BEFORE THE
NEW YORK STATE
PUBLIC SERVICE COMMISSION

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

Case 07-M-0906

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

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I. INTRODUCTION

This Brief Opposing Exceptions concludes Joint Petitioners' written submissions supporting approval of the acquisition of Energy East Corporation by Iberdrola, S.A. (*i.e.*, the Proposed Transaction).[1] Thousands of pages of information and argument have been filed with the Commission over the last year. While the details of this debate have often focused on calculations and precedent, the Commission must determine, as a guiding theme, whether New York State would be better off with Iberdrola as a member of its community of energy utilities. If the answer is in the affirmative, as Joint Petitioners submit should be the case, then the Commission should welcome and encourage Iberdrola's participation to work with the Commission and other energy public policy makers to assist the State in addressing its enormous and complex energy challenges.

The evidentiary record provides concrete evidence—not mere speculation or hyperbole—of Iberdrola's financial strength and strong standing as a safe and reliable utility service provider throughout the world. Iberdrola is also a global leader in renewable energy development and a significant investor in new technologies that will be critical to ensure a secure and environmentally responsible energy future. Joint Petitioners submit that these are precisely the kinds of positive attributes that the Commission should want for New York. If the Commission agrees, then it should encourage Iberdrola's presence in New York by approving the Proposed Transaction as in the public interest without entry fees, unreasonable hurdles or other unprecedented or unnecessary conditions.

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

Joint Petitioners have clearly demonstrated that approval of the Proposed Transaction is in the public interest under Section 70 of the New York State Public Service Law ("PSL"). Joint Petitioners urge the Commission to approve the Proposed Transaction as quickly as possible. As Joint Petitioners have shown, the benefits of the Proposed Transaction are wide-ranging and significant:

- Joint Petitioners have offered over $201 million of Positive Benefit Adjustments ("PBAs") as part of their Partial Acceptance, which will immediately result in over $54 million (or 4.4%) of delivery rate reductions on average for customers of NYSEG and RG&E.

- Joint Petitioners have agreed to sell all of Energy East's remaining fossil generating facilities in New York and to provide 90% of the "above-book" proceeds to ratepayers. Most of the sales price is likely to be part of the "above-book" value because these facilities have been largely depreciated, making this commitment a significant ratepayer benefit.

- Iberdrola is a global leader in the energy industry with extensive experience owning and operating gas and electric transmission and distribution systems throughout the world.

- Iberdrola is the world's leading producer of electricity from wind generation with over 7,000 MW of installed wind capacity, and is uniquely positioned to assist New York State in meeting its aggressive renewable energy goals. Iberdrola can also help to propel New York State into a national leadership position in renewable energy development. While Iberdrola expects that the amount of its actual renewable investment would be significantly higher, its $100 million minimum binding commitment is an unprecedented level of required investment that Iberdrola is offering as a merger condition.

- Iberdrola is a strong and financially sound company. It has strong "A" category credit ratings, is financially stronger than Energy East, RG&E, and NYSEG, and has already raised $4.5 billion from an equity offering so that Iberdrola can fund the Proposed Transaction entirely with equity.

- The Proposed Transaction is Iberdrola's "first move" into the regulated utility sector in the United States. The Proposed Transaction, therefore, does not rely upon any job reductions (in contrast to traditional mergers in which job reductions are a major driver of merger benefits). Future growth from Iberdrola's platform in New York could actually increase jobs in the State.

- Joint Petitioners have made commitments in the Partial Acceptance to the Electric Cooperatives and the City of Rochester to resolve the issues each of those parties has raised in this proceeding.

Following issuance of the Recommended Decision ("RD"), Briefs on Exceptions submitted by the Department of Public Service Staff ("Staff") and certain other parties have continued to take extreme positions in this case. Many of these positions ignore the larger picture or advance special interests. Others simply do not fit the facts presented in the record of this proceeding. In this Brief Opposing Exceptions, Joint Petitioners address those positions in the hope that the Commission will remain true to the evidentiary record in this proceeding, and to the Commission's own precedent. The Commission should reject parties' positions that lead to unreasonable, unnecessary, unprecedented and unsupported determinations. For example:

- *Approval:* While every other party in the proceeding supports Commission approval of the Proposed Transaction, Staff stands alone in arguing that the Proposed Transaction should be rejected. The Commission should approve the Proposed Transaction.

- *Renewable Energy:* While every other party (including consumer protection groups) supports permitting Iberdrola to engage in wind development, Staff stands alone in arguing that wind development throughout the State should be prohibited.[2] Staff and the Independent Power Producers of New York ("IPPNY") are the only parties that contend that Iberdrola's affiliated renewable facilities can create vertical market power concerns, even though Iberdrola Renewables' facilities are located on the low-cost side of the primary constraint in New York, and renewable wind and hydroelectric generation is intermittent (*i.e.*, no one can control when the wind will blow or when the river will run). Staff's new "alternatives" to divestiture have not been developed in the record and would create insurmountable new hurdles to renewable wind development in the State. Iberdrola's $100 million renewable development commitment in the Partial Acceptance is a clear and binding commitment for new renewable energy investment in New York, and is enforceable under the PSL.

- *$201 Million in PBAs are Higher Than Required Under Commission Precedent:* While the Commission determined in the merger proceeding between National Grid and KeySpan ("Grid/KeySpan") that the amount of benefits should yield a benefit-to-revenue ratio of 1.89%, Staff and Multiple Intervenors seek mandatory rate concessions in this case that would be many times the amount required in previous cases. In this case, unlike

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2 IPPNY argues that renewable generation interconnected to NYSEG and RG&E should be prohibited.

previous merger cases where the Commission has required rate-related concessions, there are no synergies that can fund even the $201 million Joint Petitioners have offered, let alone the amounts other parties are seeking. The Commission should carefully review these arguments so that it can maintain consistency in its own precedent.

- *Transaction Costs, PTCs and Spanish Tax Deferrals are not "Benefits" to be Shared:* Staff argues that benefits should be determined based upon "the award" Iberdrola is giving Energy East's shareholders, in the form of "a premium in the amount of $930 million" even though: (a) the Commission has never determined mandatory concessions in that fashion, and (b) Staff previously took the precisely opposite position (which we believe should be adopted here) that "a claim on a portion of the stock premium" would be inappropriate because it is "in essence a tax on the stock transfer."[3] All third-party payments (including to lawyers and bankers) are costs and not benefits of the Proposed Transaction. Federal Production Tax Credits (PTCs) and Spanish tax deferrals are unrelated to the Proposed Transaction, are uncertain, and should not be viewed as "benefits" of the Proposed Transaction that can justify ratepayer concessions.

- *Fair Financial Conditions and Same Code of Conduct:* Joint Petitioners have accepted most of the fundamental elements of the financial conditions Staff and Multiple Intervenors have proposed (*See* Attachment 2 to Joint Petitioners' Brief on Exceptions), other than items that are unnecessary, burdensome and unprecedented. Additionally, Staff seeks to impose revisions to its affiliate transaction-focused Code of Conduct even though many of the suggested provisions have nothing to do with affiliate contracts. The Commission should approve Iberdrola's commitment to step into the shoes of Energy East for purposes of the Code of Conduct.

- *No Advanced Rate Determinations:* Staff has attempted to turn this merger proceeding into multiple new rate cases for NYSEG and RG&E, an attempt properly rejected in the RD. Ruling on Staff's rate issues would constitute a denial of due process to NYSEG and RG&E under the Commission's statutory and regulatory procedures for full and fair rate cases. Other parties have agreed that Staff's rate demands are inappropriate.[4] In this Brief, Joint Petitioners offer a proposed schedule for new rate proceedings, along with auction and divestiture timetables.

- *Same Safety and Reliability Standards:* The safety and reliability standards that Staff and Multiple Intervenors propose are based on Staff's "one size fits all" approach whereby it reflexively uses Grid/KeySpan as a comparison point even though NYSEG and RG&E

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3 Exh. 113 at 9-10 (*Staff's Reply Statement*, Case 98-M-0961). *See also* Case 98-M-0961 - *Consolidated Edison, Inc., Consolidated Edison Co. of New York, Inc. and Orange and Rockland Utilities, Inc* (hereinafter "*ConEd/O&R Order*") (distinguishing asset sales from stock acquisitions).

4 Case 07-M-0906 - *Initial Brief on Behalf of Strategic Power Management, LLC*, at 25 (Apr. 11, 2008); *Initial Brief on behalf of Nucor Steel Auburn, Inc.*, at 11-13 ("Nucor"); Case 07-M-0906 - *Brief on Exceptions of Nucor Steel Auburn, Inc.*, at 2 (preferring that the utilities postpone filing rate cases).

have no service quality issues, unlike the concerns that the Commission addressed in Grid/KeySpan for those companies.

The Commission should review the Proposed Transaction in light of the full evidentiary record and approve it as in the public interest. The Commission should find that New York is better off with Iberdrola as a member of its community of regulated utility owners and immediately grant approval so that the State can start to see the many benefits of the Proposed Transaction.

II. JOINT PETITIONERS' RESPONSES TO EXCEPTIONS

A. JOINT PETITIONERS' RENEWABLE COMMITMENT

Response No. 1: The Commission should reject Staff's claim that Iberdrola's commitment to support at least $100 million of investment in renewable resources in the State is not a benefit.

a. Iberdrola's $100 Million Renewables Commitment Is Real And Enforceable

Iberdrola has made a clear commitment in this proceeding that, if the Proposed Transaction is approved, it will support the investment of at least $100 million in renewable infrastructure development in New York within the next three years, as set forth in the Partial Acceptance document (*See* Exh. 50 at 2 (Section III "Renewable Commitment")). Iberdrola's ability to bring its expertise and investment in renewable generation to New York is a significant benefit because Iberdrola will be able to assist the State in meeting its aggressive renewable goals (*See*, *e.g.*, Tr. 515-16; 1166-67). In the Staff Brief on Exceptions, Staff reasserts its claims that Iberdrola's renewable commitment is not sufficiently enforceable,[5] and should be disregarded because Commission approval or disapproval of the Proposed Transaction will, according to Staff, not influence Iberdrola's future investment decisions (Staff BE at 13). Multiple Intervenors also assert that Joint Petitioners' renewable commitment is not a

[5] Case 07-M-0906 - *Staff Brief on Exceptions*, at 11-12 (June 26, 2008) (hereinafter "Staff BE").

particularly large public benefit, because, the commitment is allegedly "weakened by numerous caveats and conditions."[6] The Commission should reject Staff's and Multiple Intervenors' positions because they fail to reflect the clear commitment Iberdrola has made to bring investment and its expertise in renewable development to the State, and fail to recognize the State's aggressive renewable goals.

First, the $100 million commitment that Iberdrola makes in the Partial Acceptance is, quite simply, a binding commitment. To Joint Petitioners' knowledge, no other developer has ever been required, or has ever offered, to be bound by a regulatory commitment to support investment in generation resources in New York. If the Commission approves the Proposed Transaction and incorporates this commitment as a merger condition, Iberdrola's commitment will be a binding obligation that the Commission can enforce via a show cause order or other enforcement proceeding under the PSL.

Contrary to Staff's and Multiple Intervenors' claims, this commitment is real and enforceable. As set forth in Section III of the Partial Acceptance, this commitment is reasonably conditioned only on there being "no material adverse change to the existing fundamental economics of wind generation development in New York State" (Exh. 50 at 2). This limited condition to Iberdrola's commitment is necessary to address events beyond Iberdrola's control that relate to fundamental changes underlying the economics of wind investment generally (*e.g.*, elimination of federal production tax credits ("PTCs") or the Renewable Portfolio Standard ("RPS"), or material changes in NYISO market prices). This limitation does not relate to the economics associated with any individual Iberdrola Renewables project (*e.g.*, land right acquisition, turbine right acquisition, financing, construction, interconnection and operation and

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6 Case 07-M-0906 - *Brief on Exceptions of Multiple Intervenors*, at 21 (June 26, 2008) (hereinafter "MI BE").

maintenance).[7] Iberdrola did not enter into the commitments contained in the Partial Acceptance lightly – these are real commitments to the State of New York that will bring benefits to the State. Iberdrola has agreed to have these commitments incorporated as conditions in any order approving the Proposed Transaction. Staff's unsupported view that this commitment is not sufficiently unequivocal is wrong and should be rejected.

Staff further claims that Iberdrola is pursuing wind generation development in other states where it does not plan to invest in a transmission-owning electric utility and that the economics of each project will drive investment, rather than ownership of a T&D utility (Staff BE at 13). Staff also asserts that it is unlikely Iberdrola would "forgo development" in New York because of the State's RPS program (*Id.*). Staff's position is incorrect. Staff fails to recognize that Iberdrola has a finite amount of investment resources that it can dedicate to renewable development in the United States, and Iberdrola has consistently emphasized that it will choose locations that are optimally designed to meet a variety of goals. It should not come as a surprise that if the Commission does not approve the Proposed Transaction, even after the substantial commitments that Iberdrola has made, then Iberdrola would not view New York as a state with an attractive regulatory environment in which to target future investment (Tr. 519-20). In that event, Iberdrola would seek to redirect its resources from New York to other locations.

Staff also suggests that Iberdrola's decision not to invest in the State will not detract from the State's being able to achieve its renewable goals because, according to Staff, Iberdrola is not needed to assist the State in meeting those goals (Staff BE at 14). With all due

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[7] In addition, Section III of the Partial Acceptance contains a standard provision stating that the investment would be subject to obtaining required permits and authorizations. Receipt of such authorizations is obviously a necessary prerequisite to building renewable generation, and such authorizations will be within the control of the Commission and other governmental authorities, rather than under the control of Iberdrola or Iberdrola Renewables.

respect to Staff and to Iberdrola's competitors, this is wrong.[8] The State's goals are admittedly aggressive and will require significant private investment. Even the Governor's own task force determined that the State needs to attract new investment in renewables in order to meet the State's goals.[9] Excluding Iberdrola – the global leader in renewable wind generation – from renewable investment in New York is shortsighted, particularly after Iberdrola has made firm commitments and has expressed goals to make even greater investments in the State.[10] Ultimately, the Commission will need to determine for itself whether it views Iberdrola's commitment in the Partial Acceptance to support the investment of at least $100 million in renewables development as a positive benefit under Section 70. For the reasons set forth herein and in the record in this proceeding, Iberdrola submits that it is indeed a substantial benefit weighing in favor of approving the Proposed Transaction.

Staff further claims that Energy East has not fulfilled certain commitments cited in the 2002 Energy East/RGS merger proceeding (Staff BE at 12). Staff's allegations are not correct, and the repetition of these claims does not add to their validity (Tr. 568). As Joint Petitioners explained in their Reply Brief, Staff is now trying to recreate history from over six years ago by claiming alleged merger commitments (that did not exist in reality), and claiming alleged noncompliance with those commitments (which is simply untrue). Seeking to expand the

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8 *See, e.g.*, Case 07-M-0906 - *Brief on Behalf of the New York State Department of Environmental Conservation*, at 5-6 (June 26, 2008) (finding that Iberdrola's assets as a potential wind developer in New York should be deemed benefits of the proposed transaction); Case 07-M-0906 - *Brief on Exceptions of the New York State Consumer Protection Board*, at 1 (June 26, 2008) (hereinafter "CPB BE") (stating that Iberdrola "has the capability and financial strength to contribute significantly to the State's efforts to develop renewable energy resources").

9 Exh. 112 - First Report of the Renewable Energy Task Force to Lieutenant Governor David A. Paterson, at 4 ("As we compete in regional energy markets, New York needs to continue attracting private investment dollars, the additional instate energy infrastructure, environmental benefits and the economic boost that comes from clean-tech investment.").

10 It is no wonder so many other policymakers appear to disagree with Staff's approach and would like to encourage Iberdrola to move forward on its renewable investments.

scope of previous Energy East/RGS merger commitments simply to claim that those commitments were not met is inappropriate and irrelevant to the issues in this proceeding (*See* Tr. 566-67).[11]

Joint Petitioners' Policy Panel testified that Energy East did, in fact, comply with the previous Energy East/RGS merger conditions imposed by the Commission (Tr. 568-69).[12] The actual commitments that Energy East made were expressly set forth in the Joint Proposal in that proceeding and were therefore subject to the Commission's oversight. As far back as 2003, Energy East responded in detail to an investigation by Staff regarding the scope of and compliance with the commitments made as part of the Energy East/RGS merger, and Energy East demonstrated that the conditions had been met.[13] Importantly, the Commission has never found any noncompliance by Energy East with the 2002 RGS Merger Order.[14]

In this case, Iberdrola's renewable commitment is made as a merger commitment to this Commission, and is not in the merger agreement with Energy East. The Commission has direct authority over this commitment and is free to include it as one of the Commission's conditions to closing that will survive the closing. Joint Petitioners expect that the Commission would include this as a condition in the Commission's order approving the Proposed Transaction and, as such, this commitment would be a binding regulatory obligation.

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11 Case 07-M-0906 - *Reply Brief of Joint Petitioners Iberdrola, S.A. and Energy East Corporation*, at 88 (Apr. 25, 2008) (hereinafter "Joint Petitioners RB").

12 Mr. Rude testified that, "Energy East reasonably met its RGS merger commitments to the Commission, even though changed circumstances required some modification in how they were met" (Tr. 568).

13 *See* Letter from Seth A. Kaplan to Dawn Jablonski Ryman, Commission General Counsel (July 17, 2003). Energy East also responded to various interrogatories from Staff on this topic. *See* Letter from Eric Nelson to Peter Catalano, Staff Counsel (May 9, 2003) (enclosing detailed response to information requests dated April 4, 2003).

14 Case 01-M-0404 - *Energy East Corp., RGS Energy Group, Inc., et al., Order Adopting Provisions of Joint Proposal with Modifications* (Feb. 27, 2002) (hereinafter "*EE/RGS Order*").

b. The Amount Of Iberdrola's Investment Commitment Is Clearly Set Forth In Section III Of The Partial Acceptance (Exhibit 50)

Staff's Brief on Exceptions (Staff BE at 14-15) and those of certain intervenors (*see* CPB BE at 10-11)[15] respond to the RD's invitation for parties to address on exceptions the level of investment that Iberdrola is committing to as part of the Proposed Transaction.[16] Iberdrola Renewables' Strategic Plan for 2008-2012 contemplates global investments of 18.8 billion Euros (approximately $29.8 billion) during that period, with approximately half of that investment in the United States. The goal of the 2008-2012 Strategic Plan is to confirm Iberdrola Renewables' current position as the leader of the world wind power sector and standard-bearer for clean energy in Spain, the United Kingdom and the United States.[17] Iberdrola has stated publicly, but not as part of this proceeding, that it has an investment plan to construct up to 1,000 MW of new renewable generation in New York with specifically identified development projects which, at approximately $2 million/MW for wind generation, would amount to approximately $2 billion. Specifically, Iberdrola announced in a recent press release that it hopes to invest $2 billion in renewable energy in New York State "if the company's proposed acquisition of Energy East clears the final regulatory hurdles in New York State and the transaction closes."[18] The fact that Iberdrola has made these public announcements is significant, and provides the State with a better understanding of the level of substantial investment that is part of Iberdrola's business plan if the Proposed Transaction is approved.

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15 *See also* Case 07-0906 - *Greater Rochester Enterprise Letter in lieu of Brief on Exceptions*, at 1-2 (June 26, 2008).

16 Case 07-M-0906 - *Recommended Decision by Administrative Law Judge Rafael A. Epstein*, at 35 (June 16, 2008) (hereinafter "RD").

17 *See* http://www.iberdrolarenovables.es/wcren/corporativa/iberdrola?IDPAG=ENMODULOPRENSA&URLPAG=/gc/en/comunicacion/notasprensa/080626_NP_IR2012.html.

18 *See* Iberdrola, S.A. Press Release, *Iberdrola Targets Some $2 Billion For Renewable Investments In New York State* (June 3, 2008).

Moreover, Iberdrola's announcement of this $2 billion business plan has received an overwhelmingly positive reaction in New York State. This public support suggests that, contrary to Staff's argument that Iberdrola is not needed to help the State meet its renewable development goals, others disagree and are encouraging Iberdrola to pursue these renewable investments.

However, Iberdrola's announcement concerning this planned level of investment was not intended to be, and cannot become, a merger condition in this proceeding.[19] To the best of Joint Petitioners' knowledge, the Commission has never before required merging parties to invest certain amounts, through an affiliate, in the development of new generation in the State, and there is no legal basis for such a condition. Similarly, there is no justification for any such condition. Iberdrola is financially strong and has offered the financial protections necessary to consummate the Proposed Transaction. Iberdrola has already offered more in PBAs than has been offered and required in prior mergers that, unlike the Proposed Transaction, were able to fund benefits from synergies. To be clear, such a merger condition would be unprecedented, unjustified, unreasonable and should be rejected by the Commission. Furthermore, there are a variety of legal and accounting reasons why converting this investment plan into a merger condition presents significant concerns for Iberdrola.

The Commission should consider Iberdrola's plans to invest at a significant scale and scope in New York, just as Iberdrola has done in other jurisdictions where it has acquired T&D utility systems, as a significant benefit to the State. For example, Iberdrola announced similar plans to invest 3 billion Euros (approximately $4.7 billion) in the United Kingdom following its acquisition of Scottish Power as part of its Strategic Plan 2008-2010 (Exh. 42), and

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[19] No party has offered any Commission precedent (or other legal basis) or any record evidence that would support a conversion of Iberdrola's investment plan into a binding merger condition. Any attempt to impose such a condition would be arbitrary and without basis.

Iberdrola has already invested over $300 million in the United Kingdom during the first quarter of 2008 alone.[20]

c. The Commission Should Reject Staff's Suggestion To Require Iberdrola To Place The Value Of Its Affiliated Wind Investments In A "PBA Account"

Staff argues that if the Commission wishes to recognize Iberdrola's planned investment in renewable generation as a benefit, it should be "rendered concrete" by tying generation investment to a "PBA account" (Staff BE at 36-39). The New York State Consumer Protection Board ("CPB") appears to make a similar argument, stating that the Commission should link "shortfalls of actual investment . . . to additional required rate decreases or avoided rate increases" (CPB BE at 11). These arguments should be rejected as eleventh-hour recommendations outside the record in this proceeding, and as non-responsive to any proposal in the RD. If the Commission nonetheless considers these arguments (which it should not), the Commission should reject them as wholly without merit.

As an initial matter, as discussed above, the "proposed investment" amount to which Iberdrola is committing in this Section 70 proceeding is the $100 million investment level referenced in Section III of the Partial Acceptance (Exh. 50 at 2), and *not* Iberdrola's publicly-announced target of future investments of up to $2 billion, which was not offered as a merger commitment or condition in this proceeding. However, even when considering the $100 million commitment in the Partial Acceptance, it would be inappropriate and unprecedented for the Commission to attempt to convert a commitment to support the investment in competitive, wholesale renewable generation development into a PBA account that somehow is set aside to

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20 *See* http://www.iberdrola.es/wcorp/gc/en/comunicacion/hechosrelevantes/080421_HR_02_en.pdf

"inure to ratepayers at a future time" if generation projects were not brought "on line" (Staff BE at 38).

First, as discussed above, there is no need to make Iberdrola's commitment to support the investment of $100 million in renewable generation development more "binding." If the Partial Acceptance is incorporated as a condition to approval of the Proposed Transaction (as Joint Petitioners have always intended it to be), this commitment will become a binding and enforceable component of the approval order subject to the Commission's full enforcement authority under the PSL.

Second, Staff sets forth no reasoned basis from the record for converting a certain amount of planned investment in wholesale generation facilities into PBAs that would become a merger condition (nor does CPB offer justification for its proposed linkage of investment amounts to rate decrease or avoided rate increase proposals). The $100 million commitment is a real benefit and was offered as a benefit to the State of New York to assist the State in meeting its renewable goals. This is not a rate benefit simply to NYSEG and RG&E customers, and any attempt to convert the $100 million renewable commitment into one is inappropriate and misses the point. The renewable investment commitment in the Partial Acceptance is not, and was never intended to be, offered as an addition to the rate-related benefits in the Partial Acceptance. As explained in Response 7 below, the $201.6 million in PBAs are already in excess of the amount of benefits in other recent merger transactions, on a benefit-to-revenue ratio basis.[21] In short, the $100 million commitment was never touted as a PBA and should not be treated as one now. Staff's attempts to convert this commitment into a PBA should be rejected.

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[21] Joint Petitioners are of the view that no mandatory rate concessions should be required in a proceeding of this nature. However, Joint Petitioners nonetheless separately offered $201.642 million in PBAs, which will provide for an approximately $54 million rate decrease immediately following closing of the Proposed Transaction (Exh. 50).

Third, Staff's proposal is unprecedented and without basis in law or policy. Effectively, Staff would have Iberdrola "fund" an account at some undetermined level with monies unrelated to synergy savings or other efficiency savings, and then have the Commission engage in ongoing administrative oversight of whether Iberdrola Renewables is bringing a sufficient amount of wind generation on line.[22] Staff's approach would also be inappropriate since the investment represents money that Iberdrola Renewables will spend to develop wholesale generation projects which have nothing to do with the retail rates of NYSEG's and RG&E's customers. Moreover, Staff offers no principled methodology in support of its arbitrary "conversion" of a $2 billion investment level into $200 million in additional PBAs, and there is no foundation for Staff's approach under the Commission's ratemaking policies (*See generally* Staff BE at 37-38 (stating that some discounting is appropriate and that "for example" the amount could be $200 million)).

Iberdrola's targeted investment levels in New York were not offered as PBAs, and they should not be converted to PBAs or incorporated as such as a condition to the merger. While the $100 million was offered as a merger commitment as part of the Partial Acceptance, which would become a merger condition if the Proposed Transaction is approved, it is also true that no part of that commitment should be converted to any kind of "PBA" account; rather, it is

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22 This is contrary to Section 70 precedent pursuant to which ratepayer savings are appropriately analyzed by determining whether such savings are synergy savings or other efficiency savings that would occur in the absence of the transaction. *See* Case 06-M-0878 - *National Grid plc and KeySpan Corp., Order Authorizing Acquisition Subject to Conditions and Making Some Revenue Requirement Determinations for KeySpan Energy Delivery New York and KeySpan Energy Delivery Long Island,* at 116 (Sept. 17, 2007) (hereinafter "*Grid/KeySpan Order*") (recognizing certain savings "that would not be made in the absence of the acquisition" as benefits). *See also id.* at 119 (The Commission did not credit certain other efficiency savings as merger savings, because they were expected to occur even if there were no merger). As explained extensively on the record, no such synergy savings exist here, as the Proposed Transaction is a "first-mover" non-synergy transaction (*See, e.g.*, Tr. 935-36).

simply another significant part of the overall package of positive benefits associated with the Proposed Transaction which is enforceable and of significant value to the State.

B. VERTICAL MARKET POWER

Response No. 2: Staff's proposed prohibition of all Iberdrola affiliated wind development activities in New York is unsupported by the record and Commission precedent, is not required under the VMP Policy Statement, and is contrary to State policies encouraging the development of renewable resources.

Staff argues that the RD erred in recommending a prohibition on the ownership and operation by Iberdrola's affiliates only of wind projects that would interconnect to the NYSEG and RG&E systems, rather than recommending a prohibition of all Iberdrola-affiliated wind development activities in the entire State (Staff BE at 15-16). Staff's justification for such a statewide prohibition is that Iberdrola would have an "incentive" to "use the T&D assets to raise the prices paid [to] generation across upstate New York, even outside the service territories" (Staff BE at 16).

For the reasons described in Joint Petitioners' Brief on Exceptions and supported in the record, Iberdrola's affiliation with entities that own or operate wind projects interconnected to the NYSEG and RG&E systems does not raise any vertical market power concerns. These reasons similarly demonstrate, with even greater force, that there is no justification for imposing Staff's proposed prohibition on Iberdrola's affiliated wind development across all of New York, even with respect to facilities that would not interconnect to NYSEG or RG&E. As Strategic Power Management, LLC ("SPM") has similarly concluded, "Staff's extreme position which would bar Iberdrola from pursuing any wind generation in New York has been rejected by the ALJ for good and sufficient reason."[23]

In particular, as described in greater detail in Joint Petitioners' Brief on Exceptions:

- The intermittent and unpredictable nature of wind generation, with its rapidly variable input levels, "makes wind-powered generating facilities ill-suited to be used in the exercise of vertical market power" (Tr. 842).[24]

- Wind generators have zero fuel costs and are typically bid into the energy markets as "price-takers," (*i.e.*, they bid into the market at zero price) to ensure that they are dispatched when capable of producing energy (*See* Tr. 818-19; Joint Petitioners BE at 37-38).

- Energy from wind generators cannot reasonably be sold into the NYISO's day-ahead market, the market in which the substantial majority of New York electricity is bought and sold. Because wind projects must participate in the NYISO's much smaller real-time market, even if NYSEG and RG&E were able to create or maintain transmission constraints to increase prices for their affiliated generation, such actions would have no impact on prices in the larger day-ahead market (Tr. 818; Joint Petitioners BE at 38).

- Because a wind project typically has a maximum capacity factor (*i.e.*, average availability) of only about 30%, its nameplate rating substantially overstates its fossil-equivalent generation capability (Tr. 817-18; Joint Petitioners BE at 38). Therefore, any theoretical incentive that NYSEG and RG&E could have to manipulate transmission to increase prices for their affiliated wind generation would be far less than that suggested by the nameplate capacity of that generation.

- All of Iberdrola's affiliated wind development projects are located on the *low-cost* side the Central-East transmission interface, the major constrained interface in New York State (Tr. 819-20).

- Since the issuance of the VMP Policy Statement, FERC and NYISO have adopted extensive market rules and other oversight and mitigation mechanisms that directly address any vertical market power concerns that could potentially arise from Iberdrola's affiliated wind development activities in New York (Tr. 826-35; Joint Petitioners BE at

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23 Case 07-M-0906 - *Brief on Exceptions On Behalf of Strategic Power Management, LLC*, at 9 (June 26, 2008) (hereinafter "SPM BE").

24 Case 07-M-0906 - *Brief on Exceptions of Joint Petitioners Iberdrola, S.A. and Energy East Corporation*, at 37 (hereinafter "Joint Petitioners BE"); *see also* Case 07-M-0906 - *Initial Brief of Joint Petitioners Iberdrola, S.A. and Energy East Corporation*, at 57 (Apr. 11, 2008) (hereinafter "Joint Petitioners IB").

39-40; *see also* Joint Petitioners IB at 52-57). In fact, when FERC approved the Proposed Transaction, it specifically concluded that the Proposed Transaction would not raise any vertical market power concerns given the comprehensive nature of the existing regulatory framework (Joint Petitioners BE at 40).[25]

- Staff relies primarily on the divestiture of the Ravenswood Station in the *Grid/KeySpan Order* to support its proposed prohibition. However, Staff fails to recognize the numerous substantive factual differences between the Ravenswood Station, a 2,400 MW natural gas-fired facility that forms a large part of the New York City load pocket as a pivotal supplier in both the energy and capacity markets, and Iberdrola's affiliates that would own or operate wind projects, many of which would not even interconnect to the NYSEG or RG&E systems (Tr. 855-56; Joint Petitioners BE at 41-43).

Staff cannot explain how Iberdrola's affiliated wind projects (whether or not they are interconnected to the NYSEG and RG&E systems) could actually be used in the exercise of vertical market power, other than to express a general concern about subtle actions that NYSEG or RG&E could potentially take to discourage competing generation or refuse to construct transmission lines to access low cost supplies (Staff BE at 17-19). However, claims of possible, unspecified and speculative actions such as those posited by Staff are insufficient to justify prohibiting Iberdrola's affiliates from owning or operating any wind generation across the entire State. This is particularly true given that, as the record evidence amply demonstrates, NYISO effectively controls all of the functions giving rise to Staff's market power concerns, including transmission system dispatch and generation redispatch, transmission planning and generation interconnection procedures (Tr. 826-27; Joint Petitioners BE at 41; *see also* Joint Petitioners IB at 53).

Staff argues that a statewide prohibition is nonetheless required because, "[s]o long as Iberdrola owns both T&D and wind generation affiliates, there is an incentive for it to exercise vertical market power" (Staff BE at 16). Staff's claim that merely an "incentive" to

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[25] As SPM noted in its Brief on Exceptions, "FERC came to its conclusion on vertical market power before the Joint Petitioners agreed to divest all of their fossil generation" (SPM BE at 8) (emphasis in original).

exercise vertical market power is sufficient to require a statewide divestiture and prospective prohibitions on the ownership and operation of wind projects by Iberdrola and its affiliates reflects a fundamental misunderstanding of the VMP Policy Statement, which establishes only a rebuttable presumption against a transmission owner's acquiring or being affiliated with generation in New York.

As Joint Petitioners have explained, all of Iberdrola Renewables' planned generation is on the low-cost side of the Central East interface, the most significant transmission constraint in New York, and therefore does not raise the concerns that the VMP Policy Statement was intended to address (Tr. 819-20; Joint Petitioners BE at 39). Staff acknowledges that the VMP Policy Statement expressly references a concern when a transmission owner is affiliated with generation on the *high*-cost side of a transmission constraint, but argues that the VMP Policy Statement should nonetheless be broadly interpreted to apply even if the affiliated generation is on the *low*-cost side of a constraint (Staff BE at 18-19). While Staff argues that the location of a generator vis-à-vis a significant transmission constraint is merely an example of an instance in which vertical market power presents a concern, Staff fails to address at all, let alone show substantively, how renewable generation on the low-cost side of a transmission constraint can realistically provide an opportunity to exercise market power to increase generation prices. As a practical matter, NYSEG and RG&E would not be in a position to use their transmission to create or maintain congestion that would raise prices on the low-cost side of the Central-East constraint. Staff's general statements about the nefarious "incentives" of NYSEG and RG&E are insufficient to justify Staff's request to require a statewide prohibition against generation developed by Iberdrola's affiliates in New York.

Response No. 3: There is no support in the record for Staff's suggested alternative mitigation measures applicable to Iberdrola's wind development activities, which are unnecessary and are not materially different from an absolute prohibition.

Staff suggests in its Brief on Exceptions that, if the Commission does not "requir[e] Iberdrola to exit the NYISO generation market entirely" (Staff BE at 20), then the Commission could address vertical market power concerns by imposing on Iberdrola's wind project affiliates (i) additional regulation, (ii) additional study requirements, and/or (iii) extensive contractual requirements. Each of these proposed alternatives should be rejected as without evidentiary or precedential basis.

a. Staff's New Proposed Alternatives Are Unprecedented And Should Be Rejected

As an initial matter, there is no discussion on the record of the three eleventh-hour alternatives identified by Staff. Apparently recognizing that the record does not provide any support for these alternatives, Staff does not even propose their adoption by the Commission, but only suggests that they "should be explored further" (Staff BE at 20). Staff's cautious approach is not surprising, given that the purpose, pros and cons of Staff's new so-called "proposals" do not even appear to have been fully considered by Staff. It would therefore be wholly inappropriate for the Commission to impose any of Staff's alternatives on Joint Petitioners as a condition to approval of the Proposed Transaction.

Moreover, since the evidence in the record shows that the Proposed Transaction does not raise any vertical market power concerns (other than Staff's speculative concerns), it would be inappropriate to impose any restrictions (either regulatory or contractual) on Iberdrola's affiliated wind activities other than those restrictions that apply to wind developers in the State generally.[26] Indeed, any such restrictions would be inimical to Iberdrola's commitment in the Partial Acceptance to support investments to develop wind projects in New York by Iberdrola Renewables of at least $100 million over the next three years (Tr. 618-19; *see also* Joint Petitioners RB at 23). While Staff suggests that these proposals should be considered if the Commission decides not to impose a statewide prohibition on Iberdrola's affiliated wind activities (Staff BE at 20), the adoption of one or more of Staff's alternative proposals would likely have the same result as a statewide prohibition – *i.e.*, a reduction in, if not a termination of, Iberdrola's investment in wind generation in New York – for the reasons described below.

b. Staff's Proposed New Vertical Market Power Review Should Be Rejected

In its first alternative, Staff suggests that the Commission could consider requiring that "a project-by-project vertical market power review … be conducted upon each Iberdrola proposal to build a wind project" (Staff BE at 21). Staff's position is that, despite the fact that Qualifying Facility ("QF") wind projects of 80 MW or less are considered "alternate energy production facilities" that are "exempt from Public Service Law regulation,"[27] the Commission could nonetheless require Iberdrola to seek approval for the construction of such QFs (Staff BE at 21-22).

For all the reasons discussed above, there is no factual basis for such an expansion of the Commission's jurisdiction because the Proposed Transaction does not raise any vertical

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26 *See also* Exh. 112, at 9 ("State and local authorities that share responsibility for, and/or have an interest or stake in, environmental assessment and permitting of new wind power generating facilities should work with stakeholders to establish and convey clear principles and methodologies or processes that will be applied consistently across the state.")

27 *See* N.Y. Pub. Serv. Law § 2(2-b) (McKinney 2008) (defining "alternate energy production facility"); § 2(3) (excluding "alternate energy production facilities" from the definition of "corporations"); and § 2(4) (excluding "alternate energy production facilities" from the definition of "person").

market power concerns. Moreover, the Commission lacks the legal basis to conduct such a review because, as Staff admits, the PSL expressly excludes alternate energy production facilities from regulation (Staff BE at 21) – in particular, no Section 68 certificate is required prior to the construction of such facilities. Staff's suggestion that the Commission could nonetheless require Iberdrola's affiliates to obtain approval for these projects would be contrary to the express legislative determination that alternate energy production facilities should be exempt from Commission review. Staff attempts to argue that the Commission could nonetheless expand its jurisdiction over these projects pursuant to Section 66-c(3) of the PSL, which allows electric corporations to establish subsidiaries that own or operate alternate energy production facilities. However, there is simply nothing in the language of Section 66-c(3) that would support Staff's view that Section 66-c(3) could be used to override the express language in Sections 2(4) and 2(13) exempting alternate energy production facilities. In fact, Staff's proposal to justify such an extension of the Commission's jurisdiction is contrary to the express language of Section 66-c(3) itself, which provides that "[a]ny such subsidiary corporation shall be exempt from any regulation by the commission under this chapter."[28]

Staff further states that when the Commission reviews a certificate petition from an Iberdrola affiliate that is *not* exempt from the requirements of Section 68 as an alternate energy production facility, then "[t]he exercise of [vertical market power] could not be excluded as an issue in [such] a § 68 review" (Staff BE at 22). Joint Petitioners recognize that Section 68 of the PSL will apply to the construction of generating facilities by Iberdrola's affiliates that are not otherwise exempt from Section 68. However, the Commission should clarify in this proceeding that any Iberdrola affiliate that submits a Section 68 petition will be subject to the

[28] N.Y. Pub. Serv. Law § 66-c(3).

same standards that apply to any wind developer in the State generally, and that Iberdrola's affiliates will not face any greater Section 68 burden given their affiliation with NYSEG and RG&E. As described above, it would be wholly inappropriate to impose any regulatory requirements on Iberdrola's affiliated wind activities other than those requirements that apply to wind developers in the State generally.

CPB recognizes that "the PSC has no jurisdiction to impose its policy views on matters affecting alternate energy production facilities, such as wind farms of less than 80 MW" (CPB BE at 6). However, with respect to projects above 80 MW, CPB states that "Iberdrola should be provided the opportunity to demonstrate that ownership of generation in Energy East's service territory would not create a realistic opportunity to interfere with competitive markets to the detriment of consumers. Iberdrola would have the burden of proof on this matter" (*Id*). CPB does not offer any guidance as to the procedural mechanism by which Iberdrola would make such demonstration, or why such demonstration would be necessary given that the Proposed Transaction does not raise any vertical market power concerns. In any case, as described above, it would be wholly inappropriate to impose any regulatory requirements on Iberdrola's planned projects other than those requirements that apply to wind developers in the State generally.

Furthermore, Iberdrola's affiliates should not be exposed to the possibility of a mandatory divestiture of their wind development projects on the basis of vertical market power concerns raised in a Section 68 proceeding. Such a high degree of uncertainty would have a chilling effect on wind development. Indeed, competing wind developers would have an incentive to raise such concerns in any Section 68 proceeding involving an Iberdrola affiliate, in the hopes being able to acquire a development project that is required to be sold. Leaving open the risk of divestiture would create an unnecessary and perhaps insurmountable hurdle for

Iberdrola's affiliates to develop wind generation projects in the State. The Commission should therefore specifically find that Iberdrola's affiliated wind projects do not raise vertical market power concerns in New York State.

c. Staff's Interconnection Study Proposal Should Be Rejected

Staff proposes, as an additional process remedy, to require Iberdrola to "establish[ ] an independent transmission planning process," including funding an independent transmission study every three years (Staff BE at 23-24). Staff does not provide any details on this proposal, and fully ignores the fact that these functions are already performed by an independent entity, the NYISO, under its Open Access Transmission Tariff. In addition, Joint Petitioners disagree with Staff that Iberdrola would in any way be in a position to "discourage[e] competitors seeking to interconnect in the NYSEG and RG&E service territories" (Staff BE at 23). The NYISO already performs, oversees or reviews all interconnection studies needed to accommodate new generation (including wind generation) to ensure that they are fair and that they do not discriminate between generators affiliated with transmission owners and generators that are not affiliated with transmission owners. For example, the Standard Large Facility Interconnection Procedures that are part of the NYISO FERC-filed Open Access Transmission Tariff (which has the effect of binding federal law) provide:

> The NYISO shall receive, process and analyze all Interconnection Requests in a timely manner as set forth in the Large Facility Interconnection Procedures. As described herein, the NYISO will process and analyze all Interconnection Requests with independence and impartiality, in cooperation with and with input from the Developers, Transmission Owners and other Market Participants. The NYISO will perform, oversee or review the Interconnection Studies to ensure compliance with the Large Facility Interconnection Procedures. The NYISO will use the same Reasonable Efforts in processing and analyzing Interconnection Requests from all Developers, whether or not the Large Generating Facilities or Merchant Transmission are owned by a Transmission Owner, its subsidiaries or Affiliates, or others. (NYISO Open Access Transmission Tariff, Attachment X, Section 2.2 (Comparability), First Revised Sheet Nos. 749-50).

Thus, the NYISO already is responsible for the interconnection studies and ensures that there is not the kind of discrimination about which Staff expresses concern.[29]

Furthermore, these procedures and NYISO's required *pro forma* interconnection agreement already address the concerns raised by Staff with respect to the affiliation of generation and transmission owners. The NYISO and FERC require that public notice be provided whenever an affiliated generation owner is seeking to pursue an interconnection request,[30] and also require nondiscriminatory treatment with respect to all interconnection activities,[31] including with respect to securing property rights,[32] and obtaining permits and other authorizations.[33]

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[29] The final and most important interconnection study that identifies what facilities are required to be constructed to accommodate the interconnection of a generating facility (the Interconnection Facilities Study) is controlled by the NYISO. This is "a study conducted by NYISO or a third party consultant for the Developer to determine a list of facilities (including Transmission Owner's Attachment Facilities and System Upgrade Facilities as identified in the Interconnection System Reliability Impact Study), the cost of those facilities, and the time required to interconnect the Large Generating Facility or Merchant Transmission Facility with the New York State Transmission System." (NYISO Open Access Transmission Tariff, Attachment X, Section 1 (Definitions), First Revised Sheet No. 744).

[30] The NYISO Tariff provides: "Before holding a Scoping Meeting with an Affiliate of a Transmission Owner and that Transmission Owner, the NYISO shall post on its OASIS an advance notice of its intent to do so. The NYISO shall post to its OASIS site any deviations from the study timelines set forth herein." (NYISO Open Access Transmission Tariff, Attachment X, Section 3.4 (OASIS Posting), First Revised Sheet No. 757).

[31] NYISO Open Access Transmission Tariff, Attachment X, Section 2.2 (Comparability) First Revised Sheet Nos. 749-50.

[32] The NYISO Tariff provides: "If any part of the Transmission Owner's Attachment Facilities and/or System Upgrade Facilities is to be installed on property owned by persons other than Developer or Transmission Owner, the Transmission Owner shall at Developer's expense use efforts, similar in nature and extent to those that it typically undertakes for its own or affiliated generation, including use of its eminent domain authority, and to the extent consistent with state law, to procure from such persons any rights of use, licenses, rights of way and easements that are necessary to construct, operate, maintain, test, inspect, replace or remove the Transmission Owner's Attachment Facilities and/or System Upgrade Facilities upon such property." (NYISO Open Access Transmission Tariff, Standard Large Generator Interconnection Agreement, Attachment X, Section 5.13 (Lands of Other Property Owners), Second Revised Sheet No. 879).

[33] The NYISO Tariff provides: "NYISO, Transmission Owner and the Developer shall cooperate with each other in good faith in obtaining all permits, licenses and authorizations that are

Staff's reference to the recent Commission order granting a Section 68 certificate to Marble River, LLC (Staff BE at 23) provides no support for its proposal to impose a transmission study obligation on Iberdrola. In fact, the Marble River order provides a litany of the substantive functions that are performed by NYISO in the interconnection process,[34] thereby supporting Joint Petitioners' position that it would not be feasible for NYSEG or RG&E to manipulate the interconnection process to favor their affiliated generation even if NYSEG and RG&E were so inclined, given the independent role of the NYISO in interconnection study matters.

d. There Is No Support Or Logic To Staff's Contract-For-Differences Proposal

Staff suggests, as another alternative to a statewide prohibition on Iberdrola's affiliated wind activities, that the Commission could consider requiring Iberdrola "to enter into a contract for each wind facility that divorces the profit from the market price" (Staff BE at 25). Staff suggests that such agreements "would dampen the incentive for Iberdrola to raise overall market prices, so that the wind generators it owns would benefit from those higher prices along with all other generators" (Staff BE at 26). Staff states that these contracts should be financial "contracts for differences."

As an initial matter, the record demonstrates that "the intermittent and unpredictable nature of wind generation 'makes wind-powered generating facilities ill-suited to be used in the exercise of vertical market power'" (Tr. 842; Joint Petitioners BE at 37; *see also*

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necessary to accomplish the interconnection in compliance with Applicable Laws and Regulations. With respect to this paragraph, Transmission Owner shall provide permitting assistance to the Developer comparable to that provided to the Transmission Owner's own, or an Affiliate's generation, if any." (NYISO Open Access Transmission Tariff, Standard Large Generator Interconnection Agreement, Attachment X, Section 5.14 (Permits), Second Revised Sheet No. 879).

[34] Case 07-E-1343 - *Marble River, LLC, Order Granting Certificate of Public Convenience and Necessity and Providing for Lightened Regulation*, at 21-22 (June 19, 2008).

Joint Petitioners IB at 57), and therefore such projects simply cannot be used to manipulate market prices (*See also* Response No. 2 above). Staff nonetheless suggests that these contracts are necessary "to adequately address the incentive to raise market prices" (Staff BE at 25-26). Joint Petitioners discuss in Response No. 2 above that the VMP Policy Statement establishes only a rebuttable presumption, and not an absolute prohibition, against a transmission owner's acquiring or being affiliated with generation in New York.

Moreover, other than Staff's proposal that these financial instruments contain ten-year terms and exclude Iberdrola's affiliates as counterparties, Staff offers no details as to how these agreements would be structured, what their purpose would be, or how they would address any vertical market power concerns, even assuming that Staff did identify any such real concerns (which it has not). It is clear that Staff has not fully considered or evaluated the merits of its own proposal given the fact that the market for this kind of long-term financial instrument lacks liquidity and depth. Significantly, Staff also does not consider the reality that mandating such contracts would increase costs for Iberdrola's affiliated wind projects as compared to other developers.[35] The result would be that Iberdrola's affiliates would be less likely to invest in wind development in New York. In addition, Staff provides no legal basis for imposing any such requirement, and does not identify any instance in which the Commission has taken such actions in the past. In short, Staff's proposal is not well developed conceptually, is without any legal or factual basis, and must be rejected.

There is simply no justification for requiring Iberdrola to enter into contracts for differences. Given the State's aggressive goals for developing renewable energy and Iberdrola's unique renewable expertise, which will help the State meet these goals (Joint Petitioners BE at

[35] Requiring long-term financial contracts, in the absence of a market with liquidity or depth, would prejudice Iberdrola Renewables' projects without serving any regulatory purpose.

23-26), the Commission should not impose such an unnecessary economic barrier to Iberdrola's renewable development activities.[36]

Response No. 4: Joint Petitioners agree to Staff's proposal for a deferral of the incentive level and other auction issues to an auction plan collaborative, with certain clarifications, and disagree with Multiple Intervenors' assertion that the Commission should resolve the auction allocation issues in this proceeding.

With respect to the procedures for auctioning the fossil facilities that Joint Petitioners have agreed to auction as part of the Partial Acceptance, Joint Petitioners agree with Staff that "the level of incentive and other auction issues should be deferred to an auction plan collaborative [which could be a separate Commission proceeding] conducted after a decision is reached on the transaction itself." (Staff BE at 27 (citing RD at 78)). As a further clarification, this collaborative and possible subsequent proceeding should occur immediately following closing and the submission of Joint Petitioners' draft auction protocols, to ensure that there is not a waste of resources (as the fossil divestiture is conditioned upon closing the Proposed Transaction). This subsequent proceeding can resolve the allocation of above-book revenues, the development of auction protocols and other related matters. The allocation of above-book revenues will be an important input to any subsequent rate proceeding (through which the portion of net proceeds to ratepayers would flow).

Multiple Intervenors, however, would have the Commission decide issues related to the allocation of the net proceeds from the auction of Energy East's fossil facilities in *this* proceeding prior to closing (*See* MI BE at 24-27). IPPNY seeks an even more hasty schedule for divestiture, regardless of the adverse consequences that it would cause with respect to ratepayer

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[36] Furthermore, any such effort would be without factual or legal basis, has never been undertaken, and is beyond the Commission's current jurisdictional authority.

value (IPPNY BE at 2-7).[37] All these issues should be deferred to an auction plan collaborative that should not occur before the closing of the Proposed Transaction. The Commission should reject Multiple Intervenors' and IPPNY's calls for a rush to judgment. Moreover, Multiple Intervenors' proposals calling for customers to receive an aggressive percentage of the above-book proceeds and/or the imposition of an absolute cap on shareholder benefits from the allocation lend themselves to the post-closing collaborative process that both Joint Petitioners and Staff recommend (*See* Staff BE at 27 (citing RD at 78)). There are terms and conditions and numerous other auction protocols (and other related matters) to determine that are associated with the auction in addition to this allocation issue. Dealing with all auction issues and procedures in one process and one proceeding makes the most sense.

C. CODE OF CONDUCT AND OTHER PROTECTIVE MEASURES

Response No. 5: The Commission should reject Staff's proposed modifications to the existing Code of Conduct

The existing Standards Pertaining to Affiliates and the Provision of Information ("Code of Conduct") (Exh. 111) were intended to govern the affiliate relationships among NYSEG, RG&E, RGS, Energy East and other Energy East affiliates. The Code of Conduct was heavily negotiated among all interested parties and was approved by the Commission as part of the Energy East/RGS merger. By all accounts, it has worked well and performed its intended purpose. Even Staff acknowledges that the Code of Conduct has been adequate to govern the affiliate relationships among Energy East holding and service companies, NYSEG and RG&E (Tr. 1425-26).

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[37] Case 07-M-0906 - *Brief on Exceptions of Independent Power Producers of New York, Inc.*, at 2-7 (June 26, 2008) (hereinafter "IPPNY BE").

To address any affiliate relationship concerns, Iberdrola, as the potential ultimate parent of NYSEG and RG&E, has agreed to "step into the shoes" of Energy East for purposes of the Code of Conduct (Joint Petitioners RB at 34). Iberdrola, therefore, would be bound by all of the existing affiliate transaction rules that currently apply to Energy East and its affiliates. Beyond this substitution of entities, there is no reason for the Commission to change the existing Code of Conduct.

While acknowledging Iberdrola's offer to step into the shoes of Energy East, Staff continues to advocate for unnecessary, ill-defined and wide-ranging changes to the existing Code of Conduct (Staff BE at 28) that go well beyond any measures needed to address affiliate relationship issues resulting from the Proposed Transaction. In certain instances, Staff's changes are inconsistent with other financial protection measures recommended by the RD. Staff's primary justification for these changes is a nebulous claim that the existing Code of Conduct cannot address the "nuances and unknowns" of the Proposed Transaction. Staff also argues that "Iberdrola is a much larger and more diverse entity than Energy East" (*Id.* at 28). Neither of Staff's offered justifications supports the fundamental changes that Staff is seeking to implement in the Code of Conduct on a unilateral basis. Moreover, Staff has failed to demonstrate on the record even a single situation when the existing Code of Conduct, with Iberdrola standing in for Energy East, could not achieve its intended purpose of governing specific affiliate interactions.

Although consistently downplayed by Staff, many of its proposed changes to the Code of Conduct are not the kind of ministerial, procedural or minor changes that Staff claims. Rather, many of these proposed changes, at their core, reflect sweeping policy determinations with wide-ranging and significant impacts that should be reflected (if at all) in new requirements applicable to all utility operating companies to be established only after input by those companies and other stakeholders. They are not just matters involving Iberdrola and Energy East. Furthermore, Staff's proposed changes represent an impermissible "back door" attempt to impose new merger conditions (before they are even meaningfully considered by the Commission) by embedding them deep in the Code of Conduct. Throughout this proceeding Staff has failed to identify fully or provide record support for each of its proposed modifications (Joint Petitioners RB at 35-36).

Recognizing the magnitude of the changes Staff is seeking, and the fact that the Code of Conduct is intended only to address matters involving Energy East and its affiliates, the RD correctly concludes that:

> Unless the transaction's opponents can show the proposed restrictions would affect only conduct involving Energy East and its affiliates or that such a criterion is inappropriate, the Commission should not impose affiliate transaction restrictions other than petitioners' proposal to substitute Iberdrola for Energy East in the current code of conduct (RD at 115).

Staff has failed to make any such showing in its Brief on Exceptions. Staff's attempts to inject changes to the Code of Conduct that have nothing to do with the measures potentially needed to address concerns with affiliate transactions, or that conflict with other financial protection measures recommended by the RD, should be rejected.

a. Staff's Claim That The RD Supports Acceptance Of Staff's Proposed Modifications To The Code Of Conduct Is Erroneous

Staff misconstrues the RD as supporting its proposed changes to the Code of Conduct. In particular, Staff asserts that the RD accepts Staff's changes to the Code of Conduct except for two issues concerning affiliate restrictions and protection from rating downgrades (Staff BE at 28). To the contrary, the language of the RD rejects all of Staff's changes to the Code of Conduct and highlights two particularly egregious proposed modifications. The RD clearly recommends that the "Commission should *not* impose affiliate transaction restrictions other than petitioners' proposal to substitute Iberdrola for Energy East in the Current Code of Conduct" (RD at 115) (emphasis added). Indeed, the RD continues by finding that Staff's expanded Code of Conduct is "*unsuitable for adoption*" given its numerous ambiguities and inconsistencies, and the fact that it goes well beyond the original scope of the affiliate transactions of concern *(Id.* at 114-15) (emphasis added).

In its discussion of various proposed protective measures, the RD recommends that the Commission approve certain protective measures, "except as follows. The first objectionable proposal involves the code of conduct [currently] applicable to transactions among Energy East, NYSEG, and RGE, and Staff's proposals for modifying it to include transactions involving Iberdrola" *(Id.* at 114). Despite Staff's apparent belief to the contrary, the RD clearly recommends *against* adoption of Staff's proposed changes to the existing Code of Conduct, which it describes as beyond the intended scope of the existing Code of Conduct and "unsuitable for adoption" by the Commission (*Id.* at 115). Accordingly, the Commission should accept the RD's recommendation that the only change to the Code of Conduct that should be required in a merger approval order is the substitution of Iberdrola for Energy East.[38]

b. Many Of Staff's Proposed Changes to the Code of Conduct Are Wholly Unrelated To Affiliate Transactions Or Inconsistent With Financial Protection Measures Recommended By The RD

Staff's proposed unilateral changes to the Code of Conduct undeniably have raised the specter of many other, as yet unidentified ambiguities, inconsistencies and problems. For example, Staff proposes many revisions to the Code of Conduct that are wholly unrelated to

[38] The RD's rejection of Staff's proposed modifications to the Code of Conduct is clear. The RD does, however, contain an inconsistent fragment of text (RD at 59), which provides no meaningful support for Staff's position. It is a summary statement contained in an unrelated section of the RD intended to address the benefits discussed in the Joint Petitioners' Reply Brief. The fragment also has obvious dropped text at the end and a cross reference "for the reasons discussed elsewhere" that is nonsensical since, as set forth above, the RD's substantive discussion of the Code of Conduct expressly rejects Staff's proposed changes.

affiliate transactions in an attempt to impose conditions related to financial reporting, credit quality, dividend restrictions and money pools (Exh. 111 at 8, 14-17), which Joint Petitioners have consistently rebutted throughout this proceeding. Among the most egregious of Staff's proposed changes to the existing Code of Conduct is an expansion of Staff's audit authority to reach every Iberdrola affiliate, regardless of whether that affiliate has any "affiliate transactions" with the New York regulated utilities (Staff BE at 32). The record in this proceeding provides no basis for such an unprecedented expansion of either the existing Code of Conduct or Staff's audit authority (Joint Petitioners RB at 35-36; Exh. 111 at 7).

Moreover, not only are these financial protection provisions unrelated to affiliate transactions and inappropriately included in the Code of Conduct, but many of Staff's proposed provisions appear to be inconsistent with the financial protections recommended by the RD. For example, while the RD rejects Staff's proposed hold harmless condition (RD at 116), Staff's proposed Code of Conduct would require that the costs of any DISCO (*i.e.*, distribution company) debt or financing be lowered to reflect a cost consistent with the DISCO's present ratings (Exh. 111 at 16).[39] This provision has nothing to do with affiliate transactions. As the RD recognized, Staff's proposed changes to the Code of Conduct are full of ambiguities and inconsistencies. The demonstrated existence of so many inconsistencies mandates that the Commission reject Staff's proposed changes to the Code of Conduct.

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39 Additionally, while Joint Petitioners have excepted to the following recommendations by the RD (*see* Exception Nos. 16 and 20 of Joint Petitioners BE), they illustrate additional substantive inconsistencies raised by Staff's proposed changes to the Code of Conduct: (i) the RD recommends that NYSEG and RG&E be required to file a plan with the Commission in the event of a credit downgrade (RD at 96), while Staff's proposed Code of Conduct would require NYSEG and RG&E to report any time its senior debt is placed on credit watch or review (Exh. 111 at 15); and (ii) the RD recommends access to the books and records for all of Iberdrola's majority-owned affiliates (RD at 103), while Staff's proposed Code of Conduct would require access for all entities in which Iberdrola owns a 10% or greater interest (Exh. 111 at 1).

c. The Commission Should Reject Staff's Allegation That The Substantive Changes Staff Now Proposes To The Proposed Code Of Conduct Are Mere Corrections Of "Typographical Errors"

Having misread the RD's analysis as supporting its proposed changes to the Code of Conduct, Staff claims that the many documented errors and inconsistencies in its proposed modifications to the Code of Conduct identified by Joint Petitioners are easily correctable "typographical errors" (Staff BE at 34). Consistent with Staff's attempts to downplay the wide-ranging substantive impact of its proposed changes to the Code of Conduct, Staff seeks to minimize to the Commission the magnitude of Staff's proposed changes to the Code of Conduct (Joint Petitioners RB at 36-38). Contrary to Staff's claims, the revisions it proposes for the first time in its Brief on Exceptions go beyond mere typographical corrections. For example, Staff now proposes the following substantive revisions to its proposed Code of Conduct: (i) the removal of Staff's proposed prohibition on "chaining transactions" (Staff BE at 34-35); (ii) revisions to Staff's proposed provision regarding compensation for transferred employees (*Id*. at 34); and (iii) the correction of a substantive inconsistency regarding Staff's proposed prohibition on Energy East officers' serving at NYSEG or RG&E (*Id*.). These changes are substantive in nature and obviously are not, as Staff claims, mere typographical corrections.

The existence of such problems is evident on the record based on the few examples set forth by Joint Petitioners. These examples were not intended to be an exhaustive review of the revisions proposed by Staff, but were provided to highlight the possibility of serious harm and other flaws inherent in Staff's proposed changes (Joint Petitioners RB at 38). As the RD recognized, Staff's proposed changes to the Code of Conduct are full of ambiguities and inconsistencies. The demonstrated existence of so many errors mandates that this proceeding not be the forum for even considering Staff's proposed changes to the Code of Conduct.

Apparently recognizing its failure to present justifiable and consistent changes to the Code of Conduct, Staff's final gambit is an attempt to shift blame for its own failure to the Joint Petitioners. Staff alleges that its multitude of drafting errors "could have been corrected had Iberdrola brought them to light earlier" (Staff BE at 34).[40] Incredibly, Staff claims that the "confusion" around the text of its revised Code of Conduct arises not because its proposed changes were riddled with errors, but because Joint Petitioners only raised objections to Staff's proposed changes in their Reply Brief. Staff's claim ignores Joint Petitioners' previous statements. Joint Petitioners have consistently opposed Staff's proposed changes to the Code of Conduct, including in their rebuttal testimony (Tr. 561), in their Initial Brief (Joint Petitioners IB at 79) and, finally, in even more detail in their Reply Brief (Joint Petitioners RB at 35-38). As Iberdrola has agreed to step into the shoes of Energy East and be fully bound by the existing Code of Conduct, Staff's proposed changes to the Code of Conduct are unnecessary and must be rejected.

d. Staff's Proposed Changes To The Code of Conduct To Prohibit Iberdrola From Providing Services to Energy East, NYSEG And RG&E Must Be Rejected.

Staff's proposed changes to the Code of Conduct include a new prohibition on the ability of Energy East, NYSEG and RG&E to obtain services from Iberdrola or its affiliates (Staff BE at 30). Interestingly, under Staff's proposal, Iberdrola and its affiliates would be asymmetrically prohibited from providing services to the Energy East entities, while Energy East would not be prohibited from providing service to Iberdrola (RD at 107). This proposed change to the Code of Conduct should be rejected by the Commission.

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[40] Staff's claim is particularly ironic given that it chose to provide its original changes to the Code of Conduct without even so much as a blackline to reflect its proposed changes, which might have allowed, if not an earlier identification of Staff's errors, at least some indication of the proposed changes.

First, the Commission has no jurisdiction over the exchange of services and allocation of costs between two holding companies such as Energy East and Iberdrola. Thus, Staff's proposed changes to the Code of Conduct are overbroad and would exceed the Commission's statutory authority.

Second, Staff's asymmetric prohibition is strictly punitive in nature and has no reasonable basis. As Staff has admitted, if these proposed affiliate standards were adopted by the Commission as Staff itself recommends, neither Iberdrola nor any of its affiliates would be permitted to perform any services for NYSEG or RG&E (Tr. 1498-99).

Incredibly, Staff claims in its Brief on Exceptions that "Iberdrola's position in this proceeding compels that result. Iberdrola claims that there will be no synergies between it and the regulated New York companies …. For these reasons, holding Iberdrola to the position it asserts, by preventing it from providing services, is reasonable" (Staff BE at 30-31). Staff's position does not make any sense and unnecessarily punishes both Joint Petitioners and ratepayers. Joint Petitioners have asserted that, although they have not identified any synergies resulting from the Proposed Transaction (because there are none in such a non-synergy "first mover" transaction), to the extent that such benefits are realized, the Commission could flow such benefits to ratepayers in normal rate cases in the future (Tr. 936). Staff's unyielding position on this issue nonsensically prevents ratepayers from ever receiving any benefits from future synergy savings that may result from the Proposed Transaction.[41]

Third, Staff's proposed prohibition blatantly ignores the fact that, under the PSL and the existing Code of Conduct, the Commission and Staff retain the ability to access all books and records necessary to review affiliate relationship matters directly involving New York

[41] At the very least, the Commission should retain flexibility to allow these types of affiliate transactions when the Commission determines that they are in the best interests of ratepayers.

utilities and to investigate any costs imposed on New York ratepayers. The Commission's control of cost allocation is limited to determining the appropriate recovery of those costs in the rates of a New York regulated entity. Additionally, the Commission has jurisdiction to audit the provision of services to a regulated utility or to audit the allocation of costs to a New York utility. Staff's unsupported claim that Iberdrola affiliates "could never be properly audited" (Staff BE at 32) is, therefore, without any legal basis or record support. As a result, ratepayers remain fully protected. As Iberdrola has agreed to be bound by existing regulations and the existing Code of Conduct, there is no justification for Staff's proposed changes.

e. The Commission Should Adopt The RD's Denial Of Staff's Proposed Limitations On The Use Of The Energy East, NYSEG Or RG&E Name

Staff specifically opposes the RD's rejection of two elements of Staff's proposed changes to the Code of Conduct. First, the RD specifically identified critical flaws in Staff's proposal to bar the use of the Energy East, NYSEG or RG&E names by affiliates. Staff alleges that this new protection must be added to the Code of Conduct to prevent confusion among the public. Staff seeks to bolster this argument by claiming that Iberdrola is somehow in violation of the existing Code of Conduct based on NYSEG's preexisting relationship with Community Energy. Importantly, Staff fails to note that the Community Energy marketing arrangement with NYSEG predates by far the merger agreement, and Joint Petitioners have agreed to take all steps necessary to comply with the existing Code of Conduct rules upon consummation of the Proposed Transaction. Therefore, Staff's reliance on the Community Energy example for support is misplaced (Tr. 523-24; Joint Petitioners RB at 41). Joint Petitioners have demonstrated that, rather than avoid confusion, Staff's proposed change to the Code of Conduct would increase public confusion by preventing consumers from knowing the identity of the corporate family they are dealing with (Joint Petitioners RB at 36).

Staff now acknowledges, for the first time, that its proposal could require NYSEG Solutions, Inc. ("NYSEG Solutions"), an unregulated ESCO affiliate, to change its name (Staff BE at 30), thus destroying the value of NYSEG Solutions' current brand and causing harm to the competitive energy services marketplace (Joint Petitioners RB at 37). NYSEG Solutions has been in existence since the late 1990s. Staff's proposed mandatory name change for NYSEG Solutions would also damage the existing NYSEG retail access program, resulting in customer confusion, which would not resolve any concerns or benefit any person or entity (other than NYSEG Solutions' competitors). In the recent NYSEG Supply Service proceeding (Case 07-E-0479), wherein the Commission reviewed NYSEG's Supply Service program, no party (including Staff) objected to the continued use of the NYSEG Solutions name, and future use of the name was not prohibited by the Commission. These harms to a pre-existing, ongoing business are not justified by Staff's unsupportable claim that the change would in some fashion avoid public confusion. Notably, Staff has not demonstrated any actual confusion caused by NYSEG Solutions' current name, and the RD's recommended rejection of this proposed Staff change to the Code of Conduct should be upheld.

f. Staff's Revisions To The Code Of Conduct Should Not Be Decided As Part Of This Proceeding

Given the numerous flaws and inconsistencies in Staff's proposed changes to the Code of Conduct, it is not surprising that Staff suggests an alternative compliance filing process. Staff notes that, if the Commission determines that the Code of Conduct "could benefit from a more thorough effort and careful drafting," Staff would be amenable to submitting a revised Code of Conduct as a compliance filing in this proceeding. Staff envisions that the parties would then be permitted to file comments on the compliance filing and the Commission could decide any remaining issues (Staff BE at 35). The many flaws and inconsistencies in Staff's proposed changes that are evident on the record support Staff's acknowledgment that any proposed changes to the Code of Conduct require a far more thorough and dedicated effort than Staff has demonstrated. In any event, however, there is no need for Staff's alternative approach where, as here, the record confirms that the existing Code of Conduct would be appropriate if modified only to recognize the substitution of Iberdrola for Energy East.

Response No. 6: The RD properly rejected Staff's "hold harmless" proposal in the event of a NYSEG or RG&E credit downgrade, and prohibition regarding indirect loans.

a. Staff's Proposal To Shift The Risk Of A NYSEG Or RG&E Credit Downgrade

Staff takes particular issue with the RD's rejection of its proposal that NYSEG and RG&E customers would "not be responsible for the effect of any downgrading from NYSEG's and RG&E's present debt ratings (BBB+/Baa1)" (RD at 96 (Condition 8); *see* Staff BE at 32). The RD properly states that such a provision is unreasonable as it would be difficult to enforce and could result in a vicious cycle of rate disallowances followed by a future ratings downgrade resulting from actions unrelated to the Proposed Transaction (RD at 116). Staff argues that Iberdrola should voluntarily assume all risk of a credit downgrade, regardless of cause, because that is "where it belongs" (Staff BE at 33). MI endorses Staff's position (MI BE at 30-33). This view gets the credit downgrade issue precisely backwards.

Conveniently, Staff's position would abdicate entirely the responsibility of utility regulators to ensure that their actions do not cause harm to fully regulated T&D utilities—notwithstanding that regulators have the authority to establish the utilities' sales, expenses, rate base, ROE and other bedrock components of their revenue requirements. Indeed, as Dr. Makholm testified, in evaluating the Proposed Transaction, rating agencies are primarily "concerned about unreasonable concessions that the Commission may require to authorize the merger" (Tr. 1064). This reality was starkly reflected in Moody's report on Energy East in December 2007, stating "regulatory decisions in the pending acquisition by Iberdrola that do not impose harsh rate concessions could also lend stability to [Energy East's] rating outlook" (Tr. 1064 (citing Moody's Investor Service, *Credit Opinion: Energy East Corp.* at 7 (Dec. 26, 2007)). In the same report, as Dr. Makholm explained, Moody's expressed particular concern about the regulatory environment in New York, given the adverse decision in the 2006 NYSEG rate case, and observed that, "*if future regulatory decisions by the [Commission] are unsupportive,* then the potential for a downgrade of the ratings of RG&E, EEC, and its other utility subsidiaries could increase" (Tr. 1065 (citing Moody's Dec. 26, 2007 report, at 7)).

Clearly, regulated T&D utilities are responsible, along with the regulators who oversee their rates, for their revenue streams that in turn directly impact the utilities' credit ratings. Staff's attempt to suggest otherwise is misguided and unsupported by the record. Staff is essentially asking for the Commission to hold Iberdrola responsible for factors beyond its control, including general market conditions and macroeconomic changes in the future credit markets. Staff's sole justification is that this provision would benefit ratepayers, while completely ignoring the cost to Joint Petitioners. Staff's proposed change would, ultimately, likely increase utility costs as a result of increased costs of capital. Accordingly, the RD correctly held that Staff's proposed hold harmless provision is unreasonable and should not be adopted (RD at 115).

b. Staff's Clarification Of The Money Pool Indirect Loan Issue Is Not Required

The RD correctly holds that only minor differences remain between the parties regarding money pool limitations. One difference is Staff's proposed inclusion of a specific prohibition on indirect loans *(Id.* at 101). The ALJ expressly sought a definition of what Staff means by an indirect loan. Staff responded by defining an indirect loan as an instance when a "subsidiary makes loans to a parent, and the parent then loans that [money] to another subsidiary participating in the money pool" (Staff BE at 33). Staff's apparent concern with indirect loans is that "[d]uring the course of the transfer…the conditions of the loan might change, circumventing the restrictions on money pool transactions" (*Id.* at 33-34). While Joint Petitioners do not take issue with Staff's proposed definition of an indirect loan, they find no need to include it in the money pool provisions. Iberdrola has already committed not to borrow from any money pool in which NYSEG and RG&E are participants, which fully satisfies Staff's concern (Tr. 556-57; Joint Petitioners RB at 69). Should the Commission determine that money pool provisions are necessary as a condition to the Proposed Transaction, the Commission can and should accept the money pool condition as agreed to by the Joint Petitioners.

D. POSITIVE BENEFIT ADJUSTMENTS

Response No. 7: Staff's comparisons of the monetary benefits in other transactions are flawed.

a. The Commission Should Adopt The ALJ's Recommendation And Reject Staff's Flawed Comparison To The Maine Transaction

The Commission should reject Staff's flawed comparison to the Maine merger approval. Staff attempts in its Brief on Exceptions to utilize improperly the level of benefits provided by Joint Petitioners in Maine to justify Staff's proposed PBAs in New York (Staff BE at 39).

In its Brief on Exceptions, Staff claims that Energy East's agreement to forgo recovery of its acquisition premium (from its previous acquisition of Central Maine Power Company) should somehow be viewed as a "benefit" of the Proposed Transaction to Maine ratepayers. As the Commission well knows, acquisition premiums are not typically permitted to be recovered in utility rates in New York, and Joint Petitioners have agreed in their Joint Petition not to seek to recover the acquisition premium related to the Proposed Transaction from NYSEG or RG&E ratepayers.[42] Moreover, Staff is applying the wrong amount as the alleged "benefit" and has made a number of other calculation errors intended to boost the so-called benefits number higher.

In analyzing Staff's original Maine comparison, the RD correctly concludes that Staff failed to properly calculate the benefits that Joint Petitioners offered in Maine (RD at 138). The RD found that the benefits in Maine amounted to only 3.3% of the delivery revenues of Central Maine Power Company ("CMP") (*Id*. at 137-38). The RD, therefore, properly gives no weight to Staff's argument that the Maine transaction supports Staff's proposed $646.4 million in PBAs (equal to 9.94% of the delivery revenues of NYSEG and RG&E).

Staff seeks to resurrect its Maine comparison by further inaccurate characterization of the facts and timetable of the Maine proceeding. Staff alleges that, since Joint Petitioners did not give up their claim until after issuance of the Maine Bench Analysis, which rejected recovery, the full amount of $306 million acquisition premium should be considered a benefit of the Maine Iberdrola/Energy East merger transaction (Staff BE at 40). Staff's analysis is deeply flawed and factually wrong. Staff appears to misunderstand the Maine regulatory process and the facts surrounding the $306 million in acquisition premium (Joint Petitioners RB at 105). The rate filing in Maine by CMP sought recovery of a share of the savings arising from its prior merger with Energy East.[43] It was submitted on May 1, 2007, well

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[42] While Staff has argued that such a commitment should not be viewed as a "benefit" of the Proposed Transaction, Staff nevertheless is trying to characterize Energy East's agreement not to seek any recovery of the previous acquisition premium from Maine ratepayers as a benefit of the Proposed Transaction. This inconsistent logic should be rejected.

[43] CMP did not directly request recovery of the Energy East/CMP acquisition premium.

before the June 25, 2007 Merger Agreement between Energy East and Iberdrola was executed. Moreover, in its May 1, 2007 filing, CMP requested only $8.8 million annually (*Id*. at 106).

Given that the May 1, 2007 filing date preceded execution of the merger agreement on June 25, 2007 and sought only $8.8 million, it is impossible that $306 million in acquisition premium recovery was “given up” to Maine to secure approval of the Iberdrola/Energy East merger. Staff’s argument that the foregone recovery of the full $306 million was a benefit to Maine from the Proposed Transaction is simply without merit. In fact, inclusion of the $8.8 million as a benefit overstates the actual benefit to Maine because CMP agreed to forgo its claim to the $8.8 million in the Maine Stipulation only because it was not likely that CMP would actually prevail on this issue had it been litigated in Docket 2007-215 (*Id*. at 106).

The RD agreed with the Joint Petitioners that CMP had not sought to recover in rates the unamortized portion of the acquisition premium cost which arose when Energy East acquired CMP, but instead only sought $8.8 million (RD at 137; Joint Petitioners RB at 105-06). As a result, if any amount is appropriate for inclusion in the benefit-to-revenue ratio calculation in Maine, it would be that $8.8 million amount.

Staff also reiterates its allegation that $86 million in benefits involving the advanced metering initiative (“AMI”) should be ascribed to the Maine transaction (Staff BE at 39). Staff alleges that “Iberdrola has failed to support its analysis of the annual AMI benefit of $1.6 million” (*Id*. at 40). While Staff is correct that a detailed calculation of the $1.6 million was not included as part of Joint Petitioners’ case (which is understandable since Joint Petitioners did not rely on the level of Maine benefits to support its New York case),[44] the number is amply supported by the record and can be derived by mathematical calculation from Attachment 2 of the Maine Merger Stipulation.[45] Thus, Staff's claim of $3.7 million of AMI benefits on an average annual basis greatly overstates the AMI benefits in Maine.[46]

The RD agreed with Joint Petitioners, ascribing only $1.6 million annually to AMI benefits (RD at 137). The RD's rejection of Staff's position was not surprising given that Staff sought to rely solely on "hearsay within hearsay" (via a quote of a newspaper article quoting an individual) as its only support for the claimed benefit (Joint Petitioners RB at 107). The RD properly concluded that, rather than Staff's claimed $86 million AMI benefit, Joint Petitioners' figure of $1.6 million annually was an appropriate calculation of the estimated annual AMI benefit(s) (RD at 137).

In addition to Staff's errors regarding (1) the foregone benefit of the $8.8 million acquisition premium, and (2) the AMI benefit of $1.6 million per year, Staff utilizes an inaccurate calculation methodology to reach its alleged benefit-to-revenue ratio of 5.6%. In an obvious attempt to increase the Maine benefit-to-revenue ratio, Staff knowingly divides its inflated and incorrect annual benefit of $12.5 million by a revenue denominator that includes

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44 The $1.6 million annual value simply represents the levelized carrying costs associated with column (5) "Deferred (over)/Under Revenue Recovery" of Attachment 2 to the Maine Merger Stipulation in Docket No. 2007-355.

45 Staff's allegation that Iberdrola had the opportunity but declined to place a monetary value on AMI (Staff BE at 40) is misleading when taken out of context of the record. As Joint Petitioners' Policy Panel explained, neither Energy East nor the Maine Commission placed any monetary value on this alleged benefit. This is not surprising since, as the panel indicated, the monetary value of the AMI levelization will be determined at a later time as part of a separate Maine proceeding (Tr. 593; Joint Petitioners RB at 107 n.133).

46 Moreover, Staff raised the comparison of benefits in Maine for the first time as part of Staff's supplemental direct during the evidentiary hearing, providing Joint Petitioners no opportunity to respond in testimony to Staff's allegations (Tr. 1460). Joint Petitioners objected at that time to Staff's alleged Maine benefits comparison and asked that the Maine information be stricken from the record as irrelevant to New York (Tr. 1661-63).

only CMP's annual distribution revenues of $233 million. Staff should have utilized approximately $311 million per year in revenues, which includes annual distribution revenue requirement, annual transmission revenue requirement, and DSM revenue requirement. Staff's choice of a lower denominator invalidates any comparison between its figure and Joint Petitioners' calculation. As explained in the Joint Petitioners' Reply Brief and as accepted by the RD, the benefit-to-revenue ratio in Maine is 3.3% ($10.4 million in benefits divided by $311 million in revenues).

b. The Commission Should Reject Staff's Attachment Calculating The Ten-Year Grid/KeySpan Benefit-To-Revenue Ratio, As Well As The Flawed Analysis Supporting It

In Attachment A to its Brief on Exceptions, Staff seeks to introduce for the first time new extra-record material that includes data and argument based apparently on a ten-year versus five-year benefit analysis. While Staff notes that the analysis was performed during the course of the proceeding, Staff fails to mention that it did not seek to introduce this analysis into the record (either through testimony or otherwise). Staff never even argued these positions to the ALJ in this proceeding. Staff's analysis is inconsistent with the Commission's own determinations in the Grid/KeySpan and Energy East/RGS proceedings, and lacks factual basis here. Moreover, Staff's ten-year benefit analysis is deeply flawed, and tracks the flaws described in Joint Petitioners' Brief on Exceptions (Joint Petitioners BE at 78-84). Accordingly, Attachment A to Staff's Brief on Exceptions should be rejected and accorded no evidentiary weight.

First, Staff's statements about the Grid/KeySpan transaction are inconsistent with the Commission's explicit determination of benefits in that proceeding. In the *Grid/KeySpan Order*, the Commission specifically determined that the benefit-to-revenue ratio should be

1.89%.[47] The Commission arrived at that ratio by including all of the benefits of the transaction from the relevant New York operating utility companies in the numerator and all of the revenues of those same New York operating companies in the denominator (*Id.* at 78-79). Both the numerator and the denominator included benefits and revenues for Niagara Mohawk and LIPA. There is no reason to artificially tinker with these numbers or the methodology the Commission explicitly endorsed. Any attempt to do so is merely an effort to drive the Commission's benefit-to-revenue ratio higher and is a collateral attack on the Commission's findings in the *Grid/KeySpan Order*. For example, in calculating its benefit-to-revenue ratio, Staff, without explanation, much less justification, includes benefits for all of those New York operating utility companies (including Niagara Mohawk and LIPA) in the numerator, but excludes Niagara Mohawk and LIPA revenues from the denominator (*Id.* at 78). This calculation is inappropriate, illogical and unsound and should be rejected as inconsistent with the Commission's stated analytic approach in the *Grid/KeySpan Order*. Second, Staff's review of the *Grid/KeySpan Order* incorrectly assumes that the Commission used $602.9 million in five-year benefits, when the Commission specifically determined that only $407.9 million of that amount should be included as benefits associated with the Grid/KeySpan transaction (*Id.* at 76). Third, Staff appears to mix and match nominal and net present value ("NPV") numbers to inflate its benefit-to-revenue ratio, using nominal numbers for years 1-5, but NPV numbers for years 6-10. Even under a cursory review, Staff's effort to recast the benefit-to-revenue ratio in the *Grid/KeySpan Order* in Attachment A is fatally flawed and should be ignored by the Commission.

[47] *Grid/KeySpan Order*, at 121.

c. The Commission Should Reject Staff's Flawed Comparison To The Energy East/RGS Merger

Staff's new calculations of the alleged ten-year benefit-to-revenue ratio in the Energy East/RGS merger are similarly flawed. Staff's calculations are based on numerous inappropriate assumptions. First, Staff's attachment assumes, without explanation or justification, net savings for years 1-5 of $164.3 million, thus totally ignoring the 50/50 sharing of those benefits between shareholders and ratepayers (*Id*. at 80). Staff's next unexplained and unjustified assumption is that there would be gross savings of $76.7 million annually for years 6-10. At the time of the Energy East/RGS merger, the Commission utilized only the merger savings available from years 1-5 in determining that the transaction was in the public interest. The merger synergies, if any, for years 6-10 were not known by the parties, were not capable of calculation at that time and were not in the record before the Commission (*Id*. at 82-83.) In addition, beyond making various inappropriate and unjustified assumptions, it appears that Staff did not utilize a true ten-year analysis, but simply multiplied "Year 5" savings (the highest savings year) by 10. Adding to the list of its flawed assumptions, Staff's analysis simply assumes that the alleged gross savings from years 6-10 for the Energy East/RGS merger should be increased by 20%. No explanation or justification is provided in support of this unwarranted assumption. Staff's Attachment A states that the extra 20% is to "reflect higher actual savings than projected," but there is no explanation or justification for that adjustment or why it should be applied to merger benefits determined prior to closing (*See* Staff BE, Attachment A, Page 2 of 2, Note (b)). Staff's gratuitous addition of 20% is simply not justifiable and should be rejected.

Given the serious flaws in Staff's calculation of the benefit-to-revenue ratio in the Energy East/RGS merger, this ratio provides no support for Staff's assertion that its PBAs in that case equate to approximately 5.1% of the delivery revenues of Energy East's New York subsidiaries. Accordingly, the Commission should find that this flawed ratio does not support Staff's PBA proposed level.

d. Comparison Of Staff And Iberdrola PBAs

Staff completes its discussion of the benefits of prior merger transactions by asserting, with no citation or analysis, that Staff's proposed PBAs would result in a reduction of 7.6% of NYSEG's and RG&E's delivery revenues. Joint Petitioners disagree with Staff's claim since the Joint Petitioners have demonstrated that the calculated percentage change in the delivery revenues would be 9.9% resulting from Staff's proposed changes.[48] In considering the percentage change in delivery revenues, the Commission should not lose sight of the fact that, should all of Staff's PBAs and other proposed conditions to the Proposed Transaction be adopted, it would reduce the delivery revenues of NYSEG and RG&E by over 26% and have a negative financial impact on the Joint Petitioners totaling $1.6 to $1.7 billion over five years (Joint Petitioners RB at 4). Such a result should be avoided by the Commission and, accordingly, Staff's proposed level of PBAs and conditions must be rejected.

E. PRODUCTION TAX CREDITS

Response No. 8: Staff is incorrect in treating potential PTCs that may in the future be available to Iberdrola Renewables as a benefit of the Proposed Transaction.

Staff acknowledges that the RD was correct in determining that Staff overstated the purported PTC "benefits" by $50 million, an amount attributable to existing Iberdrola Renewables' wind projects that have already utilized their PTCs (Staff BE at 42; *see* RD at 126-27), thereby reducing Staff's claimed benefit to $100 million. However, this is not a sufficient adjustment of Staff's claimed PTC benefits. For the following reasons (including some of the

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[48] *See* Joint Petitioners RB at 111. The primary difference in the calculation appears to be attributable to Staff's failure to include Saranac.

same reasons the RD rejected the first $50 million), Staff's calculation of the PTC benefits of the Proposed Transaction is fundamentally flawed, and the actual PTC benefit attributable to the Proposed Transaction is zero.

As an initial matter, just as the RD determined that existing Iberdrola Renewables' projects have already utilized their PTCs, the Commission should find that Iberdrola Renewables has the very same means available to utilize PTCs with respect to its future projects. As the record shows, PTCs exist for all wind projects in New York and throughout the United States, regardless of the Proposed Transaction, and regardless of Energy East's tax liability (Tr. 528). In addition, these PTCs have absolutely nothing to do with NYSEG's and RG&E's operations, customers or regulated rates (Tr. 951; 1081; 1083).

Moreover, any attempt to determine the availability of PTCs for future wind projects is simply an exercise in speculation. Even under Staff's own theory that PTCs for future Iberdrola Renewables' wind projects are somehow related to the Proposed Transaction (which they are not), Staff's calculation of $100 million for these alleged PTC benefits is fundamentally flawed. First, Staff calculated the total PTC value rather than an amount that Staff claims could be attributable to savings that would compare PTCs with and without the Proposed Transaction. As the record reflects, Iberdrola Renewables' wind projects, consistent with common industry practice, regularly "take on tax equity partners who invest in the facilities in return for the right to use the PTCs,"[49] which means that such PTCs would not be available to offset other tax liability. Second, the completion of any wind development project depends upon a variety of development risks and other factors – since the completion and operation of those projects are not certain, the availability of any associated PTCs is also uncertain (Tr. 530). Third, the

[49] Case 07-M-0906 – *Initial Brief of the New York State Consumer Protection Board*, at 22 (Apr. 11, 2008) (citing Tr. 529-30).

availability of any future PTCs is uncertain given that the PTC mechanism is currently scheduled to expire on December 31, 2008 (Tr. 528).[50]

Moreover, Staff simply ignores the public policy and economic purpose of the PTC mechanism – to provide incentives for the development of renewable generation and promote competition between renewable energy sources and conventional energy sources – that would be undermined if the Commission were to accept Staff's proposal to treat PTCs as synergistic benefits (Tr. 527-28; Joint Petitioners IB at 39). As the Commission has acknowledged, "renewable resources are generally more expensive than non-renewable resources, such as fossil fuels. Therefore, without access to financial incentives to cover all or some of these above-market costs, renewable resources struggle to compete with resources using fossil fuels."[51] If the Commission were to take a position effectively obstructing the flow of these federal tax incentives to their intended recipients, this would likely create additional barriers to the development of renewable generation projects (Tr. 527-28; 651-52). It would be entirely improper for the Commission to rely on PTC benefits that may be available to Iberdrola Renewables' wind projects in the U.S. as a justification for any portion of the PBAs proposed by Staff.

For all these reasons, any amount Staff suggests of PTC value attributable to the Proposed Transaction (either \$100 million or \$150 million) is incorrect, unsupported by either record evidence or logic, and should be rejected.

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[50] While Joint Petitioners anticipate that Congress may extend the PTC mechanism beyond 2008, there is no guarantee that this will happen (Tr. 530-31).

[51] Case 03-E-0188 - *Proceeding on Motion of the Commission Regarding a Retail Renewable Portfolio Standard, Order Regarding Retail Renewable Portfolio Standard*, at 2-3 (Sept. 24, 2004).

F. PROCESS ISSUES FOR ANY SUBSEQUENT RATE PROCEEDING

Response No. 9: Staff's proposals to establish temporary rates and conduct expedited rate reviews are unnecessary and a denial of due process.

In its continuing effort to impose a negative financial impact of $1.7 billion over five years (resulting in a 26% decrease in delivery revenue) and a rush to judgment on a myriad of rate issues,[52] Staff takes exception to the RD's recommendation to defer consideration of the rate plan issues to an 11-month rate case (Staff BE at 45-49). Without regard to due process, Staff asks the Commission—for the first time in its Brief on Exceptions—to require a 4.4% temporary rate reduction, *without determining the exact level of PBAs*, and to establish new permanent rates through a truncated rate proceeding (*Id.*). Staff's proposal is unnecessary and unreasonable because it would modify existing rate plans and impose new rates with neither an adequate evidentiary record nor any semblance of due process. The Commission should accept Joint Petitioners' proposal to implement the specified PBAs of $201.6 million, resulting in an immediate and permanent rate reduction of $54.8 million, by utilizing the specific write-offs and write-downs Joint Petitioners proposed in their Partial Acceptance. As detailed in Joint Petitioners' Brief on Exceptions, the Commission should only establish new rates for NYSEG and RG&E, if necessary, through staggered 11-month rate proceedings consistent with the Commission's procedures and due process requirements (Joint Petitioners BE at 84-86).

a. Temporary Rates Are Not Needed

Staff's proposal to impose temporary rates, to be followed immediately by an expedited rate procedure to establish permanent rates, is inconsistent with NYSEG's and RG&E's existing rate plans and orders. Its proposal is also unnecessary in light of Joint Petitioners' offer to implement PBAs of $201.6 million, which would result in immediate,

[52] *See* Table 1, *infra*.

permanent rate reductions of $54.8 million. The terms of the existing rate plans for NYSEG Gas, RG&E Electric and RG&E Gas, as well as the recent rate order for NYSEG Electric, should not be abrogated by a temporary rate reduction. Moreover, Staff's suggestion that the existing rate plans and orders require the establishment of new rates is disingenuous. The NYSEG Gas Rate Plan is to continue beyond December 31, 2008, unless or until a new gas rate plan has been approved by the Commission.[53] Similarly, under the RG&E Joint Proposal, gas and electric rates may be continued as requested in a filing submitted on February 1, 2008. Given that NYSEG and RG&E are operating under valid rate plans and orders, all of which are effective at least through December 31, 2008, and may be continued thereafter, Staff's proposal to impose temporary rates unilaterally that could then be retroactively modified in an abbreviated rate review is inequitable and a denial of due process.

Staff's exaggerated claims of overearnings also do not require temporary rates or immediate rate changes (Staff BE at 44). Indeed, Staff mischaracterizes the RD by asserting, wrongly, that the ALJ agreed that NYSEG and RG&E are overearning (Staff BE at 44). On the contrary, the RD simply refers to Staff's claims, but does not endorse them and states that any subsequent proceeding would need to "consider" "contested" regulatory adjustments (RD at 145) – hardly an endorsement of Staff's position. The earnings for NYSEG's and RG&E's electric operations reflect the increased risk associated with the fixed-price Supply Service program and are within the range of earnings expected when those rates were approved.[54] Similarly, the earnings for NYSEG's and RG&E's gas businesses are not excessive and within a range of

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53 Section VI (2) NYSEG Gas Joint Proposal.

54 *See* Cases 03-E-0765, 02-E-0198, and 03-G-0766, *Order Adopting Provisions of Joint Proposal with Conditions*, at 7 (May 20, 2004) (allowing RG&E to retain electric earnings up to 12.25% threshold, with 50/50 sharing above threshold) (hereinafter "*RG&E 2004 Rate Plan Order"); EE/RGS Order*, at 5 (allowing NYSEG to retain delivery earnings up to 12.5% threshold and commodity earnings up to 15.5% threshold, with 50/50 sharing above threshold).

expected returns.[55] In fact, in supporting the ROE thresholds in RG&E's last rate case, the Commission noted Staff's position that "the ultimate winners, if the Company is able to realize returns at or above the thresholds, are ratepayers."[56] Staff's analysis also overstates the earnings of NYSEG (2002-2006) and RG&E (2004-2007) by using a multi-year analysis that reflects earnings in prior years when different rate plans were in effect with higher expected returns.[57]

Joint Petitioners propose to implement $201.6 million of specific PBAs, which will result in an immediate delivery rate reduction of $54.8 million, and agree with the RD that such a decrease should be applied equally across all rate classes. Staff's proposal that the Commission impose a temporary decrease in rates of 4.4%, without determining the exact level of PBAs necessary to achieve that rate reduction is unnecessary and does not provide Joint Petitioners with due process. The difference between Joint Petitioners' proposal and that of Staff is critical. It is fair and equitable to determine PBAs and merger benefits in this proceeding (which Joint Petitioners submit should be no more than $201.6 million in designated PBAs) and then initiate rate cases utilizing the Commission's standard methodology for determining new rates. Joint Petitioners have already proposed a generous rate reduction created by identified PBAs, to which they are willing to commit, as a condition in this merger proceeding and that would be part of the approval of the Proposed Transaction.

Staff's concern that the $201.6 million of PBAs proposed by Joint Petitioners will decrease after July 1, 2008 is also unfounded (Staff BE at 38). Joint Petitioners offered the $201.6 million of PBAs based on a July 1, 2008 effective date and, as Staff notes, the value of

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[55] *See* Cases 01-G-1668 and 01-G-1683, *Order Establishing Rates*, at 4 (Nov. 20, 2002) (allowing NYSEG to retain gas earning up to 12.5% threshold with 50/50 sharing above threshold); *RG&E 2004 Rate Plan Order,* at 7 (allowing RG&E to retain gas earnings up to 12.0% threshold with 50/50 sharing above threshold.)

[56] *RG&E 2004 Rate Plan Order*, at 18-19 (citing Staff Comments on Joint Proposal, at 13).

[57] *Compare* Staff BE at 44 *with NYSEG 2002 Electric Rate Plan Order*, at 5.

those PBAs may decrease after July 1, 2008, due to ongoing amortizations (*Id.*). While it is now impossible for the Proposed Transaction to close by July 1, Joint Petitioners emphasize that they do not propose any decrease in the $201.6 million of PBAs or the corresponding average 4.4% reduction in rates. The PBA regulatory assets will continue to amortize until they are implemented. Accordingly, Joint Petitioners will maintain the $201.6 million value of their proposed PBAs by increasing the Environmental SIR reserves PBA by the corresponding reduction in the regulatory asset PBA balances. Joint Petitioners' Attachment 1, appended to this Brief, illustrates the PBAs and corresponding rate reductions as of July 1, August 1, or September 1, 2008, each of which results in a 4.4% decrease in rates.

b. New Rates Must Be Determined Based Upon Full Rate Case Proceedings

The RD correctly recommends that Staff's rate issues should not be decided in this proceeding and that new rates should only be established in a full 11-month rate case, which is consistent with the PSL and long-standing Commission rate case procedures. If the Commission determines that rate proceedings are required (which it need not do here), it should adopt the RD's recommendation for subsequent 11-month proceedings, under the staggered time frame recommended by Joint Petitioners which allows for divestiture of generation assets by RG&E. Throughout this proceeding, Staff's changing proposals for imposing $1.7 billion of negative financial impacts have been a moving target. Staff's latest proposal for a truncated rate review process is unreasonable, unnecessary and would deny NYSEG and RG&E due process. In lieu of a full rate proceeding, Staff proposes that NYSEG and RG&E be required to file financial projections within 45 days of the approval of the transaction for all four operations—NYSEG Electric, NYSEG Gas, RG&E Electric and RG&E Gas (Staff BE at 45, 49). Staff understates the practical impact and legal impropriety of its proposals noting that it "does not strictly adhere to major rate case protocols" (*Id.* at 48). The Commission should reject Staff's proposals.

As explained in Joint Petitioners' Brief on Exceptions, requiring preparation and litigation of four rate cases within the same 11-month suspension period would be overly burdensome and unreasonable (Joint Petitioners BE at 84-86). Under the guise of "expediting" the rate case process and allowing Joint Petitioners to pursue integration activities, Staff would impose an impossible burden upon NYSEG and RG&E to essentially prepare four rate filings within 45 days. There is no reasonable rationale for the abbreviated procedures proposed by Staff and they must be rejected. Staff's prediction that the "streamlined" rate-setting process would result in the negotiation of "sensible rate plans" (Staff BE at 48) is unfounded and unsupported by past experience. As with the PBAs, Annual Compliance Filing ("ACF") issues and other rate plan modifications in this case, Staff's proposal is merely a veiled attempt to force rate concessions or impose rate conditions that Staff admits it could not require in a formal rate proceeding.

Moreover, Staff's proposal is contrary to established legal procedures under the PSL. Due process and the Commission's own rules require that all parties be afforded the opportunity to present their cases on a multitude of rate issues under the 11-month rate case process. Section 66 of the PSL, Part 61 of the Commission's regulations, and the Commission's procedures governing rate cases set forth specific ground rules for information to be provided and considered in establishing new rates.[58] Such rate determinations must be based upon historical and forecasted cost-of-service information, including a fully adjusted cost-of-service that is typically considered over an 11-month period. In addition, the Statement of Policy on

[58] *See Statement of Policy on Test Periods in Major Rate Proceedings*, 17 N.Y. PSC 25-R (Nov. 23, 1977) ("Statement of Policy on Test Periods").

Test Periods specifically provides that applicants must use a 12-month historical test period expiring at the end of a calendar quarter no earlier in time than 150 days before the date of filing. Following the filing of this information in conformance with Commissions requirements, and the filing of testimony, followed by extensive discovery, the parties either enter into a Joint Proposal recommending a proposed rate plan, or the Commission issues a final rate decision based upon its extensive cost-of-service evaluation, hearings and briefing by the parties. Under the settlement process, a utility may agree to, but the Commission may not impose, a multi-year rate plan, while in a litigated proceeding, the Commission ordinarily may only establish rates for a period of one year.

Staff's proposals to impose abridged rate-setting procedures for NYSEG and RG&E ignore these due process rights. They would also exceed the authority of the Commission to the extent they would require imposition of multi-year rate plans. The Commission may and should approve the Proposed Transaction without requiring rate plan modifications or subsequent rate proceedings. However, in the event that the Commission does condition the Proposed Transaction upon Joint Petitioners' agreement to conduct subsequent rate proceedings, such proceedings must be conducted and scheduled in a manner consistent with NYSEG's and RG&E's due process rights and all applicable statutes and procedures, consistent with the proposal set forth below:

Post-Closing Event	Timing
Initiating Auction Plan/Protocol Collaborative and Related Proceedings	Draft auction protocols filed with the Commission 30 days after the Proposed Transaction closes; Collaborative started immediately after filing of draft auction protocols
Filing of NYSEG electric/gas rate cases	Within the prescribed 150-day period following the close of the quarter that follows the closing of the Proposed Transaction
Divestiture of RG&E fossil facilities	Targeted for 150 days following Commission approval of the auction protocols[59]
Filing of RG&E electric/gas rate cases	Within the prescribed 150-day period following the close of the quarter that follows the completion of the fossil divestiture

Accordingly, Joint Petitioners must first be allowed to close the Proposed Transaction before any subsequent rate applications are filed. In addition, the auction and divestiture of RG&E's fossil generation facilities should be completed before any subsequent rate filing for RG&E occurs, since those divestitures and the allocation of above-book proceeds will impact rates. Staff has provided insufficient evidence and justification for even considering the many rate adjustments which it has raised in this proceeding. As specified in Joint Petitioners' Brief on Exceptions, the scheduling of deadlines for any rate filings, if deemed necessary, should be staggered. This is critical to provide sufficient time for preparation and review of rates for the four divisions of NYSEG and RG&E (Joint Petitioners BE at 85-86).[60]

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59 The overall schedule and the amount of time required for the fossil divestiture will be determined in large part by the collaborative and the market, including the ability of parties to the acquisition(s) to close the transaction(s) within this timeframe.

60 Other parties in this proceeding have recognized that NYSEG and RG&E should be allowed to stagger their rate filings to allow for a thorough compilation and review of rate case data and the efficient utilization of resources. *See* Case 07-M-0906 - *Reply Brief of Nucor Steel Auburn, Inc.*, at 3 (Apr. 25, 2008).

Staff's requests for immediate rate plan modifications or proceedings are based on the erroneous assumption that these measures are needed to provide immediate rate benefits. Because Joint Petitioners propose to flow through immediately the benefits of the PBAs in customers' rates, the Commission need not require revised or new rate plans. At least one party has suggested that the implementation of the PBAs be followed by a two-year stay-out provision.[61] Joint Petitioners would consider a stay-out provision that accurately reflects in rates the PBAs to which Joint Petitioners have agreed, but that otherwise leaves intact the existing rate orders and JPs for NYSEG and RG&E.

G. RATE ISSUES

As Joint Petitioners explained in their Reply Brief, Staff raises a multitude of rate issues that generally fall into three categories: (1) PBAs; (2) rate changes ("One-time Adjustments"); and (3) modifications to NYSEG's and RG&E's existing rate plans and orders (Joint Petitioners RB at 110). The flaws in Staff's PBA proposals were addressed in detail in Joint Petitioners' Brief on Exceptions (Joint Petitioners BE at 68-83). Staff's additional rate issues—rate changes and modifications to existing rate plans and orders—are beyond the scope of, and in no way necessary to, the Commission's determination in this proceeding. As Joint Petitioners' Rate Adjustment Panel ("RAP") demonstrated, Staff's rate proposals are both procedurally flawed and substantively incorrect (Tr. 320-411). The table below, which was included in Joint Petitioners' Reply Brief, shows that Staff's rate proposals would result in a negative financial impact on Joint Petitioners totaling $1.7 billion over five years, including $646 million of PBAs, $209 million of One-time Adjustments and $855 million of Rate Plan

[61] Case 07-M-0906 - *Initial Brief of Multiple Intervenors*, at 26-28 (Apr. 11, 2008).

Modifications, and would reduce the delivery revenues of NYSEG and RG&E by over 26%, which exceeds any level approved by the Commission for any transaction.

Table 1 – Totality of Staff's Proposals

Million

Description	Staff Proposal NYSEG	RG&E	Total	% of Delivery
PBA's	$ 308	$ 338	$ 646	9.9%
Additional One-Time Adjustments	$ 137	$ 71	$ 208	3.2%
Rate Order and Rate Plan Modifications	$ 307	$ 547	$ 855	13.1%
Total - PBAs, One-Time Adjustments and Rate Plan Modifications	**$ 753**	**$ 957**	**$ 1,710**	**26.3%**

Staff's reasons for excepting to the RD's recommendation to defer consideration of rate plan issues to an 11-month rate proceeding are based upon a fundamental failure to recognize that no rate case was ever filed in this proceeding, and the scope of the proceeding is limited to whether the Proposed Transaction is in the public interest under Section 70. Staff tries to defend its attempt to expand the scope of this proceeding by making an erroneous comparison to the *Grid/KeySpan Order* and continuing to attempt to force a premature adoption of Staff's rate adjustments without robust rate case quality data, or due process (Staff BE at 49). In Grid/KeySpan, the Commission had established separate rate proceedings for the KeySpan gas utilities,[62] and the Commission was therefore able to review and consider rate case quality

[62] *See Grid/KeySpan Order*, at 4 (noting the establishment of separate rate case proceedings). *See also* Case 06-G-1185 - *KeySpan Energy Delivery New York - Gas Rates, Order Suspending Major Rate Filing* (Oct. 25, 2006); Case 06-G-1186 - *KeySpan Energy Delivery Long Island - Gas Rates, Order Suspending Major Rate Filing* (Oct. 25, 2006).

information within the context of the merger proceeding.[63] Thus, it was appropriate for the Commission to make determinations affecting the development of rate plans for the T&D utilities contemporaneous with a ruling on the Grid/Key Span merger.

In contrast, in this proceeding, the Commission only has Staff's bare assertions of the need for rate plan modifications, unsupported by a rate filing or rate case quality data. Moreover, during the course of this proceeding Staff failed to provide details or backup for its adjustment based on NYSEG's ACFs (Tr. 1704-05). Accordingly, there is no evidentiary basis for adopting Staff's rate plan modifications in this proceeding. Staff also asserts that the need to modify the RG&E Supply Service program before October 1, 2008 justifies an immediate determination on its rate proposals in this proceeding (Staff BE at 50). As detailed herein, Joint Petitioners propose that RG&E adopt the terms and conditions of the NYSEG Supply Service program, as appropriate, in order to implement a revised RG&E Supply Service program effective January 1, 2009.

Finally, in Section 10 of its Brief on Exceptions, Staff proposes that the Commission determine all or some of the rate plan issues in this proceeding and merely repeats verbatim the arguments submitted in its Initial Brief.[64] Joint Petitioners offer the following objections to Staff's positions.

Response No. 10: The Commission should reject Staff's proposed revenue adjustments associated with NYSEG's Annual Compliance Filings.

Staff repeats verbatim the proposal in its Initial Brief that a regulatory adjustment is required to correct errors in the ACF calculations of NYSEG and RG&E (Staff BE at 64; Staff

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63 *See Grid/KeySpan Order*, at 67 n.210 (noting that the merger order decides "a large portion but not all of the revenue requirement issues").

64 *Compare, e.g.*, Case 07-M-0906 - *Staff Initial Brief*, at 181-83 (Apr. 11, 2008) (hereinafter "Staff IB") *with* Staff BE at 118-23.

IB at 181). As pointed out in Joint Petitioners' Reply Brief, however, Staff acknowledged its failure to conduct a timely review of the ACFs submitted by NYSEG and RG&E over the last several years (Tr. 1694-95; *see* Joint Petitioners RB at 118), and Staff's admitted failure even to complete its own review of the ACFs warrants rejection of Staff's proposed adjustments.

The record shows that Staff expects to issue its audit reports on the ACFs *six to seven years* after NYSEG and RG&E began to submit them in 2002. Despite Staff's dilatory performance in addressing these ACFs and its failure to provide *any* responses to date, Staff repeats its request that the Commission institute multiple rate adjustments based upon its previously undisclosed critique of the ACFs and without support of any workpapers, calculations or detail describing the adjustments. Staff's assertion regarding the ACFs is procedurally and substantively defective and its litany of excuses for failing to submit routine audit reports for seven years neither justifies Staff's inaction nor lends support to its flawed analysis (Staff BE at 64-65). In fact, Staff's own testimony states that Staff has not completed its audits and will not have final reports until sometime prior to NYSEG's and RG&E's next rate cases (Tr. 1655; 1756). The Commission should reject Staff's attempt to ramrod a decision on these issues here, which conflicts with Staff's own sworn testimony that it has not even completed its own review. In the event the Commission decides to address any of these issues in its order, however, specific responses to Staff's contentions are set forth below.

a. The NYSEG Equity Balance

Staff argues that NYSEG has, in its compliance filings, performed calculations using an "excessive level" of equity (Staff BE at 63). The Commission should reject Staff's proposal that the Commission decide in this proceeding the NYSEG equity ratio calculation used in NYSEG's 2002-2006 ACFs. First, Staff has never provided NYSEG with any workpapers or information supporting Staff's proposed calculation. Second, it appears that Staff is attempting to change the plain language from the 2002 NYSEG Joint Proposal and impose a common equity "amount" standard in place of the equity "ratio" requirement stated in Section VII.B of the JP.[65] Third, Staff may also be double-counting the financial impact of the NYSEG electric OPEB liability by including the liability in rate base (through the EBCAP adjustment) and including the non-cash return credit on the OPEB liability above the line as a reduction to O&M expense. Based on the OPEB proceeding (Case 06-M-1413), NYSEG and Staff are well aware that the non-cash return credit was included as a reduction to O&M expense in setting NYSEG's electric rates in 2002. The RD was correct in not making any recommendation on this issue, and the Commission should also defer any decision in regard to this matter.

b. The NYSEG Standby Deferral

Staff repeats its allegation from its Initial Brief that NYSEG inappropriately utilized the S.C. 7 Transmission non-Industrial High Load Factor ("IHLF") rate as the "otherwise applicable rate" for Cornell University when the lower S.C. 7 Transmission High Load Factor ("HLF") rate should have been utilized (Tr. 1625-26; Staff BE at 65; Staff IB at 183-84). Because Staff ignores Joint Petitioners' response on this issue in their Reply Brief (Joint Petitioners RB at 119), to preserve their rights, Joint Petitioners are compelled to summarize their arguments again here.[66]

Staff's position, that standby lost revenues calculations should be based on a rate at a single point in time and should not reflect any changes in rates associated with a customer's declining load factor (Staff BE at 65), is illogical (Tr. 184). The Commission should reject Staff's attempt to utilize a lower rate that might have applied at one point in time, but no longer

65 *See NYSEG 2002 Electric JP*.

66 Staff also pointedly ignores the fact that it was aware as far back as October 3, 2005 of NYSEG's calculation methodology for the Cornell revenues when, at Staff's request, NYSEG provided workpapers supporting the lost revenues calculation for Cornell and other customers (Staff IB at 185).

does. NYSEG utilized the historical rate that was consistent with the actual load factor of the customer (Tr. at 184-85). Staff asserts, with no record support, that "[h]ad there been no standby rate Cornell could have continued to meet the 68% load factor test and could continue to have qualified for the [lower] HLF rate" (Staff BE at 66). This claim is directly rebutted by the fact that the actual historical load factor of Cornell did not meet the applicable threshold for the relevant period (Tr. 184-85). Moreover, NYSEG reviews all of its standby accounts annually to verify continued qualification for a particular rate based on that customer's usage during the prior year (*id.* at 184) and did not single out Cornell. Thus, there can be a reduction or increase in lost revenues depending upon whether each particular customer meets the IHLF criteria for that year and, accordingly, NYSEG did not improperly increase the amount of lost revenues it claimed.[67]

Response No. 11: The Commission should reject Staff's proposed revenue adjustments based on RG&E's Annual Compliance Filings.

a. Storm Costs

Staff argues that RG&E has in some fashion double-counted recovery of Storm Costs by including capital costs in the calculation (Staff BE at 69; Staff IB at 186). Joint Petitioners have demonstrated that Staff's claim of double recovery is incorrect (Tr. 386-89). In summary, Staff's allegations fail because the RAP's testimony fully rebutted Mr. Haslinger's claim that capital costs were included by RG&E in the amount sought for deferral (*Id.* at 389). Any capital costs were capitalized and only non-capital incremental expenditures incurred to restore service during or after a major storm were treated as eligible for deferral (*Id.* at 434).

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67 Even assuming, *arguendo*, that Staff's methodology is correct (which it is not), Staff acknowledges that its calculations were in error and must be corrected (Staff IB at 186).

Staff also repeats its allegation that RG&E has deferred non-incremental costs associated with a major storm (Staff BE at 68; Tr. 1663). The RAP clearly demonstrated, however, that RG&E only sought to defer incremental O&M costs incurred to restore service during and as a result of the event (*Id.*).[68] Staff also continues to try to minimize the extreme nature of the heat wave weather event because "hot weather…does not constitute a storm" but is merely an "expected weather event" in the summertime (Staff BE at 69). The record, however, demonstrates that the "unprecedented heat wave" was anything but "predictable" as it caused numerous outages affecting 39,156 customers (approximately 11% of RG&E's customers) over a period of four days (Tr. 387), and that the heat wave fits squarely within the definition of a Major Storm as set forth in the Joint Proposal ("JP") and order in Case 03-E-0756 (*Id.* at 386). Both the 10% threshold and the 24-hour threshold were exceeded and, therefore, the event clearly met the definition of a major storm.[69]

b. The Security Cost Deferral

Staff argues against RG&E's deferral of certain security costs, stating "such deferrals are limited to incremental costs" (Staff BE at 69; *see also* Tr. 166). As Joint Petitioners stated in their Reply Brief in response to the same claim, Staff's position that the JP in Case 03-E-0765 only set targets for the costs of obtaining security services from outside vendors (Tr. 1666) is not supported by the relevant language of the JP, which states that "Security Costs are reconciled in total" (*Id.* at 391). Moreover, despite Mr. Haslinger's opposition to recovery of

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68 Over the last four years there has been only one event that accumulated over $250,000 in total costs and at the same time less than $250,000 in incremental costs.

69 Staff witness Mr. Haslinger also suggests that increased consumption and any "extra" revenue should offset the costs of the event (Tr. 387). While some customers may have increased their usage during this period, it certainly is not true for interrupted customers, and there is no record basis to determine how usage balanced out (*Id.* at 388). Moreover, if Staff's position were to be adopted, it would logically follow that storm-related incremental costs would have to include all lost revenues that RG&E has not taken in the past (*Id.*).

legitimate security costs, the Staff Policy Panel recognized the importance of maintaining the security of utility T&D assets and data systems (*Id.* at 1423-24). The Commission should encourage utilities, rather than hinder them, in their efforts to protect utility assets, such as the Ginna nuclear plant, from security risks. The Commission should decline to implement Staff's proposals.

c. The VYC Deferral

On exceptions, Staff reiterates the claim in its Initial Brief that RG&E's expenditures for *Voice Your Choice* ("VYC") were "excessive" and should not be deferred (Staff BE at 70; Staff IB at 188). These arguments are fully rebutted by Joint Petitioners' Initial and Reply Briefs, which demonstrate that the deferral is consistent with the operative rate plan (Tr. 1699; Joint Petitioners IB at 88; Joint Petitioners RB at 123). In summary, Joint Petitioners demonstrated that the VYC program for RG&E was developed in close coordination with Staff, was reviewed by Staff, was publicly lauded by then-Chairman Flynn and undeniably produced the results desired by Staff and the Commission (*Id.*; Exh. 40). Many years later, Staff cannot reach back and economically punish RG&E for cooperating with the Commission.

Staff also acknowledged in its briefs in this case that Staff "might have 'reviewed'" RG&E's outreach and education efforts, but it nonetheless argues that the Commission should not infer that Staff accepted the costs RG&E incurred (Staff BE at 70; Staff IB at 189-90). Staff has failed to demonstrate that RG&E's VYC expenditures were excessive and were inappropriately deferred, and Staff cannot reasonably do so since the media utilized and the outreach efforts were reviewed by Staff (Exh. 40). Staff could have challenged the use of particular media (in particular, television) had Staff felt that such media were too expensive or inappropriate to achieve the Commission's goals. Staff did not do so at the time, and Staff today has completely failed to show that it took any such action.[70]

Accordingly, Staff's challenge to RG&E's VYC deferral lacks any record support and should be denied.

Response No. 12: The Commission should reject Staff's revenue adjustments related to software costs.

In its Brief on Exceptions, Staff repeats its arguments in favor of eliminating capitalized software from rates (Staff BE at 71-72; Staff IB at 178). Staff proposes adjustments that exclude 100% of capitalized software from RG&E's and NYSEG's rate base and reduces RG&E's and NYSEG's depreciation expense by the annual amount of depreciation that is accrued on capitalized software (Tr. 374-75). These issues were previously litigated and resolved in Case 05-E-1222 and Staff's collateral attack in this proceeding should be rejected. The August 23, 2006 Order in Case 05-E-1222 clearly states, "We adopt the judges' recommendation to allow the Customer Care System to enter rate base given the evidence that the system has been placed into service…." The Order goes on to state "the total cost of this system compares favorably with the amounts that other firms have incurred for comparable systems."[71] All of the points raised by Staff (Staff BE at 72; Staff IB at 178) in this proceeding mirror those argued and lost by Staff during the Case 05-E-1222 proceeding. Furthermore,

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70 Staff's comparison of RG&E's VYC costs and NYSEG's costs is irrelevant (Staff BE at 70-71). The nature of the two service territories and the needs of the individual utilities' VYC programs differ. Thus, comparing NYSEG's expenses to RG&E's proves little since the media required to inform ratepayers varied. In particular, the television media necessary to reach RG&E's ratepayers effectively is more expensive than print media. To the best of RG&E's knowledge, the selection of specific media was made known to Staff prior to or around the time of placement with the various media outlets and Staff did not object.

71 Case 05-E-1222 - *Proceeding on Motion of the Commission as to the Rates, Charges, Rules and Regulations of New York State Electric & Gas Corp. for Electric Service, Order Adopting Recommended Decision with Modifications*, at 73 (Aug. 23, 2006).

virtually every utility in the State capitalizes major software costs and those costs are included in setting their rates.

Staff challenges NYSEG's capitalization of software costs from an angle it did not raise in Case 05-E-1222, namely that, "[w]hile NYSEG there was allowed to replace CCS costs in rate base, the accounting there amounted to deferral accounting…" (Staff BE at 73; Staff IB at 180). As is clear from the Commission's decision in Case 05-E-1222, however, the CCS costs represented a new investment in an asset that was capitalized and that was "placed into service"—a traditionally-accepted term referring to the capitalization of plant. Indeed, the titles of the basic capital investment accounts in the Commission's own Uniform System of Accounts for Account 101 are "Electric Plant in Service" and "Gas Plant in Service."

Staff also repeats the same inaccurate statement that "[t]he petitioners assert their interpretation of the NYSEG Electric Order also applies to the capitalization of software at RG&E" (*See* Staff BE at 72; Staff IB at 179). Joint Petitioners have made no such assertion. In fact, as the records in numerous other RG&E proceedings reflect, RG&E has been capitalizing software investments since the mid-1990s, during the period in which the Commission issued Orders and approved several rate plans.[72]

If the Commission determines that it is appropriate to reopen this issue, Staff's proposed adjustments should be revised to correct for the errors identified in Joint Petitioners' Reply Brief, *i.e.,* to include recovery of 100% of CCS software would result in a total decrease in RG&E's depreciation ($1.4 million electric and $749,000 gas) of approximately $2.1 million and a total decrease in RG&E's net plant ($11.6 million electric and $6.2 million gas) of approximately $17.9 million (Tr. 376; Joint Petitioners RB at 117-18).

[72] *See, e.g.,* Cases 95-E-0673, 95-G-0764, 96-E-0898, 02-E-0198, 02-G-0199, 03-E-0765, and 03-G-0766.

Staff's proposed capitalized software adjustment is also overstated (Tr. 377), although an accurate reconciliation of Staff's calculations is not possible because Staff did not provide any supporting documentation or workpapers. In light of the fact that (a) CCS is a legitimate capital cost to be included in rates, (b) RG&E's CCS went into service in October 2006, and (c) Staff was using calendar year 2006 data upon which it projected its forward-looking revenue requirements for RG&E, Staff should have made an adjustment to annualize CCS (Tr. 378). Depreciation expense should have been increased by $1.523 million (electric) and $820,000 (gas), and rate base should have been increased by $9.623 million (electric) and $5.181 million (gas).

Response No. 13: The Commission should reject Staff's proposed revenue adjustment to eliminate NYSEG Gas Pension Expense.

Staff's proposal to eliminate NYSEG gas pension deferral (Staff BE at 74-75; Staff IB at 215) should be rejected, because none of Staff's justifications for the elimination of the gas pension deferral is appropriate. As the RAP testified, the deferral is based on incremental or decremental changes from the assumed 9% return on assets and 6.75% discount rate (Tr. 369-70). The return on assets and the discount rate are intrinsic to actuarial calculations and are not "outdated." In fact, the financial data upon which the true-up is based are provided annually as part of the ACF submitted for Staff's review (Tr. 369). The NYSEG gas pension deferral in 2006 was $6.5 million. Thus, gas customer rates reflect pension income that is $6.5 million higher than actual pension income (*Id.*). This amount is significant for NYSEG's gas business, equaling 14% of gas earnings or 139 basis points on equity using NYSEG's 2006 annual compliance filing rate base and equity (*Id.* at 369-70).

Moreover, the fact that the approach used by NYSEG does not conform exactly to the Commission's Policy Statement on Pensions and OPEB ("Pension Policy Statement")[73] is not a justification for eliminating the deferral. There are many utility companies in New York that have some sort of variance or inconsistency from the Pension Policy Statement included in their approved rate plans and NYSEG's deferral methodology was approved by the Commission in Case 01-G-1668.

While Joint Petitioners agree that the appropriate place to address this issue is in a separate proceeding that would establish prospective gas rates, Staff's suggestion that NYSEG's Gas Rate Plan will expire simply as a result of the passage of time is incorrect. As noted in Section VI(2) of the Joint Proposal approved in Cases 01-G-1668 and 01-G-1683, "all Gas Rate Plan provisions shall continue beyond December 31, 2008 unless or until a new gas rate plan has been approved by the Commission."

In its rate adjustments, Staff also fails to reflect the removal of the gas pension deferral in its gas revenue requirement. The impact of the pension deferral increase amounts to 208 basis points using Staff's lower rate base and equity (Tr. 370; Exh. 125). Staff has overstated the NYSEG Gas ROE by 208 basis points, because it failed to adjust operating expenses to reflect its recommendation to eliminate deferred accounting for gas pension costs (Tr. 370). Accordingly, Staff's ROE schedules are erroneous and should not be relied upon in this proceeding.

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[73] Case 91-M-0890 - *Statement of Policy and Order Concerning Accounting and Ratemaking for Pensions and Post-Retirement Benefits Other than Pensions* (Sept. 7, 1993).

Response No. 14: Staff's ROE proposal is inadequately supported and should be rejected.

Staff has proposed a 9.0% ROE for NYSEG and RG&E (Staff BE at 75), but in doing so, offered no credible market analysis or other support for such an unreasonably low return. Staff's ROE proposal has no merit.

Staff's attempts to distinguish the 9.8% ROE granted in the *Grid/KeySpan Order* from the artificially low ROE of 9.0% it proposes to apply to NYSEG and RG&E in this case are unavailing (*Id.* at 75). While Staff asserts that only a one-year analysis is appropriate to support its 9.0% ROE, Staff fails to reconcile its use of a multi-year analysis in its attempt to demonstrate excessive earnings by NYSEG and RG&E. Staff's overearnings analysis is misleading because it includes historical earnings for years in which prior rate plans were in place, with expectations for higher returns. Staff also seeks to impose a lower return than in Grid/KeySpan by using a 38% equity ratio (*See* Tr. 1399). While Staff stated that the use of the actual capital structure in Grid/KeySpan was justified because Grid/KeySpan agreed to certain bankruptcy protection requirements (*see* Tr. 1577), Staff fails to explain why an actual capital structure should not be applied in this case in light of the fact that Joint Petitioners have agreed to adequate bankruptcy protection measures (*See* Joint Petitioners BE at 58-59).

Staff also tries to bolster its claim that a 9.0% ROE would be reasonable by referencing the slightly higher 9.1% ROE adopted in the recent Consolidated Edison rate case.[74] However, as Joint Petitioners explained in their Reply Brief, Moody's issued a new negative outlook and noted how markedly low this ROE level was for an electric utility:

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[74] Staff BE at 75-76 (citing Case 07-E-0513 [sic] - *Consolidated Edison Co. of New York, Inc., Electric Rates, Order Establishing Rates for Electric Service* (2008) (hereinafter "*Con Ed Rate Order*")).

> [Consolidated Edison's] electric rate case, which granted only about 35% of the $1.2 billion rate increase requested (new rates effective April 1, 2008), also based on a 9.1% allowed ROE (*reportedly the lowest ROE granted to an electric utility in over 30 years*).[75]

Thus, contrary to Staff's position, the *Con Ed Rate Order* does *not* demonstrate the reasonableness of an even lower ROE level here. Nor does Staff offer any rebuttal to Dr. Makholm's finding that Staff's ROE is markedly lower than returns approved for utilities in other states (Tr. 1065-66). Accordingly, the Commission must reject and give no weight to Staff's ROE arguments.

Response No. 15: Staff has failed to justify its proposal to eliminate the Gas Cost Incentive Mechanism ("GCIM").

The RD appropriately left intact NYSEG's and RG&E's GCIM 2 and the Commission should reject Staff's effort to have it eliminated. According to Staff, the GCIM 2 sharing mechanism should be eliminated because it is specific to Energy East and because it "unnecessarily over-compensates the two LDCs" for procuring and managing their gas supply which they are already required to do (Staff BE at 77; Staff IB at 217-18).

As Joint Petitioners explained in their Reply Brief, the Commission adopted NYSEG's GCIM 2 sharing methodology in Case 01-G-1668 and Case 04-G-1278, which increased the benefit to customers by allocating 56.25% to customers and 43.75% to shareholders (Joint Petitioners RB at 137; Tr. 384).[76] The new allocations and methodology for GCIM sharing were the result of numerous meetings during 2005 between NYSEG and Staff to resolve concerns related to GCIM classifications (Tr. 384-85). Staff recognized in those

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[75] *See* Joint Petitioners RB, Attachment 2, at 2 (emphasis added).

[76] Case 01-G-1668 and Case 04-G-1278 - *Proceeding on Motion of the Commission as to the Rates, Charges, Rules and Regulations of the New York State Electric & Gas Corporation for Gas Service and In the Matter of the Filing of Annual Reconciliations of Gas Expense and Gas Cost Recoveries, Order Approving Gas Cost Incentive Mechanism Methodology* (Oct. 7, 2005).

proceedings that it was appropriate to provide an incentive to NYSEG and RG&E to create gas supply savings based upon the joint optimization of Energy East LDC gas supply assets. Contrary to Staff's assumption, the rate plans in which the GCIM 2 was established will not expire as of December 31, 2008,[77] and the Commission should not discontinue the sharing mechanism which Staff aided in developing and agreed to less than three years ago.

If the Commission determines that it is appropriate to address Staff's proposed rate adjustments in its final decision, it should take into account the benefits that the GCIM 2 has created for customers since its adoption, and recognize that the savings were brought about because of the joint optimization of the combined Energy East LDC gas supply assets across several states which creates opportunities for NYSEG and RG&E to achieve savings which would not normally be available (Tr. 455). Although NYSEG and RG&E agree that they have an obligation to obtain gas supplies at the least cost, the Commission has recognized the importance of having an incentive mechanism so that NYSEG and RG&E will employ creative methods to pursue optimum levels of efficiencies for these assets (*Id.*).

Response No. 16: The Commission should reject each of Staff's rate proposals categorized as "Implementation of Commission Policies."

In its Brief on Exceptions, Staff addresses and improperly characterizes a number of topics, such as revenue decoupling mechanisms, capital expenditures, and certain retail access matters, as "Implementation of Commission Policies" (Staff BE at 78). These matters are in fact individual rate case issues that should be addressed, if at all, in subsequent rate proceedings.

a. Revenue Decoupling Mechanisms

As stated in Joint Petitioners' Brief on Exceptions, the RD correctly concluded that revenue decoupling mechanisms ("RDM") should be considered as part of NYSEG's and

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[77] *See* discussion *supra* Response No. 9.

RG&E's next rate cases (Joint Petitioners BE at 87). In developing the proposals for filing at that time, NYSEG and RG&E will review the Commission's precedent on RDM proposals, including, as Staff suggests, the 2007 Con Ed RDM (*See* Staff BE at 79).

b. Capital Expenditures

Staff continues to propose an asymmetrical reconciliation of capital expenditures for both gas and electric businesses at RG&E and NYSEG based on average planned capital spending (after adjusting for certain projects) (*See* Staff BE at 79-85; Staff IB at 194-99). As the RD recognized, such reconciliation is a rate plan issue that is appropriate for consideration in NYSEG's and RG&E's next rate case (RD at 142). At a minimum, there must be symmetrical reconciliation such that any overspending would be subject to a carrying charge as would any under spending (*See* Joint Petitioners RB at 140-42; Tr. 385-86).

In its Brief on Exceptions, Staff proposes that NYSEG and RG&E be required to file annually a five-year forecast of planned electric system upgrades (Staff BE at 80). The filing should forecast expected costs for each project and reconcile the prior year's construction with prior forecasts (*Id.*). While Joint Petitioners do not see the need for such additional reporting requirements, Joint Petitioners do not oppose providing additional capital expenditure information so long as such reports are granted appropriate trade secret status.

Staff repeats its assertion that "RG&E's capital expenditures substantially exceed the $280 million target, because the company has exceeded forecast costs for the [Rochester Transmission Project ("RTP")] by approximately 60%" and goes on to state that "the company may have improperly included software costs in its capital expenditures" (Staff BE at 82; Staff IB at 196). Staff's assertion is irrelevant. Moreover, Staff has been informed of the progress of the RTP throughout the history of the project and whether or not the RTP exceeded a circa-2002 forecast of costs is irrelevant despite Staff's insinuations to the contrary. Since the RTP is an approved and valid capital expenditure, and any given capital project may come in under budget or over budget, the costs of the RTP are appropriately included in the comparison to the $280 million target. As discussed above, software costs are properly included in capital expenditures and Staff's suggestion that they be excluded from the amount to be compared to the $280 million target is only intended to financially harm the utility.

c. Bill Issuance and Payment Processing

Once again, Staff insinuates that NYSEG's and RG&E's treatment of the Bill Issuance and Payment Processing ("BIPP") is in violation of a Commission order. Staff's allegation is simply untrue. As Joint Petitioners have repeatedly explained, NYSEG and RG&E have complied with all Commission orders in the Unbundling Track proceeding (Case 00-M-0504), including those related to unbundled cost of service and rate design and unbundled bill format (Tr. 170-73; Joint Petitioners IB at 111; Joint Petitioners RB at 151). NYSEG also complied with orders in its last electric rate case (Case 05-E-1222) that addressed and resolved BIPP matters (Tr. 171; Joint Petitioners IB at 111; Joint Petitioners RB at 151). Therefore, there is no reason (and no adequate grounds or evidence in the record) for the Commission to "insist that NYSEG and RG&E comply with established BIPP policy in Staff's rate plan process," as demanded by Staff in its Brief on Exceptions (Staff BE at 88), and Staff's BIPP proposals should be rejected outright by the Commission.

Importantly, the BIPP should not be addressed outside the context of a rate case for NYSEG and RG&E for the numerous reasons set forth by Joint Petitioners' Rate Design and Retail Access Panel (Tr. 173-75; Joint Petitioners IB at 111; Joint Petitioners RB at 151). This case is not and was never intended to be a rate case. Should the Commission find that Staff's position on BIPP warrants further review, any such review should take place as part of an 11-

month rate case, not in the expedited process proposed by Staff, for all of the reasons set forth above and in the testimony of Joint Petitioners' Rate Design and Retail Access Panel.

d. Further Unbundling Of Utility Rates

In its Brief on Exceptions, Staff states "[w]hile many of [the Energy East] utilities' charges have been unbundled from rates and are no longer subject to back-out credits, RG&E in particular should be required to file revised tariffs that convert all existing back-out credits to unbundled charges in a revenue neutral manner, including the merchant function credit and metering back-out credits" (Staff BE at 88). As discussed above, NYSEG and RG&E have complied with all relevant unbundling orders. For this reason and those set forth above, Staff's positions regarding the filing of tariffs should be outright rejected by the Commission.

Similar to the BIPP matters discussed above, unbundling is associated with revenue requirement and rate design and should only be considered, if at all, during NYSEG's and RG&E's next major rate case (Tr. 174; Joint Petitioners RB at 152). Thus, should the Commission find that Staff's position on further unbundling warrants further review, any such review should take place as part of an 11-month rate case, not the expedited process proposed by Staff.

e. ESCO Referral Program

The RD correctly stated that the ESCO Referral Programs suggested by Staff "are not listed as a condition ameliorating any harm from the merger, nor are they cited as benefits flowing from the merger" and, thus, the RD properly recommended that the Commission should address ESCO Referral Programs elsewhere (RD at 149). Staff's Brief on Exceptions does not address the RD's findings. Instead, Staff simply reiterates its prior argument and suggests that the Commission should "impose on NYSEG and RG&E requirements regarding ESCO Referral Programs that are similar to the requirements the Commission imposed on KeySpan and NFG, for implementation in Staff's rate plan process" (Staff BE at 89). Staff, therefore, apparently agrees that the ESCO Referral Program proposals are unrelated to the Proposed Transaction and do not belong in this proceeding.

Joint Petitioners have also shown that there is no evidence in the record to support Staff's proposed ESCO Referral Program collaborative. Throughout this proceeding (and as repeated in Staff's Brief on Exceptions), Staff's only rationale for its proposal was that other utilities were required to undertake an ESCO Referral Program collaborative. As Joint Petitioners have shown, there is no analysis of NYSEG's and RG&E's existing retail access programs and practices, and no discussion of why NYSEG and RG&E should engage in a new round of discussions; nor is there any filing proposing an ESCO Referral Program, or other evidence in the record in this proceeding to support a finding that NYSEG and RG&E must initiate an ESCO Referral Program collaborative (Joint Petitioners IB at 111-12; Joint Petitioners RB at 152-53). In combination with the RD's recommendation that the proposal is unrelated to the merger, Staff's proposal should be outright rejected by the Commission.

In the alternative, the Commission could find that NYSEG's existing ESCO Introduction Program collaborative is appropriate and should be continued. If the Commission decides to modify RG&E's Supply Service program, it should adopt a similar program for RG&E instead of an ESCO Referral Program.

If, however, the Commission decides that Staff's ESCO Referral Program should be further considered and addressed in another proceeding, the appropriate place to do so is any subsequent NYSEG and RG&E 11-month rate case (as compared to Staff's expedited rate process, which as explained above, should not be adopted by the Commission).

f. AMI

Staff asserts in its Brief on Exceptions, that a careful approach to the AMI issue is needed and therefore AMI should be excluded from any subsequent rate process (Staff BE at 91). Staff also states that "[c]onsideration of those issues should be postponed until additional proceedings on AMI have been conducted; proposals to install AMI in the NYSEG and RG&E service territories have been carefully analyzed; and, all of the questions Staff has raised here have been answered" (*Id.*). NYSEG and RG&E still believe that AMI provides important electric infrastructure and customer benefits, but recognize that no progress will be made until the Commission resolves its apparent opposition to AMI. Joint Petitioners, therefore, agree with Staff that the issues surrounding AMI require additional review and should be addressed in other proceedings (*See also* Joint Petitioners RB at 137).

g. Low-Income Program

Staff's Brief on Exceptions proposes that its low-income program proposals should be addressed, "[a]s with all other rate issues related to this proceeding," as part of the "Staff rate plan process" (Staff BE at 92).

As Joint Petitioners have shown, there is no record evidence to support Staff's proposals (Joint Petitioners RB at 139). Given the lack of evidence to support Staff's proposals and lack of any relationship to the Proposed Transaction, the Commission should outright reject Staff's low-income proposals. However, should the Commission decide that the issues should be reviewed further, the appropriate place to do so is NYSEG's and RG&E's next 11-month rate case. Low-income programs should not be addressed (nor should any other rate case type item) in an expedited proceeding as advocated by Staff, for all of the reasons discussed above.

h. Economic Development Programs

Similar to low-income programs, Staff in its Brief on Exceptions states that NYSEG and RG&E should be directed to address economic development programs and economic development spending in the "rate plan process" proposed by Staff. Through this statement, Staff appears to concede that any economic development programs are unrelated to the merger. Given this apparent concession, the Commission should outright reject any Staff proposal on this topic. Moreover, if the Commission finds that this topic is appropriate for any subsequent rate proceeding, the Commission should reject Staff's "expedited rate plan" concept and find that the subsequent proceedings should utilize the traditional 11-month rate case process, as proposed by the ALJ.

i. Outreach and Education Plan Filings

In its Brief on Exceptions, Staff notes that NYSEG and RG&E oppose additional reporting, but states that "[a]s regulated utilities, however, they are required to provide the information necessary for Staff to perform its oversight function" (Staff BE at 93). Staff not only misses the point of Joint Petitioners' arguments in this proceeding on Outreach and Education Plan Filings – that adequate reporting already exists – but also, as it has done throughout this proceeding, provides no support for its position and fails to rebut Joint Petitioners' valid reasons why such additional reporting should not be required. Joint Petitioners have shown that the content of NYSEG's and RG&E's current overall outreach and education plan filings, which include budgets for certain initiatives, is sufficient (Tr. 137-38; Joint Petitioners RB at 140). Staff apparently agrees, because when asked in an interrogatory about Staff's proposed plan, Staff simply referred NYSEG and RG&E to their prior filings (Tr. 138; Exh. 8 at 48; Joint Petitioners RB at 140). There is no basis in the record to the contrary that would support adoption of Staff's recommendation, and it should be rejected outright by the Commission.

If, however, the Commission finds that this topic is appropriate for any subsequent rate proceeding, the Commission should reject Staff's "expedited rate plan" concept and find that the subsequent proceedings should utilize the traditional 11-month rate case process, as proposed by the ALJ.

H. SERVICE QUALITY ISSUES

Response No. 17: The Commission should reject the service quality measures Staff improperly seeks to impose in this proceeding.

The RD appropriately declines to recommend Staff's[78] proposed "enhancements" to NYSEG's and RG&E's service quality measures in the areas of gas safety and reliability, customer service, and electric reliability that are in place under their current rate plans.[79] To persuade the Commission to adopt the revised metrics, Staff resurrects its arguments for enhancements from its Initial Brief (Staff BE at 52-61). Staff continues its "one size fits all" approach by urging the Commission to use basis point rate assessments that are modeled on the Grid/KeySpan merger, and argues that more stringent metrics are needed because Iberdrola's acquisition of Energy East "creates incentives for the parent to squeeze capital out of the New York subsidiaries by cutting operational costs…" (*Id.* at 52). The evidence demonstrates that Staff's persistent comparison between the Grid/KeySpan merger and the Proposed Transaction is

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[78] Multiple Intervenors merely reiterates Staff's flawed arguments and provides no support for the adoption of any specific performance standards or revenue adjustments (MI BE at 13-19).

[79] Case 01-G-1668 - *Proceeding on Motion of the Commission as to the Rates, Charges, Rules and Regulations of New York State & Electric Corporation for Gas Service, Order Establishing Steel Mains Replacement Program* (Nov. 7, 2005) (hereinafter "*2005 NYSEG Order and JP*"); Case 03-G-0766 - *Proceeding on Motion of the Commission as to the Rates, Charges, Rules and Regulations of Rochester Gas and Electric Corporation for Gas Service, et al., Order Adopting Provisions of Joint Proposals With Conditions* (May 20, 2004) (hereinafter "*2004 RG&E Order and JP*").

inappropriate, and that there is no justification for imposing on NYSEG and RG&E the same changes to service quality measures and revenue adjustments adopted by the Commission in the *Grid/KeySpan Order* (where, unlike here, there were known service quality issues). To the extent that the Commission finds any of Staff's recommendations worthy of consideration (which, for the reasons set forth below and in Joint Petitioners' post-hearing briefs, they are not), it should address such matters in separate rate proceedings to be commenced after the close of the Proposed Transaction.

a. Gas Safety And Reliability

There is no justification for imposing on NYSEG and RG&E the doubling, tripling, quadrupling mechanism adopted in the *Grid/KeySpan Order* for failure to meet gas safety and reliability targets (*See* Staff BE at 51). Despite Staff's rhetoric, the superior performance of NYSEG and RG&E compared to National Grid and KeySpan is apparent from Staff's own report (Exh. 18). For example, in the area of mismarks, Staff stated, "NGRID remains an outlier . . . with the lowest measure of performance among the LDCs" (Exh. 18 at ii, 10). In excavation errors, Staff also noted, "KeySpan continues to experience more than double this type of damage than most of the other LDCs" (*Id.* at ii, 17). Finally, in the area of backlogs, Staff noted that KeySpan "continues to have high repairable leak backlogs" (*Id.* at 26). A review of the various tables throughout the report, for virtually every category measured, also demonstrates that NYSEG's and RG&E's performance does not present any cause for concern. NYSEG's and RG&E's performance certainly does not warrant the same level of revenue adjustments adopted in the *Grid/KeySpan Order* for entities that Staff has acknowledged required significant improvement.

There is no evidence to substantiate Staff's charge that Iberdrola will be able to cut operational costs (Staff BE at 52) and, therefore, Staff's claim that "Iberdrola will squeeze capital out of the New York subsidiaries" (*id.*) is without basis, explanation or logic and should be ignored. In fact, Joint Petitioners have told the Commission that no change in NYSEG's and RG&E's operations is anticipated as a result of the Proposed Transaction (Exh. 41, at 16-17). Staff argues that this is inconsistent with Joint Petitioners' statements that it will share information regarding best practices (Tr. 204-05). Contrary to Staff's criticism, sharing of information regarding best practices is not the same as identifying known mechanisms to improve performance. The important point here is that the evidence is clear that NYSEG's and RG&E's performance will not deteriorate after the closing of the Proposed Transaction, because they will benefit from Iberdrola's global experience and expertise (Tr. 253).

During the evidentiary hearings, Joint Petitioners' Gas Safety Panel acknowledged the minor error in its prefiled testimony that, in addition to NYSEG and RG&E, two other utilities were not required to self-assess their performance (Tr. 230). This misstatement does not "undermine" (Staff BE at 54) the fundamental point, however. Simply because two other utilities (in addition to NYSEG and RG&E) performed well enough to avoid self-assessments does not diminish the positive performance associated with NYSEG and RG&E. In either case, the principle remains the same – several of the State's utilities, including KeySpan and National Grid, were directed to submit action plans to improve their performance, but NYSEG's and RG&E's superior performance exempted them from this requirement (*See* Exh. 18, at 27).

In its Brief on Exceptions, Staff also continues to fixate on a minor discrepancy between the number of gas services indicated on Exhibit 18 and in NYSEG's and RG&E's testimony (Staff BE at 54), which Joint Petitioners have explained is due to a simple typographical error: the figure "2,196" for gas services on Exhibit 22 should have been "2,169"

(Tr. 242). Moreover, this transposition error has no significance because NYSEG's goal is to accomplish 2,000 gas service replacements each year for five years, and never to replace fewer than 1,900 in a given year, which makes the discrepancy between 2,196 and 2,169 moot.[80]

Staff continues to belabor the same point it raised in its Initial Brief about its recommendation to increase capital spending by $1.6 million (Staff BE at 54). Staff's recommendation ignores the explanation in Joint Petitioners' Reply Brief that Staff's $1.6 million per year estimate fails to take into account the costs of replacing pipe for highway projects (Tr. 212-13; 231-39). NYSEG and RG&E are each required to replace a certain number of miles of bare steel mains, ineffectively coated steel mains, and cast-iron mains.[81] Because NYSEG's cast iron pipe was completely replaced in 2005, the Gas Rate Plan JP was renegotiated for the remaining rate period ending December 2008.[82] Under the 2005 Order and JP, NYSEG is required to replace a minimum of 15 miles of bare steel and ineffectively coated gas mains each year.[83] RG&E must also replace a minimum of 15 miles of bare steel, ineffectively coated gas mains and cast iron mains each year; but if any of the pipe is replaced in conjunction with a highway project, RG&E is not permitted to count the highway mileage toward the 15 mile mandate (Tr. 231). Staff's estimate of $1.6 million per year in Exhibit 18 is artificially low because it is incorrectly derived by taking the *total* mileage of mains replaced at RG&E for both categories (highway and non-highway projects), and only dividing that total by the funds

80 Case 01-G-1668 - *Proceeding on Motion of the Commission as to the Rates, Charges, Rules and Regulations of New York State Electric and Gas Corporation for Gas Service, Joint Proposal dated September 12, 2002, Order Establishing Rates*, at 5, Item 2(a) and (b) *(*Nov. 20, 2002) ("*2002 NYSEG Order and JP*").

81 *2005 NYSEG Order and JP,* Appendix A, at 3, § B.1.a; *2004 RG&E Order and JP*, at 21, §XVII 4 (c) 1.

82 *2005 NYSEG Order and JP*.

83 *2005 NYSEG Order and JP,* Appendix A, at 3, § B.1.a.

expended on non-highway projects, which results in a lower average cost of replacement (*Id.* at 213).

Staff's assertion that construction in 2007 declined compared to 2006 is erroneous (Staff BE at 55-56). As NYSEG and RG&E have previously explained, the fact that the number of one-calls in 2006 (117,890) was approximately the same as, or slightly higher than, in 2007 (116,483), does not mean that the level of construction that occurred in 2007 was the same as or lower than in 2006 (Staff IB at 204). In repeating the incorrect assertion that the "deterioration" in performance cannot be traced to an increase in one-call activity, Staff completely disregards the testimony that much of the construction related to the one-calls that were received in 2006 did not take place in 2006 and was deferred until 2007 (Tr. 218). The alleged deterioration in NYSEG's and RG&E's performance in 2007 compared to 2006 was also negligible, despite Staff's exaggerated rhetoric, and NYSEG's and RG&E's 2007 results were still well within their current targets.

Staff's assertion that NYSEG's and RG&E's rate plans are now out of date and irrelevant is erroneous (Staff BE at 56). As recently as 2005, the Commission adopted revised gas safety metrics for NYSEG that were agreed to by Staff.[84] Moreover, the targets for both companies continue in effect through 2008 and from year to year thereafter, unless modified by the Commission.

b. Customer Service Performance

In its Brief on Exceptions, Staff summarizes its position on customer service performance as follows: (1) service quality measures for NYSEG and RG&E should be made consistent with each other; (2) a new Escalated Complaint Response Time should be added to

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[84] *2005 NYSEG Order and JP*.

both NYSEG's and RG&E's measures; and (3) the current rate adjustment assessments should be doubled (Staff BE at 57-59).[85] In support of its position, Staff once again looks to the *Grid/KeySpan Order*, asserts that the new Escalated Complaint Response Time measure is justified, and alleges that its proposed additional reporting requirements are needed to alert Staff to any degradation of customer service. Staff also states that NYSEG and RG&E overstate their past performance. Staff, however, fails to rebut Joint Petitioners' showing that:

- RG&E and NYSEG have consistently exceeded their targets for all performance measures (with a limited exception that has been adequately explained and on which progress has been made). Staff testified that NYSEG's and RG&E's performance has been satisfactory (with the one limited exception) and offers no justification for its proposal to make the service quality measures consistent. NYSEG and RG&E provided convincing reasons for separate metrics for each company (Tr. 122-24, 126-28, 134; Exh. 9; Joint Petitioners IB at 106-07; Joint Petitioners RB at 148-49);

- No other utility has an Escalated Complaint Response Time metric, and Staff provides no evidence to warrant adoption of the metric (Tr. 129; Joint Petitioners IB at 107-08; Joint Petitioners RB at 148); and

- Staff's sole reasoning for its service quality proposals – that the Commission imposed service quality conditions in the Grid/KeySpan merger – is misplaced. As Joint Petitioners have explained repeatedly, the Proposed Transaction does not present the same risks as the Grid/KeySpan merger (Tr. 933, 959-64; Joint Petitioners IB at 108). Moreover, in direct contrast to NYSEG's and RG&E's high-quality service, Staff raised specific concerns in the Grid/KeySpan merger proceeding regarding Niagara Mohawk's declining service quality (Tr. 132; Joint Petitioners IB at 108-09; Joint Petitioners RB at 147-48).

Given that Staff's proposals are unsupported by the record evidence and are arbitrary, the Commission should reject them outright.

c. Electric Reliability

Staff explains in its Brief on Exceptions that it proposes to continue the existing reliability performance mechanisms for NYSEG and RG&E, but it proposes to increase the

[85] While Staff doubles the proposed amount at risk for RG&E Electric and RG&E Gas, the proposed amount at risk for NYSEG Electric more than doubles and for NYSEG Gas it is almost five times more the current total amount at risk.

associated revenue adjustments (Staff BE at 60-61). Staff proposes for NYSEG and RG&E the same doubling mechanism adopted in the Grid/KeySpan merger proceeding (*i.e.*, by doubling the amount at risk, and doubling the amount at risk again in any year subsequent to a year in which a target is missed). Staff attempts to justify its proposal by stating that "[a]n electric reliability performance mechanism is a common feature of electric utility rate plans" and "the characteristics of Iberdrola's proposed acquisition strongly resemble the circumstances at issue in the KeySpan/Grid Order…" (*Id.*). Staff is wrong for two reasons.

First, this proceeding is not a rate case and, as Joint Petitioners have repeatedly stated, rate case matters in general are unrelated to the consideration of whether the Proposed Transaction meets the PSL Section 70 public interest standard (*See, e.g.*, Joint Petitioners IB at 87, 98).

Second, Staff continues incorrectly to rely on the *Grid/KeySpan Order*, because distinct electric reliability shortcomings on the part of National Grid were addressed in that proceeding. As Joint Petitioners have explained at length, the Proposed Transaction is very different from and does not present the risks involved in the Grid/KeySpan transaction (Joint Petitioners IB at 98-101; Joint Petitioners RB at 149-50). As for electric reliability in particular, Staff continues to ignore the fact that the Commission was very concerned about Niagara Mohawk's declining performance (Joint Petitioners IB at 100-01; Joint Petitioners RB at 150). Similar concerns do not exist in this proceeding in light of NYSEG's and RG&E's history of exceeding their electric reliability targets – a point Staff concedes (Tr. 146; 1857-59).

In addition to being unrelated to this proceeding, Staff's proposals are unsupported by the record evidence and are arbitrary. Accordingly, the Commission should reject Staff's electric reliability proposals outright.

I. RG&E'S SUPPLY SERVICE PROGRAM

Response No. 18: Joint Petitioners agree that the Commission should address the RG&E Supply Service program.

Staff asserts that the configuration of RG&E's Fixed Price Offer ("FPO") for electric supply service should be decided in this proceeding in order to commence the sign-up period by October 1, 2008, with new prices effective January 1, 2009 (Staff BE at 50, 61). Notwithstanding Joint Petitioners' disagreement with Staff's characterizations of the RG&E FPO, Joint Petitioners agree that it would be preferable to have the Commission address the RG&E Supply Service program in this proceeding in order to allow for the introduction of the revised program in October 2008.

The revisions to the RG&E Supply Service program would include adoption of a fixed non-bypassable charge ("NBC") subject to annual reconciliation, open enrollment, and a revised earnings sharing mechanism ("ESM").[86] All downside risk will be borne by shareholders. Under the ESM, 85% of overearnings would accrue to ratepayers and 15% to shareholders, above a threshold level of $6.0 million of pre-tax earnings that will be retained by shareholders.[87] Joint Petitioners also propose implementation of a Price-to-Compare program for RG&E consistent with the Price-to-Compare proposal filed by NYSEG on November 30, 2007, and approved by the Commission, in Case 07-E-0479. RG&E would also agree to pursue development of an ESCO Introduction Program consistent with that proposed for NYSEG. The ESCO Introduction Program would replace the controversial ESCO Referral Program and could

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86 RG&E's existing ESM would still be subject to the total commodity and delivery thresholds specified in the JP for its current rate plan.

87 RG&E's 2007 electric rate base ($902,598,000) is approximately 60% of the electric rate base of NYSEG ($1,517,817,000). Accordingly, the threshold under the ESM for RG&E ($6 million) should be set at 60% of the threshold adopted for NYSEG (*i.e.*, $10 million).

be developed in a subsequent collaborative, consistent with the ALJ’s determination to defer any decision on the ESCO Referral Program to a later time.

III. CONCLUSION

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

Respectfully submitted,

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