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**Via Hand Delivery**

April 11, 2008

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

Re: Case No. 07-M-0906 – Joint Petition of IBERDROLA, S.A., Energy East Corporation, RGS Energy Group, Inc., Green Acquisition Capital, Inc., New York State Electric & Gas Corporation and Rochester Gas and Electric Corporation for Approval of the Acquisition of Energy East Corporation by IBERDROLA, S.A.

Dear Secretary Brillig:

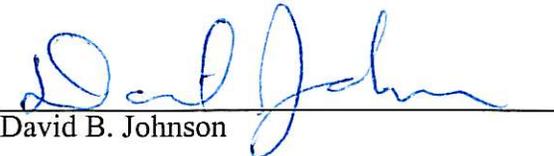
Enclosed is an original and 25 copies of the *INITIAL BRIEF OF INDEPENDENT POWER PRODUCERS OF NEW YORK, INC.*, filed in the above-referenced proceeding.

Thank you.

Respectfully submitted,

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

By:

  
David B. Johnson

Enclosures

cc: Hon. Rafael Epstein (*Via Hand Delivery; w/enc.*)  
Leonard Van Ryn, Esq. (*Via Hand Delivery & Electronic Mail; w/enc.*)  
Active Parties (*Via Electronic Mail and/or U.S. Mail; w/enc.*)

STATE OF NEW YORK  
PUBLIC SERVICE COMMISSION

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

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Case 07-M-0906

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

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Dated: April 11, 2008  
Albany, New York

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STATE OF NEW YORK  
PUBLIC SERVICE COMMISSION

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

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Case 07-M-0906

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

**INTRODUCTION**

Independent Power Producers of New York, Inc. (“IPPNY”), by its counsel, Read and Laniado, LLP, hereby submits this Initial Brief in the above-captioned proceeding. IPPNY is a not-for-profit trade association representing the independent power industry in New York State. Its members include more than 100 companies involved in the development, operation and ownership of electric generators and the marketing and sale of electric power in New York’s wholesale and retail markets, including the markets in the service territories of Joint Petitioners New York State Electric & Gas Corporation (“NYSEG”) and Rochester Gas and Electric Corporation (“RG&E”).

IPPNY strongly favors the continued development of a fully competitive electric market in New York. Competitive electric markets lead to more efficient operations and support lower utility bills for customers, a better climate for companies seeking to do business in the State, and a healthier State economy overall. IPPNY has been a strong supporter of the Public Service Commission’s (“Commission”) long-standing policy separating generation from transmission

and distribution (“T&D”) to eliminate the potential that T&D utilities that own generation could exercise vertical market power (“VMP”) to the detriment of wholesale competitive electricity markets and consumers.<sup>1</sup> The Commission’s policy on VMP assures energy market participants considering doing business or making further investments in the State that the Commission is committed to a competitive electric market. Divestiture also increases the number of competing generation companies “which can result in a dynamic and aggressive market.”<sup>2</sup>

On June 25, 2007, Energy East Corporation (“Energy East”), the ultimate parent of NYSEG and RG&E, Iberdrola, S.A. (“Iberdrola”) and Iberdrola’s wholly-owned subsidiary Green Acquisition Capital, Inc. (“Merger Sub”) (collectively, the “Joint Petitioners”) entered into an Agreement and Plan of Merger (“the “Merger Agreement” or the “Transaction”). The Merger Agreement provided that the acquisition of Energy East by Iberdrola would be consummated by Merger Sub merging into Energy East. Energy East would then be a wholly-owned subsidiary of Iberdrola, while NYSEG and RG&E would continue to be wholly-owned subsidiaries of Energy East.

On August 1, 2007, the Joint Petitioners filed a Joint Petition with the Commission seeking the Commission’s approval of the Transaction pursuant to Section 70 of the New York State Public Service Law (“PSL”). After settlement discussions failed, evidentiary hearings were held in Albany, New York between March 17 and March 20, 2008. Following the hearings, Administrative Law Judge (“ALJ”) Rafael Epstein adopted a schedule for the parties to submit post-hearing briefs, pursuant to which IPPNY submits this Initial Brief.

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<sup>1</sup> Case 96-E-0900 *et al.*, *In the Matter of Orange & Rockland Utilities, Inc.’s Plans for Electric Rate Restructuring Pursuant to Opinion 96-12*, Appendix I, Statement of Policy Regarding Vertical Market Power (July 17, 1998) (hereinafter “VMP Order”; Appendix I, hereinafter “VMP Statement”).

<sup>2</sup> Cases 94-E-0952, *et al.*, *In the Matter of Competitive Opportunities Regarding Electric Service*, Opinion and Order regarding Competitive Opportunities for Electric Service, Opinion 96-12 (May 20, 1996), p. 65. (hereinafter “Opinion 96-12”).

On the eve of the hearings, March 14, 2008, the Joint Petitioners submitted a Partial Acceptance Document (“PAD”) to the ALJ and the parties, in which they unilaterally accepted certain conditions proposed by Department of Public Service Staff (“DPS Staff”) and intervenors, which they now agreed should be included in a Commission order approving the Transaction (Exh. 50). In the PAD, Joint Petitioners pledged, *inter alia*, to competitively bid and auction RG&E’s 257 MW coal-fired Russell Station, the 63 MW Allegany Station, the 14 MW Peaker Station 3, the 14 MW Peaker Station 9 and Cayuga Energy’s 67 MW Carthage Peaking Unit (collectively, the “Fossil Generation Facilities”), if the Commission approved the Transaction.<sup>3</sup>

While IPPNY supports the Joint Petitioners’ commitment to divest the Fossil Generation Facilities, their commitment does not go far enough to comply with the Commission’s long standing policy that generation should be separate from transmission and distribution. In the Commission’s seminal order on competition, the Commission established its policy for the creation of a competitive wholesale generation market, finding that competitors would have a greater incentive to lower costs than utilities under cost of service regulation, which would inure to the benefit of New York’s consumers.<sup>4</sup> The Commission also recognized that the most efficient means of selecting new resources was via the competitive market. Further, the Commission found that one of the primary benefits of competitive markets is that investment risks shift from captive utility ratepayers to private investors.<sup>5</sup> Thus, it strongly favored divestiture of generation by the electric utilities.

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<sup>3</sup> Exh. 50, p. 1. As discussed at length herein, RG&E already had a pre-existing obligation to divest the Russell Station upon the completion of the Rochester Transmission Project (“RTP”).

<sup>4</sup> Opinion 96-12 p. 32.

<sup>5</sup> *Id.*, pp. 30-31, 54-55.

Two years later, the Commission further defined its pro-competition policies by adopting its VMP Policy Statement. The Commission again emphasized the importance of structural separation of generation from transmission and distribution:

In creating a competitive electric market, the Commission has viewed divestiture as a key means of achieving an environment where the incentives to abuse market power are minimized. Recognizing that vigilant regulatory oversight cannot timely identify and remedy all abuses, it is preferable to properly align incentives in the first instance.<sup>6</sup>

As more fully described below, the Commission established a rebuttable presumption that allowing one entity to own both transmission and generation would unacceptably exacerbate the potential for VMP.<sup>7</sup>

The Commission recently reaffirmed its VMP policy when it conditioned the approval of the merger of National Grid PLC (“National Grid”) and KeySpan Corporation (“KeySpan”) on National Grid’s agreement to divest KeySpan’s 2,450 MW Ravenswood generating facility.<sup>8</sup> Finding other alternatives insufficient to adequately address VMP concerns, the Commission held: “We agree with IPPNY and others that a decision by us to rely solely on regulatory solutions would signal and in fact would amount to a weakening of our resolve to ensure a competitive generation market and its attendant benefits.”<sup>9</sup>

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<sup>6</sup> VMP Statement p. 1; *see also*, VMP Order p. 3.

<sup>7</sup> *Id.*, p. 1-2.

<sup>8</sup> Case 06-M-0878, *Joint Petition of National Grid PLC and KeySpan Corporation for Approval of Stock Acquisition and Other Regulatory Approvals*, Order Authorizing Acquisition Subject to Conditions and Making Some Revenue Requirement Determinations for KeySpan Energy Delivery New York and KeySpan Energy Delivery Long Island (September 17, 2007) (hereinafter “Grid/KS Merger Long Order”).

<sup>9</sup> *Id.*, p. 134.

As discussed below and in the Direct Testimony of Mr. Mark D. Younger in this proceeding, consistent with the Commission's long-standing policy to separate generation from transmission, the Commission should require, as a condition to any order approving the Transaction, that: (i) Joint Petitioners file with the Commission (no later than a date to be specified in the Commission's Order) their process to auction to an unaffiliated third party the Fossil Generation Facilities and NYSEG's and RG&E's hydroelectric generation facilities<sup>10</sup> (collectively, the "Existing Generation"), which process shall include a detailed time line with milestones, that provides for the consummation of the sale of the Existing Generation within nine months of the Commission's ruling on the Transaction; (ii) Joint Petitioners and their affiliates will not, and will not seek to, construct, acquire or otherwise own any interests in any electric generating facilities interconnected with RG&E's or NYSEG's transmission or distribution system, unless ordered by the Commission; and (iii) Joint Petitioners and their affiliates will not, and will not seek to, construct, acquire or otherwise own any interest in any electric generation in New York that is subject to cost-based rate regulation, unless ordered by the Commission. These measures are necessary to ensure that Joint Petitioners will not be able to harm the competitive electricity markets and consumers by exercising VMP and/or owning rate-based electric generating facilities.

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<sup>10</sup> The following hydroelectric facilities are owned by NYSEG and RG&E: NYSEG: Cadyville 1-3 (5.5 MW); High Falls 1-3 (15.0 MW); Kent Falls 1-3 (12.4 MW); Lower Saranac 1-3 (6.7 MW); Mechanicville 1-2 (16.4 MW); Mill C 1-3 (6.0 MW); Rainbow Falls 1-2 (2.6 MW); RG&E: Station 2, 26, 5 (53.3 MW).

**I. THE COMMISSION SHOULD REQUIRE THAT, AS A CONDITION OF TRANSACTION APPROVAL, NYSEG AND RG&E DIVEST THEIR EXISTING FACILITIES TO UNAFFILIATED THIRD PARTIES WITHIN NINE MONTHS OF THE COMMISSION'S ORDER.**

In their PAD, the Joint Petitioners agreed to competitively bid and auction the Fossil Generation Facilities if the Commission approves the Transaction “subject to reasonable protocols determined by the Commission, which should provide that such assets would not be sold below book value.”<sup>11</sup> Divestiture is consistent with the Commission’s policy of protecting consumers from the exercise of VMP and encouraging competitive electric markets in New York State.<sup>12</sup> The PAD does not go far enough, however, to avoid the incentive for market power abuse and the opportunity to exercise VMP.<sup>13</sup>

VMP occurs when an entity that has market power in one stage of the production process leverages that power to gain advantage in a different stage of the production process. “A [T&D] company with an affiliate owning generation may, in certain circumstances, be able to adversely influence prices in that generator’s market to the advantage of the combined operation.”<sup>14</sup> As part of the Section 70 approval process, the Commission’s VMP policy places a high burden on the proponents of proposals to own both transmission and generation:

To guard against undesirable incentives, a rebuttal [*sic*] presumption will exist for purposes of the Commission’s Section 70 review of the transfer of generation assets, that ownership of generation by a T&D company affiliate would unacceptably exacerbate the potential for vertical market power. To overcome the presumption the T&D company affiliate would have to demonstrate that vertical market power could not be exercised because the circumstances do not give the T&D company an opportunity to exercise

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<sup>11</sup> See Exh. 50, p. 1.

<sup>12</sup> Opinion 96-12, p. 32.

<sup>13</sup> *Id.*, pp. 65-66; VMP Order, pp. 3-4.

<sup>14</sup> See VMP Statement, p. 1.

market power, or because reasonable means exist to mitigate market power. Alternatively, the T&D company would need to demonstrate that substantial ratepayer benefits, together with mitigation measures, warrant overcoming the presumption.<sup>15</sup>

The Commission has identified various forms of VMP. There is potential for VMP when, first, utility owned generation is in the same market as the T&D utility and second when utility owned generation is on the high side of a transmission constraint. In both instances, the T&D utility and its affiliates may use its ownership of generation assets to thwart competition, or to increase constraints within the system, thereby raising the value of its own generation assets (Tr. 905-906; *see also* VMP Statement, p. 1).

Since opening the electric market to competition in New York State more than a decade ago, the T&D utilities within the State have divested essentially all of their generation.<sup>16</sup> As recently as last fall, the Commission reaffirmed its policy favoring divestiture:

For more than 12 years, this Commission has taken numerous actions to develop competitive markets for generation products in New York. The long-term goal is that customers should be able to obtain generation products by paying prices resulting from a fully competitive generation market in lieu of regulated prices (or rates) based on the costs of generation.<sup>17</sup>

Indeed, the Commission has recently put forward a process to develop a long range plan for electric resources in the state. The Order continues the Commission's previous policies supporting competitive markets and market mechanisms as the most efficient means to serve the public and to fulfill the Commission's mission to provide "safe and adequate service at just and

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<sup>15</sup> *Id.*, p. 1-2.

<sup>16</sup> The one notable exception is Consolidated Edison of Company of New York, Inc. ("Con Edison"), which has been permitted to retain a small subset of its generation portfolio because it is needed to serve its steam system needs in New York City.

<sup>17</sup> Grid/KS Merger Long Order, p. 128.

reasonable rates.”<sup>18</sup> Requiring the prompt divestiture of the Existing Generation is important to prevent the opportunity for the exercise of VMP so that the benefits available from the competitive markets can continue to be realized by customers.

**A. The Commission Should Require NYSEG and RG&E To Divest Their Hydroelectric Facilities.**

To avoid the potential exercise of VMP, it is important for the Joint Petitioners to divest all of NYSEG’s and RG&E’s generation, including their hydroelectric plants, to an unaffiliated third party. As DPS Staff’s Policy Panel testified in this proceeding:

[Should the hydro and gas peaking facilities owned by RG&E and NYSEG be sold?] Yes. There is a market for even small hydro and gas peaking facilities. Other utilities like Niagara Mohawk and Orange and Rockland sold such facilities when divesting their other generation facilities. More recently, Orange and Rockland’s former hydro and gas peaking facilities were sold to a new owner, Central Hudson successfully sold a small hydro facility, and there have been other similar transactions. With the sale of these facilities, Energy East would exit the generation market entirely, eliminating incentives to exercise VMP to the detriment of ratepayers and ending disputes over VMP issues (Tr. 1420-1421).

After divesting the hydroelectric facilities to an unaffiliated entity, NYSEG and RG&E can still maintain the benefits to customers of low-cost renewable resources by executing a long-term contract with the new owner of the hydroelectric facilities, as the Joint Petitioners have proposed to do with the new owners of divested fossil plants (Tr. 609-610; 692-693). Additional benefits could also accrue to ratepayers if the new owner redeveloped or enlarged the hydroelectric facilities (Tr. 694).<sup>19</sup> Such benefits could include a greater percentage of electricity being supplied by a renewable resource, which furthers the State’s renewable energy goals.

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<sup>18</sup> Case 07-E-1507 *et al.*, *Proceeding on Motion of the Commission to Establish a Long-Range Electric Resource Plan and Infrastructure Planning Process*, Order Initiating Electricity Reliability And Infrastructure Planning (December 24, 2007) (hereinafter “ERP Order”), pp. 4-5.

<sup>19</sup> The viability of a new owner of RG&E’s hydroelectric facilities increasing their capacity is demonstrated by RG&E’s announcement on April 4, 2007 that it “plans to invest more than \$20 million over the next three years in its ... hydroelectric plants on the Genesee River in the City of Rochester

**B. The Commission Should Require Joint Petitioners To Divest The Existing Generation Within Nine Months Of The Commission's Order.**

The Joint Petitioners have pledged to divest the Fossil Generation Facilities if the Transaction is approved.<sup>20</sup> IPPNY witness Mark Younger testified that, in the event the Transaction is approved, the Joint Petitioners should be directed to:

[F]ile with the Commission its process to auction Russell Station which shall include a detailed time line with milestones, including a commitment to complete the sale of Russell Station within 9 months of the Commission's order. . . . (Tr. 922).

This time line is a fair condition to place on the Joint Petitioners. Indeed, on cross-examination, the Joint Petitioners' Benefits and Public Interest Panel admitted that a nine month time period is not an "unreasonable goal" (Tr. 693).<sup>21</sup>

The Commission should impose a firm deadline, with milestones, to ensure that Energy East satisfies this requirement without delay. As Mr. Younger explains in his testimony, RG&E committed to divest Russell Station after it completed its Rochester Transmission Project ("RTP").<sup>22</sup> Notwithstanding this obligation, RG&E informed the Commission that it planned to

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[which] will result in additional generating capacity of 9 megawatts (mw) at the two plants that currently have a combined generating capacity of approximately 49 mw." (See RG&E press release, April 4, 2007, "RG&E to Invest Millions in Upgrading Hydroelectric Plants", *available at*, <http://www.rge.com/OurCompany/News/news04042007.html> (last visited April 11, 2008)).

<sup>20</sup> Exh. 50, *supra* note 3.

<sup>21</sup> It should be noted that National Grid just completed the auction process for a much larger facility in approximately a six-month period. While the regulatory approvals must be obtained, National Grid was able to proceed this far in its divestiture process without any advanced work on an auction process. RG&E has been on notice that it had this obligation since December 16, 2004 when the Russell-RTP Order was issued. Case 03-T-1385, *Rochester Gas and Electric Corporation*, Order Granting Certificate of Environmental Compatibility and Public Need (December 16, 2004) (hereinafter "Russell-RTP Order"). With the completion of the RTP expected imminently, RG&E presumably is well along with its auction process design.

<sup>22</sup> RG&E is constructing the RTP to ensure adequate, reliable service to the Rochester area following the closing of Russell Station. Russell Station is scheduled to be retired in the second quarter of 2008 upon

repower the facility.<sup>23</sup> While the requirement to divest Russell Station was clear, RG&E's actions in the face of this unambiguous directive demonstrate the need to impose explicit conditions on the Joint Petitioners.

As specifically noted in the Commission's order approving the construction of the RTP, RG&E expressly committed in an information request response to "follow an appropriate competitive auction process with a goal of the sale of the Russell Station site to a non-affiliated entity."<sup>24</sup> This commitment is embodied in the Joint Proposal approved by the Commission in the Russell-RTP Order, with the only condition that the actual transfer of ownership was set to occur upon the completion of the RTP.<sup>25</sup>

On March 19, 2007, RG&E's parent, Energy East, announced it planned to invest \$500 million for repowering Russell Station using clean coal technologies, and on May 2, 2007, Energy East announced that RG&E had informed the NYISO that it planned to build a new 300 MW plant at the Russell Station site.<sup>26</sup> Both proposals were to be funded by ratepayers via rate-based, cost-of-service regulation. Further, when the proposed Transaction was announced on June 25, 2007, RG&E pointed to Iberdrola's construction expertise as a benefit of the proposed merger, expertise that could help in the repowering of Russell Station.<sup>27</sup>

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the completion of the RTP.

<sup>23</sup> Cases 03-E-0765 *et al.*, *Proceeding on Motion of the Commission as to the Rates, Charges, Rules and Regulations of Rochester Gas and Electric Corporation for Electric Service*, RG&E Filing (February 1, 2008), p.3.

<sup>24</sup> Russell-RTP Order, p. 5.

<sup>25</sup> *Id.*, Appendix B, Joint Proposal, p. 30.

<sup>26</sup> *Id.*

<sup>27</sup> Energy East press release, *June 25, 2007*, "IBERDROLA Reaches an Agreement to Acquire Energy East for \$4.5 Billion (3.4 Billion Euros)," *available at*, <http://phx.corporate->

In April, 2007, IPPNY requested that the Commission initiate a proceeding to investigate the planned redevelopment of Russell Station.<sup>28</sup> In his response to IPPNY's request for an investigation, Mr. James P. Laurito, President and CEO of NYSEG and RG&E, stated:

Redeveloping the Russell Station site will, without question, address an identified reliability concern of the NYISO in their most recent Reliability Needs Assessment (RNA), and position this plant as an important part of New York's long-term energy future. (Exh. 61).

As Mr. Younger testified, the NYISO did not choose RG&E's proposed repowering of Russell Station because other market-based solutions were available to meet the reliability need (Tr. 912). That fact did not deter RG&E from continuing to seek to repower Russell Station as a rate-based project, however. Nearly nine months later, RG&E offered a new excuse for why repowering of the facility is necessary. In response to an IPPNY information request, RG&E disclosed for the first time that the RTP will not meet the reliability needs of the Rochester area after Russell Station is retired (Exh. 60). RG&E attached to its information response its 2006 "Rochester Area 1900 MW Source Study" to demonstrate that the bulk transmission transformers that supply the Rochester region are forecasted to be above their rating in three years and that "another source to the region is required" (*id.*).<sup>29</sup>

Despite completing the Source Study in the Spring of 2006, RG&E did not state in its May 2, 2007 press release nor disclose to the NYISO that the Russell Station repowering was

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[ir.net/phoenix.zhtml?c=104038&p=irol-newsArticle&ID=1019243&highlight=](http://ir.net/phoenix.zhtml?c=104038&p=irol-newsArticle&ID=1019243&highlight=) (last visited April 11, 2008).

<sup>28</sup> Case 07-E-0435, Complaint of Independent Power Producers of New York, Inc., Concerning Plans of Energy East Corporation to Repower Coal and Hydroelectric Facilities.

<sup>29</sup> RG&E's claim that increasing load in the Rochester region will soon cause local reliability problems is belied by the NYISO's recently published 2008 Load and Capacity Data Book ("the Gold Book"). The updated forecast for the Rochester region (NYISO Zone B) has declined significantly from the forecast provided in the 2007 Gold Book. The Rochester region load that was previously forecast for 2010 is now not forecast to occur until sometime after 2018. This is likely to be delayed even further if the Commission adopts aggressive conservation plans in its EPS proceeding.

needed to meet a local reliability need.<sup>30</sup> Clearly, RG&E's justifications for why a repowering of Russell Station is needed have changed over time.

In light of RG&E's past conduct in seeking to repower Russell Station in violation of its commitment to divest the plant, which was approved by the Commission, it is essential that the Commission impose a firm deadline, with milestones, on Joint Petitioners to divest the Existing Generation so the company cannot again attempt to evade its commitments. As DPS Staff and Mr. Younger concluded, divestiture of all of NYSEG's and RG&E's generation is essential to put to rest concerns that the Joint Petitioners will engage in VMP through their ownership of generation assets connected to NYSEG and RG&E's T&D systems.

**II. AS A CONDITION OF TRANSACTION APPROVAL, THE COMMISSION SHOULD PROHIBIT THE JOINT PETITIONERS AND THEIR AFFILIATES FROM ACQUIRING OR CONSTRUCTING ELECTRIC GENERATION FACILITIES THAT ARE INTERCONNECTED TO NYSEG'S OR RG&E'S TRANSMISSION OR DISTRIBUTION SYSTEM.**

It is the stated intention of Iberdrola that, should the proposed Transaction be approved by the Commission, the company would seek to develop as many projects in New York as possible (Tr. 688).<sup>31</sup> As explained above and in Mr. Younger's testimony, any new generation acquired or developed by the Joint Petitioners or their affiliates that would be interconnected to NYSEG's or RG&E's transmission or distribution system would violate the Commission's VMP policy.

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<sup>30</sup> Case 07-M-0906, Joint Petitioners' Responses to On the Record Requests and Items Subject to Check, p. 12.

<sup>31</sup> In fact, at the time Joint Petitioners filed their Section 70 petition, Iberdrola repeatedly pointed to the fact that it did not have plans to construct generation that would be interconnected to NYSEG's or RG&E's transmission system (Tr. 813). On March 14, 2008, however, Iberdrola supplemented its earlier response to an information request on this specific point, disclosing for the first time that it is now planning to build three wind projects interconnected to NYSEG and that one of these projects was acquired from another developer (Exh. 57).

If Joint Petitioners or their affiliates are permitted to acquire or construct generation facilities interconnected to RG&E's or NYSEG's transmission or distribution system, there are myriad ways in which competition could be impaired. As Mr. Younger stated:

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

If Joint Petitioners or their affiliates are allowed to own both generation and transmission and distribution in the Energy East affiliates' service territories, it will not only harm the competitive electric market in the State, but also chill the interest of market participants in future investment in the State, which would do immense harm to the market.

In an attempt to support their position that there are no VMP issues, the Joint Petitioners offered the testimony of Dr. William Hieronymus. In his rebuttal testimony, Dr. Hieronymus asserted that the Commission's VMP Policy Statement had been "superseded by almost ten years of significant change in the electricity industry in New York" (Tr. 807). This characterization of the VMP policy was countered by the DPS Staff Policy Panel, which correctly stated, "the conclusion [reached by Dr. Hieronymus that the VMP is out-dated] is directly contradicted by the Commission Order on the National Grid PLC acquisition of KeySpan Corporation. *The VMP Policy Statement is clearly applicable to the proposed transaction in this proceeding*" (Tr. 1258-1259) [emphasis added]. Dr. Hieronymus went even further on cross-examination, when asked whether he agreed with the Commission's decision in Case 06-M-0878 (the National Grid/KeySpan Merger) that the divestiture of KeySpan's Ravenswood generation facility was

required to address VMP issues. His response was unequivocal, stating: “I think it’s utter nonsense.” (Tr. 891).<sup>32</sup>

Likewise, Dr. Hieronymus was asked, on cross-examination, whether he felt it mattered, for the purposes of VMP, how much wind generation Iberdrola added in the Energy East service territories, and he responded:

[Based on your testimony, is it true that it doesn’t matter how much wind Iberdrola adds upstate and it doesn’t matter where it is located with respect to vertical market power?]

[t]he controls over the exercise of VMP are so substantial that, under at least most circumstances, any circumstance that I reasonably can contemplate, what you said would be true. (Tr. 889). . .the control over the transmission system is always relevant to VMP and rests in the main with New York ISO, and to the extent that they are not fully covered that way they are back-stopped by a quite Draconian [*sic*] capability at FERC to impose penalties and whatever additional penalties this Commission might impose on the basis of misbehavior (Tr. 893).

Thus, it is Dr. Hieronymus’ position that the regulatory tools at the Commission’s disposal are more than adequate to address the VMP issue – a position that this Commission expressly rejected just last Fall in the National Grid-KeySpan proceeding. The Joint Petitioners favor the regulatory approach rather than the structural separation set forth in the Commission’s VMP policy that has assured the continued competitiveness of New York’s electric market. However, the very essence of the Commission’s VMP policy has been to remove the incentive to exercise VMP in the first instance, so regulatory tools would not have to be used (Tr. 916).<sup>33</sup> Nothing has changed in the structure of the markets since the VMP Statement was issued – and certainly not since last Fall – that justifies the Commission departing from this position.

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<sup>32</sup> It should be noted that National Grid accepted the condition to divest the Ravenswood generation and, as noted herein, is moving quickly to comply with the Commission’s order to divest Ravenswood. On March 31, 2008, it was announced that a subsidiary of TransCanada Corporation would acquire the 2,480 MW Ravenswood Facilities.

<sup>33</sup> See also, VMP Order, p. 3

Regulatory oversight is extremely difficult and inefficient to apply on a case-by-case basis. In its Order requiring National Grid to divest the Ravenswood generation facility, the Commission reiterated its VMP policy: “it prefers divestiture as the means to minimize market power abuse because vigilant regulatory oversight cannot timely identify and remedy all abuses.”<sup>34</sup> In its VMP Statement, the Commission found that “[i]t is also difficult for regulators to detect an inappropriate failure to act when critical information resides with the T&D utility.”<sup>35</sup> That finding is consistent with DPS Staff’s filed testimony in the Grid/KS Merger Proceeding, as reiterated by the Commission:

- While a blatant exercise of VMP could be detected by the ISO or other market participants, subtle actions or failures to act in the short- and long-run (such as a failure to perform required maintenance or a failure to propose and build needed transmission timely) would be much harder or impossible to detect or prove and this is why it is necessary to address directly the incentives to exercise VMP.<sup>36</sup>
- While it is true that the ISO reviews and can deny requests for transmission outages for reliability reasons, the ISO cannot deny a request for a transmission outage based on economic reasons. Once a transmission facility is out of service there is also no deadline for its return to service. The penalty provisions set forth in Attachment N to the NYISO tariff are also not a factor because any penalties incurred would be recovered automatically by National Grid through its Transmission Services Charge unless there is a determination that costs were incurred imprudently.<sup>37</sup>
- The Petitioners might not reasonably implement electric energy efficiency programs ... if the merged company owns generation in [the same market in which it has transmission and distribution.]<sup>38</sup>

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<sup>34</sup> Grid/KS Merger Long Order, p. 129 (citing VMP Statement, p.1).

<sup>35</sup> *Id.*

<sup>36</sup> *Id.*, pp. 132-33.

<sup>37</sup> *Id.*, p. 132.

<sup>38</sup> *Id.* See also, Case 07-M-0548, Proceeding on Motion of the Commission Regarding an Energy Efficiency Portfolio Standard, *Order Instituting Proceeding* (May 16, 2007), p. 2, in which the Commission delineated, and established a proceeding by which it will effectuate the State’s policy to “[realize] the State’s energy efficiency potential and [reduce] New York’s electricity usage 15% from expected levels by 2015....”

Just as it did in the National Grid/KeySpan merger,<sup>39</sup> the Commission should obviate the risk of VMP being exercised by requiring divestiture as a condition to approval of the Transaction.

Dr. Hieronymus' contention that, after the Transaction Joint Petitioners would have no economic incentive to add small wind projects in NYSEG's and RG&E's service territory<sup>40</sup> is without merit. The Joint Petitioners' Policy Panel testified that Iberdrola has substantial "expertise, capacity and resources at its disposal"<sup>41</sup> to meet the State's renewable energy goals and that Iberdrola's affiliates "have a most impressive track record"<sup>42</sup> with respect to completing wind projects. In an information response submitted to the parties on March 14, 2008, Iberdrola disclosed for the first time that it was developing five additional wind projects in New York (Exh. 57). Three of the proposed wind projects will be interconnected to NYSEG's system and are under 80 MW (Sangerfield, 46 MW; Houck Mountain, 60 MW; and Sugarcreek, 60 MW). These units are particularly problematic because any wind projects that are up to 80 MW would be "alternative energy production facilities" under PSL § 2(2-b) and therefore would not be subject to the Commission's jurisdiction (PSL § 2(13)).<sup>43</sup> A blanket prohibition on the ownership of generation connected to NYSEG or RG&E is needed because the statute may effectively preclude application of the VMP Statement with regard to units up to 80 MW.

For all of the above reasons, the Commission should prohibit the Joint Petitioners and their affiliates from acquiring or constructing electric generation facilities that are interconnected

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<sup>39</sup> Grid/KS Merger Long Order, p. 64.

<sup>40</sup> Tr. 849.

<sup>41</sup> Tr. 489.

<sup>42</sup> Tr. 520.

<sup>43</sup> Mr. Hieronymous conceded this point (Tr. 882).

to NYSEG's or RG&E's transmission or distribution system as a condition to approval of the Transaction.

**III. AS A CONDITION OF TRANSACTION APPROVAL, THE COMMISSION SHOULD PROHIBIT THE JOINT PETITIONERS AND THEIR AFFILIATES FROM ACQUIRING OR CONSTRUCTING ELECTRIC GENERATION FACILITIES THAT ARE SUBJECT TO COST OF SERVICE RATE REGULATION ANYWHERE IN NEW YORK STATE.**

As a condition of Transaction approval, the Commission should prohibit the Joint Petitioners and their affiliates from building or acquiring any cost of service based, rate regulated generation facilities in New York State. This prohibition is needed to guard against the exercise of VMP and to protect consumers from cost overruns resulting from regulated projects.<sup>44</sup> As Mr. Younger testified:

When a utility recovers the costs of new infrastructure through cost-of-service rate regulation, ratepayers can be required to pay the costs of significant cost overruns that they would otherwise not bear if the infrastructure were built by private developers (Tr. 903).

Competitive markets are harmed by regulated generation because it can artificially depress the market clearing price from competitive levels (Tr. 914). Moreover, if the Joint Petitioners or their affiliates are allowed to acquire or have an interest in cost of service based rate regulated generation, ratepayers will ultimately be put at risk of shouldering any cost overruns of such projects. In the case of a merchant generation facility, the developer's shareholders bear the risk of loss, not consumers, and since they must rely on the market to cover their costs and produce revenue, they are forced to be more efficient (Tr. 903).

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<sup>44</sup> Con Edison's East River Repowering Project had an estimated cost of \$406 million. However, final costs were capped at \$788.3 million, almost a 100% overrun of original cost estimates. Case 05-S-1376, *Proceeding on Motion of the Commission as to the Rates, Charges, Rules and Regulations of the Consolidated Edison Company of New York, Inc. for Steam Service*, Order Determining Revenue Requirement and Rate Design (September 22, 2006), p. 6.

The Commission continues to reiterate its concerns regarding “the costs and risks to consumers” of utilities constructing, owning, or operating generation plants, and with the existence of vertical market power.”<sup>45</sup> RG&E’s construction of its RTP (albeit a transmission project) demonstrates the validity of the Commission’s concerns. At the time the Commission authorized the project, RG&E’s projected capital cost was approximately \$75.4 million.<sup>46</sup> Its latest estimate is \$125 million, a 60% increase over its earlier estimate (Tr. 904). The uneconomic nature of cost of service, rate based generation leads merchant companies looking to develop generation and transmission in this State to look elsewhere, thereby harming the competitive market and ultimately consumers. Problems such as cost overruns and negative impacts on the competitive markets can be avoided by prohibiting Joint Petitioners and their affiliates from constructing or acquiring cost of service, rate regulated generation assets.

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<sup>45</sup> ERP Order, p. 5 (citing Grid/KS Merger Long Order; Opinion 96-12, pp. 29, 30-31, 64-66; and VMP Statement).

<sup>46</sup> Russell-RTP Order, p. 6.

**CONCLUSION**

For the above reasons, IPPNY respectfully requests that Your Honor recommend that the Commission impose the conditions set forth in this brief if it approves the Transaction.

Respectfully submitted,

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