidiaries?

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1 A. Neither transaction was consummated.

2 Q. Why not?

3 A. As indicated in Energy East's Schedule 14A Proxy Statement filed September 26,  
4 2007, the Board of Directors discussed the potential benefits of those two  
5 strategic transactions and determined that the benefits of completing those  
6 transactions were outweighed by the benefits associated with the Proposed  
7 Transaction with Iberdrola.

8 Q. Staff objects to the need for confidentiality regarding various details of the  
9 tentative transactions and the identity of the involved parties. Is the identity of the  
10 parties and the specific assets involved in exploration of these types of proposed  
11 transactions customarily kept confidential?

12 A. Yes. It is normal for parties to explore sensitive strategic initiatives only after  
13 confidentiality has been guaranteed. In fact, Energy East and the two interested  
14 parties entered into confidentiality agreements for both transactions. These  
15 agreements place restrictions on Energy East's ability to reveal specific  
16 information.

17 Q. The Staff Policy Panel alleges that Energy East has refused to provide information  
18 on the proposed transactions (at 35-36). Is this accurate?

19 A. It is not accurate. Energy East provided information to Staff regarding the  
20 transactions. There was a good faith dispute over the relevance of some of the  
21 information requested and that dispute has been resolved by Administrative Law  
22 Judge Epstein's ruling.

23 Q. Are the alternative transactions described in the Proxy Statement valid for

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1 comparison purposes?

2 A. No. They provide no useful basis for comparison to Iberdrola's proposed  
3 acquisition of Energy East. The two transactions are irrelevant since neither  
4 involved an alternative bid for the sale of Energy East. In other words, the sale of  
5 Energy East to a third party was not at issue in those transactions.

6 Q. The Staff Policy Panel claims that "since there were competing proposals, by  
7 proceeding with the Iberdrola transaction Energy East could be forgoing or could  
8 have foregone other transactions that offered synergy savings for customers" (at  
9 36). Do you agree that the two transactions identified in the Proxy Statement are  
10 competing proposals in the sense utilized by Staff?

11 A. As we testified previously, there were no "competing proposals" for the purchase  
12 of Energy East. Any alleged synergies or other benefits to New York ratepayers,  
13 had the proposed acquisition of a small electric company or the sale of certain  
14 Energy East operating subsidiaries been completed, were not quantified and any  
15 attempt to do so after the fact would be exceedingly speculative since the terms of  
16 the transactions were not finalized and neither transaction was consummated. We  
17 also note that the Commission has approved many "first mover" transactions in  
18 the past.

19 Q. Do you agree with the Staff Policy Panel's allegations that the Board of Energy  
20 East "in evaluating several competing proposals ... should have considered each  
21 option's chance of being approved in all jurisdictions, including New York" (at  
22 35)?

23 A. No. As we noted previously, there were no "competing proposals" and none of

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1 the alternative transactions required New York approval.

2 **IX. RGE Merger Commitments**

3 Q. Mr. Rude, do you agree with the Staff Policy Panel's statements that Energy East  
4 has "not completely" followed through on its commitments when it acquired RGS  
5 (at 64)?

6 A. No. Energy East reasonably met its RGS merger commitments to the  
7 Commission, even though changed circumstances required some modification in  
8 how they were met.

9 Q. Is there a specific document that contains the RGS merger commitments?

10 A. Yes. The commitments made by Energy East to the Commission with respect to  
11 its acquisition of RGS were set forth in full in the Joint Proposal and the 2002  
12 Merger Order adopting that Joint Proposal, *Order Adopting Provision of Joint*  
13 *Proposal with Modifications*, issued February 27, 2002 in Cases 01-E-0359 and  
14 01-M-0404.

15 Q. What specific claims does Staff make regarding Energy East's commitments?

16 A. First, Staff alleges that RG&E's proposed rate filing in 2003 with a 6% increase  
17 was contrary to the company's commitment to provide stable rates. Staff,  
18 however, ignores the fact that the rates approved by the Commission actually  
19 froze RG&E's electric and gas base delivery rates through December 31, 2008 and  
20 limited overall increases in RG&E electric and gas revenues to \$7.4 million  
21 (about 1.4%) and \$7.2 million (2.2%), respectively. RG&E thus satisfied its  
22 commitment to provide stable rates. Staff also alleges that RG&E failed to

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1 increase its financial strength due to a downgrading of its debt. As noted in the  
2 Rebuttal Testimony of Dr. Makhholm and Mr. Fetter, debt ratings are subject to  
3 various factors, including cash flow, which for regulated utilities is driven  
4 ultimately by the Commission's rate orders. Staff further ignores the inherent  
5 financial strength in RG&E becoming part of a far larger financial organization.  
6 With regard to the announcement of layoffs noted by Staff, at the time of the RGS  
7 Merger Petition, the petitioners in that transaction had no plans to reduce  
8 workforce. However, workforce reductions were ultimately necessary in light of  
9 the amount of synergies the Commission required as part of its merger approval.  
10 In addition, very few of these reductions involved involuntary separations. Staff  
11 also alleges that the petitioners' commitment to the region in that transaction was  
12 reduced rather than enhanced when Energy East's headquarters were moved to  
13 Maine. Staff ignores the fact that Energy East strengthened its commitment to the  
14 region by maintaining the headquarters of RGS, NYSEG and RG&E in  
15 Rochester, New York. In addition, significant shared service operations,  
16 including supply chain and IT, were established in Rochester. Finally, Staff  
17 argues that three RGS Directors were not placed on Energy East's Board as  
18 committed. Staff did not mention the circumstances surrounding these issues,  
19 which have already been addressed in prior proceedings before the Commission.  
20 In particular, one of the directors was elected but unable to serve and another  
21 chose to retire. The remaining RGS director was elected to Energy East Board  
22 and continues to serve to this day. There was no agreement on alternative  
23 directors for the other two positions.

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1 Q. Have you reviewed the Staff Exhibit \_\_ (PP-21)?

2 A. Yes. This exhibit compares the value of Staff's proposed Positive Benefits  
3 Adjustments in the current proceeding with Staff's calculation of customer  
4 benefits from the National Grid/KeySpan transaction and the earlier Energy  
5 East/RGS merger.

6 Q. With respect to the Energy East/RGS merger, what calculation does Staff make  
7 regarding the level of customer benefits?

8 A. Staff's filed Exhibit \_\_ (PP-21) shows that Staff has calculated that customers of  
9 NYSEG and RG&E received almost \$821.7 million in cumulative reductions over  
10 five years, or approximately 12.6% of five-year delivery revenues.

11 Q. Do you agree with this characterization of the benefits from that transaction?

12 A. No.

13 Q. Has Staff indicated that it made a calculation mistake on its filed Exhibit \_\_ (PP-  
14 21)?

15 A. Yes. In Staff data response IBER/EE IR No. 73, Exhibit \_\_ (JPP-1), Staff states,  
16 "(i)n preparing this workpaper, Staff corrected errors to Exhibit \_\_ (PP-21), and  
17 included the corrections in the workpaper. A revised Exhibit will be filed at a  
18 later time." Staff apparently realizes that its initial calculation of the Energy  
19 East/RGS merger benefits was incorrect. However, Staff's revised calculation is  
20 also incorrect and misleading. We will discuss both of Staff's calculations below.

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1 Q. How did Staff develop its initial calculation of \$822 million in merger benefits  
2 related the EE/RGS merger?

3 A. While Staff has not provided backup, we believe that Staff used the  
4 “NYSEG/RG&E Synergy Estimate, Synergy Allocation Appendix A,” which was  
5 a table of projected annual merger benefits filed with the Joint Proposal in Case  
6 01-M-0404 – Energy East/RGS Merger. The Synergy Appendix A showed a five  
7 year total net benefit figure of \$164.3 million for the four Companies (NYSEG  
8 and RG&E electric and gas). The Synergy Appendix A is attached as Exhibit \_\_  
9 (JPP-8). It appears that Staff incorrectly multiplied total five-year net synergy  
10 benefit by another 5 years (\$164.3 x 5 years) to arrive at its comparison amount of  
11 \$821.7 million shown on Exhibit \_\_ (PP-21).

12 Q. How has Staff revised its calculation?

13 A. Staff has apparently revised its EE/RGS merger benefit calculation to now equal  
14 \$383.4 million?

15 Q. Do you agree with either calculation?

16 A. No. For several reasons both calculations are incorrect. Staff’s initial  
17 computation utilized a five-year amount and then multiplied it by another five  
18 years (\$164.332 million from Appendix A times 5 years). Staff effectively  
19 measured 25 years of net synergy benefits. Staff's revised calculation utilizes  
20 only the “year 5” benefit amount of \$76.673 million and then multiplies it by 5  
21 years. Even in its revised calculation, Staff does not utilize the five-year amount  
22 that was used by the Commission itself in approving that merger. Instead Staff

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1 has created a calculation that is misleading and an incorrect basis for its  
2 comparison schedule.

3 Q. Why is Staff's revised calculation misleading?

4 A. Because Staff did not utilize the five-year synergy amount from the Energy  
5 East/RGS merger. Appendix A of the Energy East/RGS merger clearly shows a  
6 total five-year synergy savings of \$164.332 million. This amount should then be  
7 multiplied by 50% to reflect the 50/50 sharing between customers and  
8 shareholders.

9 **X. THE CITY OF ROCHESTER'S ALLEGATIONS**

10 Q. Mr. Laurito, does the City of Rochester ("City") support the merger?

11 A. In its testimony, the City states that it believes it could support the merger if  
12 certain "concerns" were resolved.

13 Q. What are those concerns?

14 A. The City alleges at page four of its testimony that it has an existing "right-of-way  
15 facilities issue" with RG&E, and asks Iberdrola to commit to a "satisfactory  
16 resolution." The City is also concerned with the aesthetics of "unsightly" utility  
17 poles and wires. Utility plants, in the form of poles, wires, and related equipment,  
18 are the basic infrastructure of energy distribution. This infrastructure traditionally  
19 has been constructed largely above-ground given that such construction is the  
20 most cost-effective way of providing reliable electric service. Recent legislation  
21 has required placing electric facilities underground for certain new construction,  
22 and in statutorily defined "visually significant" areas (such as state parks). RG&E

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1 makes significant effort to locate its distribution lines in places that are out of  
2 public view, to the greatest degree possible. I note that none of these concerns is  
3 in any way related to the Proposed Transaction.

4 Q. Is RG&E responsible for the resolution of the City's concern?

5 A. While there generally is no legal basis for requiring underground installation at  
6 utility expense for aesthetics alone, RG&E is committed to working with the City  
7 on a project-by-project basis to do what it can, under its tariff, to accommodate  
8 the City's development interests. This may include involving the Commission  
9 where necessary.

10 Q. The City also references discussions with RG&E involving the purchase by the  
11 City of street lighting facilities still owned by RG&E. What is the status of those  
12 discussions?

13 A. The City and RG&E have been in regular communication on the sale of these  
14 facilities and are currently negotiating a fair sale price and other relevant terms  
15 and conditions.

16 Q. The City alleges that several RG&E facilities are characterized by "substantial  
17 unresolved environmental issues" (at 5-8). Can you comment on each of these  
18 facilities and the steps RG&E has taken, and continues to take, to deal with  
19 associated environmental issues?

20 A. Yes. The City identifies three RG&E facilities in which it has particular interest.  
21 It should be noted that the City's interest in these facilities is driven by a  
22 downtown development strategy that incorporates RG&E property into the City's  
23 vision. I will address each facility in turn.

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1 Q. What about Beebee Station?

2 A. Beebee Station is a generating facility that was retired in substantial part in 1999.

3 The site still is home to a small gas turbine electric peaking facility and two

4 substations. It is also the location of a former manufactured gas plant (“MGP”)

5 site. As such, it is included among other similar sites in a Voluntary Cleanup

6 Agreement (“VCA”) entered into by RG&E and the New York State Department

7 of Environmental Conservation (“DEC”) in 2003. Pursuant to the VCA, RG&E is

8 preparing a remedial investigation work plan for submittal to the DEC for review.

9 Upon approval by the DEC the investigation will be performed and the results

10 captured in a remedial plan targeted to be initiated, based on current planning and

11 assumptions, in 2012.

12 Q. Can you comment on the various buildings on the site referenced in the City’s

13 testimony?

14 A. Concurrent with activities under the VCA, RG&E has initiated projects to survey

15 building materials on the property in anticipation of the eventual demolition or

16 sale of the buildings, and remediation of the site. Additionally, RG&E has begun

17 moving the substation facilities to a new location. That relocation work is

18 expected to be completed by mid-2009. Demolition of certain facilities has

19 already begun, with two stacks to be razed by March 2008, weather dependent.

20 Q. Why has it taken so long to prepare the site for future use?

21 A. The Beebee site is large and complex, having been used for a variety of utility

22 purposes for more than ninety years. Preparing the site for a new commercial use

23 is expensive and time consuming. It is also subject to regulatory oversight by

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1 several agencies, each with its own agenda and timetable. However, RG&E has  
2 clearly demonstrated by the many ongoing activities at that site and the  
3 expenditure of associated funds that it has a real commitment to managing the site  
4 in a responsible manner with all interests, including the City's, being considered.

5 Q. What about Andrews Street?

6 A. The Andrews Street facility, described by the City's witness as "an unresolved  
7 brownfield site" (at 7), is in the midst of an active remedial program overseen by  
8 the DEC. The site has a varied history, first being utilized as an MGP from the  
9 mid-1800s. It was later the location of RG&E's energy control center ("ECC").  
10 The building housing the ECC was demolished in 2000. RG&E received an offer  
11 to purchase the site from a private developer. At the City's request, however, that  
12 offer was rejected in cooperation with the City's development plans. RG&E  
13 completed a site investigation and submitted its report to the DEC in January  
14 2006. The DEC has yet to respond to that report. Notwithstanding the DEC's  
15 timetable, RG&E is currently preparing a remedial plan for the site so that  
16 remediation can begin as soon as possible.

17 Q. Why do you believe the DEC has not yet responded to the investigation report?

18 A. The report identified less contamination than was speculated, and given scarce  
19 DEC resources and other RG&E environmental projects, the DEC may have  
20 directed resources to sites of greater concern.

21 Q. What remains to be done at the site?

22 A. Upon DEC approval, the investigation report will be used to finalize a remedial  
23 plan which, by current estimates, is targeted to be completed and implemented by

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1 late 2009. Total costs expended to date on all activities associated with preparing  
2 the site for future use are approximately \$1,000,000 plus demolition costs.

3 Contrary to the City's allegations, the Andrews Street site is at the tail end of the  
4 regulatory process that will make it available for commercial use.

5 Q. What interest does the City have in the 81 South Avenue facility?

6 A. That RG&E facility, which currently houses a substation and breaker for Station  
7 26, dates back to the late 1800s, and is built on the foundation of an even earlier  
8 structure important to the City for historical purposes. The City desires public  
9 access to that facility as a part of a to-be-constructed pedestrian passageway  
10 between the Rochester Riverside Convention Center and the Blue Cross Arena,  
11 via an old aqueduct.

12 Q. Does RG&E object to the City's interest in access to the facility?

13 A. No. Subject to a review of the facility's structural condition and consideration of  
14 any necessary safety enhancements and other issues required for public access,  
15 RG&E believes that the City's interest can be accommodated.

16 **XI. CONCLUSION**

17 Q. Does this complete the Panel's rebuttal testimony at this time?

18 A. Yes, it does.