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

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I. EXECUTIVE SUMMARY

In this proceeding, IBERDROLA, S.A. ("Iberdrola"), Energy East Corporation ("Energy East"), RGS Energy Group, Inc. ("RGS"), Green Acquisition Capital, Inc. ("Green"), New York State Electric & Gas Corporation ("NYSEG") and Rochester Gas and Electric Corporation ("RG&E") (together, the "Joint Petitioners") seek approval under Section 70 of the New York State Public Service Law ("PSL"), for the acquisition of Energy East by Iberdrola (the "Proposed Transaction"). The Proposed Transaction presents significant rate, financial, employment and public policy benefits to the State of New York and the customers of NYSEG and RG&E, without any realistic offsetting risks. None of these benefits would exist without the closing of the Proposed Transaction.

Sound regulatory policy requires that the Commission analyze merger transactions fairly, with the goal of properly balancing the interests of consumers and investors. This approach will ensure that New York State remains an attractive climate for the in-flow of, and access to, needed capital, which is critical to the State's interests. Regulatory decisions should recognize the value of attracting investment into the utility sector, rather than focusing solely upon the level of rate concessions that can be forced upon merging parties without regard to any direct or logical nexus with the proposed merger. Moreover, any necessary conditions for approval of a merger should be directly linked to likely risks or benefits that arise from the merger if consummated and should be designed to mitigate reasonably likely risks to ensure appropriate sharing of reasonably likely benefits. Here, the positions of the Department of Public Service Staff ("Staff") represent a major departure from these fundamental regulatory principles by providing an inconsistent assessment of benefits and risks, demonstrating an apparent aversion to the participation of major international investors in New York's regulated utilities, and proposing to impose an enormous "toll" to entry that is unrelated to the Proposed

Transaction. The Commission should resist any invitation to depart from these vital regulatory principles in evaluating the Proposed Transaction.

It is critical to remember that the Proposed Transaction involves Iberdrola's first investment in regulated utility companies in the United States. Thus, this is a "first-mover" transaction for Iberdrola that will not result in the kind of immediately quantifiable "synergy" savings for ratepayers and investors that the Commission has seen in the combination of other electric and gas utility operations in New York in recent years, including when Energy East acquired RGS Energy Group in 2002. The Commission has approved a number of other "non-synergy" mergers (*i.e.*, mergers that resulted in no quantifiable ratepayer benefits) as in the public interest based on tangible (but not immediately quantifiable) benefits of the type demonstrated here—namely, the acquisition of a public utility by a financially stronger upstream owner, and the experience of a larger, diversified parent company. Disregarding this precedent, Staff seeks to create a new standard for electric and gas utility mergers whereby a non-synergy merger would be required to produce immediately quantifiable ratepayer benefits even if none exist. In so doing, Staff seeks to impose an artificial toll on investors looking to invest in electric and gas utilities in New York. If successful, this effort can serve only to harm New York. Capital markets are global, and if costs or barriers to investors are raised, the inevitable result is that it will be more difficult for New York utilities to attract the capital they need at reasonable cost, to the detriment of New York's economy and ratepayers.

Joint Petitioners' commitment to provide substantial and immediately quantifiable ratepayer benefits (in addition to myriad other public interest benefits that are not immediately quantifiable) simplifies the Commission's evaluation of the Proposed Transaction. Uncontroverted evidence in this case shows robust and wide-ranging benefits to the State of New

York (including NYSEG and RG&E ratepayers) as a result of the Proposed Transaction. First and foremost, through the Joint Petitioners' acceptance of a number of the parties' positions in this proceeding, consumers in New York will receive the following quantifiable economic benefits:

- **Rate Adjustments -** The ratepayers of NYSEG and RG&E will receive the benefit of over $201.6 million in one-time permanent rate adjustments, which translate into approximately $54.8 million dollars in immediate, annual delivery rate reductions for customers (Exh. 50).

- **Generation Divestiture -** The divestiture of all of the fossil generation facilities owned by Energy East in New York State will bring benefits by eliminating any potential market power issues. Moreover, the Joint Petitioners have committed to share with ratepayers, in a manner and amount to be determined by the Commission, the above-book proceeds resulting from the auction of the divested fossil assets (*Id.*).

- **Renewable Commitment -** Iberdrola is supporting investments by its subsidiary, Iberdrola Renewables, of at least $100 million in renewable generation resources in New York over the next three years. These commitments will bring economic development and new jobs, particularly in upstate New York (*Id.*).

- **Electric Cooperatives -** A task force will be formed and studies undertaken, among other things, to bring enhanced reliability benefits to three electric cooperatives and the Village of Sherburne (collectively, the "Cooperatives") (*Id.*).

- **City of Rochester -** The Joint Petitioners have committed to the City of Rochester to address the process of remediation of, and public access to, old facility sites and to address issues regarding above-ground wiring and street lighting (*Id.*).

In addition, the record demonstrates several other public interest benefits:

- **Financial Stability -** As a larger, stronger and more diversified holding company with "A" category credit ratings from all major ratings agencies, Iberdrola will bring financial strength and stability to Energy East and its operating subsidiaries NYSEG and RG&E, which have credit ratings in the "BBB" category. Iberdrola's financial strength should in the future provide NYSEG and RG&E with greater access to capital at lower costs, ultimately benefiting ratepayers (Tr. 504).

- **Global Energy Expertise -** Iberdrola is an international leader in the energy industry with extensive global utility expertise. Iberdrola commits to share information regarding best practices with NYSEG and RG&E (Tr. 505).

- **Focus on Efficiency and Environment -** Iberdrola brings to New York a focus on energy efficiency, clean technology and the environment (Tr. 486).

- **No Rate Recovery of Transaction Costs or Acquisition Premium -** The Joint Petitioners commit that they will not seek to recover in rates the transaction costs or the acquisition premium associated with the Proposed Transaction (Tr. 491-492).

- **No Job Reductions -** Because the merger is not a synergy transaction, there are no job reductions resulting from the Proposed Transaction (Tr. 524).

- **Maintaining New York Headquarters -** Iberdrola has committed that the headquarters of NYSEG and RG&E will not move out of upstate New York as a result of the Proposed Transaction (Tr. 492).

The Joint Petitioners have also responded to Staff's and other parties' alleged concerns relating to transparency and reporting, data security, credit quality, capital structure, and affiliate transactions and have stipulated to the following seventeen (17) additional conditions:

Transparency and Reporting

- **Books and Records -** The Commission will have access, in English and in New York, to (1) the books/records of NYSEG and RG&E, and (2) any books/records of Iberdrola or any Iberdrola affiliates that are related to NYSEG or RG&E. The Commission will have access, in English and in New York, to any minutes of the Iberdrola Board of Directors, and any sub-committee thereof, to the extent that such minutes discuss Energy East, NYSEG or RG&E. Iberdrola also shall translate such other documents as the Commission determines to be reasonably necessary to fulfill its statutory duties (Tr. 549).

- **Audit Reports -** The Commission will have access, in English and in New York, to all internal and external audit reports and recommendations for NYSEG and RG&E, and for any Iberdrola affiliate with respect to the provision of goods and services for compensation to NYSEG or RG&E (*Id*.).

- **Financial Statements -** Iberdrola's consolidated balance sheets, income statements and cash flow statements will be made available to the Commission, in English and in New York, on an annual basis and in a format that is mutually agreed to between Iberdrola and the Commission Staff. Audited financial statements will be in accordance with the International Financial Reporting Standards ("IFRS"), as issued by the International Accounting Standards Board, consistent with Securities and Exchange Commission ("SEC") requirements. Additionally, Iberdrola agrees to provide specific answers to particular questions raised by the Commission and its Staff with respect to IFRS (Tr. 550).

Data Security

- **Sensitive Data Maintained in U.S. -** The Joint Petitioners commit that information about vulnerabilities in the New York electric grid and the gas pipeline network, in all media formats, shall remain within the headquarters of NYSEG and RG&E. The Joint Petitioners also commit that customer data (*e.g.*, names, addresses, telephone numbers, social security numbers, credit reports) shall remain, in all media formats, within the headquarters or customer service centers of NYSEG and RG&E (Tr. 552).

Credit Quality

- **Credit Ratings** - Iberdrola, Energy East, NYSEG and RG&E will maintain credit ratings with at least two generally accepted ratings agencies (*e.g.*, Standard & Poor ("S&P") and Moody's) (Tr. 554).

- **Reporting of Credit Events -** If there is a "Credit Event" (defined as the downgrade of Iberdrola's, Energy East's, NYSEG's or RG&E's credit rating below "BBB"/"Baa3", or credit rating of "BBB-"/"Baa3" with a "Watch Negative", by at least two major credit reporting agencies (*e.g.*, S&P and Moody's)), NYSEG and RG&E will make a timely filing notifying the Commission of any such Credit Event, and subsequent filings with the Commission every three months, identifying (1) the current credit rating during such Credit Event and (2) a plan to remedy such Credit Event, until such Credit Event is eliminated (*Id.*).

- **Ratings Agency Presentations and Reports -** Iberdrola, Energy East, NYSEG or RG&E, as applicable, will provide the Commission on a confidential basis with copies of all slide presentations to credit ratings agencies relating to Energy East, as well as all rating agency reports relating to Energy East or any Energy East subsidiaries, on an on-going basis (*Id.*).

- **Cost of Debt -** NYSEG and RG&E ratepayers shall not be responsible for any increase in NYSEG's or RG&E's cost of debt caused by Iberdrola's financial status. For ratemaking purposes, the Commission may impute a reasonable cost of debt that is based on NYSEG's and RG&E's stand-alone risk profile (*Id.*).

Capital Structure

- **Minimum Common Equity Ratio -** NYSEG and RG&E will at all times maintain common equity capital at levels equal to or greater than 38% of total adjusted capital (including common equity, preferred equity, long-term debt, short term debt, capitalized leases, Current Maturities of Long-Term Debt and Current Maturities of Capitalized Long-Term Leases). Notwithstanding the foregoing, NYSEG and RG&E shall maintain the right to petition the Commission for an exception to this condition. One-time events, such as mandated changes in accounting, that temporarily affect equity will be reported to the Commission and excluded from the common equity ratio calculation (Tr. 556).

- **No Cross Default -** There will be no cross default provisions in any joint credit arrangements among NYSEG and RG&E, on the one hand, and Iberdrola and its affiliates, on the other hand, unless otherwise authorized by the Commission (*Id.*).

- **Money Pool Participation -** NYSEG and RG&E may participate in Iberdrola money pools provided the other participants in such money pools are limited to regulated utility affiliates of Iberdrola in the U.S., unless otherwise authorized by the Commission. Iberdrola shall not borrow from money pools in which NYSEG and RG&E are participants (Tr. 556-57).

- **Dividend Policy -** NYSEG and RG&E will maintain their respective dividend policies with due regard for the financial performance and needs of NYSEG and RG&E, irrespective of the financial performance and needs of Iberdrola. Iberdrola will report to the Commission in the event that the dividend payout for any year is more than 100% of income available for dividends calculated on a two-year rolling (eight calendar quarter) average basis (Tr. 557).

Affiliate Transactions

- **Cost Allocations -** NYSEG and RG&E will continue to utilize Energy East's cost allocation methodologies and Energy East will allocate centralized costs from Iberdrola to NYSEG or RG&E only to the extent that such costs are properly chargeable to utility operations and accepted by the Commission. Costs charged by Iberdrola or its affiliates to Energy East and any of its U.S. affiliates that either directly or indirectly affect NYSEG's or RG&E's costs of service shall be based on Energy East's approved cost allocation methodology, unless otherwise permitted by the Commission (Tr. 560).

- **Separate Accounting and Financial Statements -** NYSEG and RG&E will maintain separate and independent accounting records and financial statements from that of Iberdrola and all other affiliates (*Id.*).

- **Asset Transfers -** NYSEG and RG&E will not transfer or sell material assets or facilities to Iberdrola or any affiliate without prior approval of the Commission. All asset sales to these entities will be on an arm's-length basis, and be subject to market vs. book value tests (*Id.*).

- **No Lending -** NYSEG and RG&E will not loan funds to Iberdrola or any unregulated affiliate, either through a money pool or otherwise, unless otherwise authorized by the Commission (*Id.*).

- **No Credit Support -** NYSEG and RG&E will not provide guarantees, collateral, or pledge or provide any other type of credit support for the benefit of Iberdrola or any affiliate (*Id.*).

Notably, many other parties recognize the public interest benefits the Proposed Transaction will bring to the State and to NYSEG and RG&E ratepayers. Indeed, the Greater

Rochester Enterprise and Empire State Development each express support for the Proposed Transaction in recognition of Iberdrola's global leadership in the utility industry and the economic development opportunities that the Proposed Transaction would bring to New York. Additionally, Natural Resources Defense Council ("NRDC"), the City of Rochester, the New York State Department of Environmental Conservation ("DEC") and the Consumer Protection Board ("CPB") have each recognized the importance of renewable energy benefits that Iberdrola will bring to the State and that the Commission should consider in evaluating the Proposed Transaction. This support comes as no surprise given the substantial benefits associated with the Proposed Transaction.

At the outset, the Commission should recognize the one-sided nature of Staff's complaints about risk in this case. Where the Joint Petitioners indicate the likelihood of a benefit, but recognize that the precise future effects are unknown, Staff discounts the benefit entirely. On the other hand, Staff raises a host of "concerns" about risk, none of which is quantified, and each of which is invented or vastly exaggerated, but nevertheless suggests that these concerns provide a fully sufficient basis for rejecting the Proposed Transaction or imposing unreasonable costs or conditions.

Staff's conditions and complaints can be categorized broadly in three categories: (1) Staff identifies a list of "positive benefit adjustments" (or "PBAs") and one-time rate adjustments that total $855 million that are unrelated to the Proposed Transaction, but that reflect Staff's desire to recast the public interest standard and require production of immediately quantifiable ratepayer benefits even where none exist; (2) Staff identifies approximately $1.6 billion of so-called "proxy benefits" in an attempt to justify its proposed PBAs, even though the "proxy benefits" are not benefits to Iberdrola, NYSEG or RG&E, or are based on alleged opportunities for "synergies" that do not really exist; and (3) Staff identifies a number of other rate and service quality issues that are beyond the scope of, and in no way necessary to satisfy, a public interest determination in this Section 70 proceeding, but which Staff opportunistically seeks to resolve here as a further toll or cost of admission for investors. In total, the impact of Staff's various demands, if accepted, would be $1.6 to $1.7 billion over five years—or approximately *25%* of delivery revenues for NYSEG and RG&E. This total is far in excess of any amount that could possibly be warranted under the public interest standard of Section 70 (even in a *synergy* merger, which this is not) and would signal to the global financial community that investors need to make extreme economic concessions, wholly unrelated to a proposed merger, as an entry fee in New York. Furthermore, the imposition of such a toll is unnecessary given that the closing of the Proposed Transaction in no way impedes the ability of Staff or any other party to pursue rate initiatives and adjustments at NYSEG and RG&E in subsequent proceedings.

Staff devotes many pages of its Policy Panel's testimony to the invention of a series of hypothetical and unsubstantiated "risks" that supposedly require either denial of the Proposed Transaction or offsetting ratepayer benefits and other conditions. The Joint Petitioners have taken care to respond to Staff's concerns in Section V of this Initial Brief, and have stipulated to several conditions to give greater comfort on these issues, as noted in the list above. However, the Joint Petitioners strongly dispute that any of these so-called "risks" identified by Staff are valid or warrant rejection of the Joint Petition or any further conditions. Actual ratepayer risks, *e.g.*, risks tied to the regulated capital structures of RG&E and NYSEG, were not demonstrated and should not be presumed. On the contrary, the evidence shows that Staff's identified "risks" are invented or greatly exaggerated.

Two examples illustrate this well. Staff asserts that if the Proposed Transaction is approved there could be declines in NYSEG's and RG&E's credit quality, in spite of the fact that Iberdrola has "A" category credit ratings, which are higher than those of Energy East, NYSEG and RG&E. To reach the illogical conclusion that Iberdrola's higher credit quality is a "risk," Staff undertakes a contorted exercise that focuses on a single financial ratio for Iberdrola that is of limited significance to the ratings agencies, and then uses this ratio to assign its *own* credit rating for Iberdrola (substantially lower, of course, than the *actual* credit ratings assigned by Moody's, S&P and Fitch). Another example of an invented risk is Staff's obsession with Goodwill (representing the value paid for Energy East in excess of book value), which will be placed on the books of Iberdrola (and not on the books of Energy East, NYSEG or RG&E) as a result of the Proposed Transaction. The mere existence of Goodwill is typical for virtually all utility holding company stock acquisitions, and Iberdrola's commitment to record the Goodwill on its *own* books, rather than to "push" it down to the books of NYSEG or RG&E, assures that ratepayers will not be adversely impacted. The type of hypothetical risks suggested by Staff from speculative future events that have virtually no chance of occurring and cannot be quantified are far outweighed by the net tangible and quantifiable benefits of the Proposed Transaction.

Other "risks" identified by Staff and Intervenors justify neither denial of the Proposed Transaction nor the imposition of any of the extraordinary concessions demanded by Staff, as addressed further in Section V below:

- Section V.A explains that there are no market power concerns raised by the Proposed Transaction;
- Section V.B responds to Staff's flawed comparisons of the Proposed Transaction with the National Grid/KeySpan proceeding, and also explains that various financial protections proposed by Staff are not justified;

- Section V.C demonstrates that Staff's unsubstantiated claim that Iberdrola's "A" category credit ratings could somehow be a detriment if the Proposed Transaction is approved notwithstanding the lower, "BBB" category/negative outlook ratings of Energy East, NYSEG and RG&E;
- Section V.D responds to Staff's complaints about the level of Goodwill that will be placed on Iberdrola's books;
- Sections V.E and V.G address Staff's concerns regarding financial transparency and affiliate transactions, and set forth certain commitments from Iberdrola to resolve the concerns;
- Section V.F responds to Staff's proposal for strict ring-fencing or a "golden share" mechanism, and explains why it is inadvisable to take such an extreme and administratively intrusive measure into the corporate governance of a public utility company; and
- Section V.H sets forth the measures Iberdrola has committed in order to ensure data security.

Section VI addresses certain rate matters (*e.g.*, Staff's proposals for return on equity ("ROE"), consolidated capital structure and an earnings sharing mechanism) that Staff has improperly attempted to introduce in a Section 70 proceeding, which should be focused solely on whether the Proposed Transaction is in the public interest. As described further in Section VI, any proposed modifications to existing Rate Plans and Rate Orders should not be part of this proceeding, and are items that may be addressed, as appropriate, in subsequent proceedings after the close of the Proposed Transaction. Because of Staff's testimony on these issues, the Joint Petitioners have been compelled to respond and set forth why they believe, if these issues are raised in a subsequent rate proceeding, they would fail on their merits. In doing so, however, Joint Petitioners in no way concede that *any* of these issues are properly before the Commission in this proceeding or have any substantive merit.

Section VII of the Initial Brief sets forth the Joint Petitioners' objections to various recommendations that Staff seeks to impose as conditions of the Proposed Transaction related to reliability, safety and service quality. Section VIII explains the Joint Petitioners' position on the revenue decoupling issues that were incorporated into this proceeding when it was consolidated with Case 07-M-0996.[1]

Every other governmental agency with jurisdiction to review and approve the Proposed Transaction has granted approval, including the Maine Public Utilities Commission, the Connecticut Department of Public Utility Control, the New Hampshire Public Utilities Commission, the Federal Energy Regulatory Commission ("FERC"), and the Federal Communications Commission. Additionally, the Hart-Scott-Rodino waiting period has expired without the Department of Justice issuing a second request, the Committee on Foreign Investment in the United States has granted Iberdrola clearance to acquire Energy East, and the Staff of the Nuclear Regulatory Commission has advised the Joint Petitioners in a no-action letter that it believes no Nuclear Regulatory Commission approval for the Proposed Transaction is required under the Atomic Energy Act. All of these regulatory authorities have found that the Proposed Transaction meets all applicable legal standards. In particular, the other state public utility commissions found that the transaction meets each of their respective "public interest" statutory standards. Thus, the only remaining approval needed to close the Proposed Transaction is the approval of this Commission under Section 70 of the PSL.

For the reasons set forth below, the Joint Petitioners respectfully request that the Commission approve the Proposed Transaction without any conditions beyond those offered by the Joint Petitioners. The record has demonstrated that the Proposed Transaction will bring extensive benefits to Energy East, to NYSEG's and RG&E's ratepayers and to the State of New York. These benefits meet and exceed the "public interest" standard of Section 70 of the PSL.

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[1] Case 07-M-0996 - *Proceeding on Motion of the Commission to Consider a Revenue Decoupling Mechanism for New York State Electric and Gas Corporation, Notice Consolidating Proceedings* (Oct. 22, 2007).

II. PROCEDURAL HISTORY

On August 1, 2007, the Joint Petitioners filed the Joint Petition for Approval of the Acquisition of Energy East Corporation by Iberdrola, S.A. (the "Joint Petition") (Exh. 41). The Agreement and Plan of Merger, dated as of June 25, 2007, among Iberdrola, Green and Energy East, is included in the Joint Petition as Exhibit 8. Also filed with the Joint Petition was the Direct Testimony of the Benefits and Public Interest Panel, consisting of Pedro Azagra Blazquez, Director of Corporate Development of Iberdrola, James P. Laurito, President and Chief Executive Officer of both NYSEG and RG&E, and Robert E. Rude, Senior Vice President and Chief Regulatory Officer of Energy East and Energy East Management Corporation. The Benefits and Public Interest Panel's testimony describes the benefits of the Proposed Transaction and demonstrates why it is in the public interest.

Subsequent to the filing of the Joint Petition, Administrative Law Judge Rafael A. Epstein ("ALJ") was assigned to be the Presiding Judge for this proceeding. A prehearing conference was held on the record in Albany on September 10, 2007 (Tr. 1-64). At the prehearing conference, issues pertaining to possible supplemental filings, discovery, scheduling and settlement were addressed. The ALJ issued a Procedural Ruling on October 4, 2007 (a) establishing a procedural schedule for the proceeding; and (b) adopting procedures and a Protective Order for addressing confidential information pursuant to the Commission's regulations.[2]

On November 28, 2007, the Joint Petitioners filed supplemental direct testimony on vertical market power issues. Staff and Intervenors filed their proposed direct testimony on January 11, 2008, and the Joint Petitioners filed their rebuttal testimony on January 31, 2008.

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[2] 16 NYCRR §§ 6-1.3, 6-1.4.

Public statement hearings, which were announced in public notices published in newspapers throughout the NYSEG and RG&E service territories, were held from February 19 through 22, 2008 in six different locations throughout the State: Carmel, Binghamton, Ithaca, Lancaster, Rochester and Plattsburgh. Public statements were received from speakers at the hearings and written submissions were invited and received as well.

Evidentiary hearings commenced on March 17, 2008 and concluded on March 20, 2008. The record consists of 1,902 pages of transcript and exhibits numbered 1 through 136.[3] At the close of the hearings, the parties agreed upon, and the ALJ adopted, a briefing schedule providing for initial briefs to be due on April 11, 2008 and reply briefs on April 25, 2008 (Tr. 1897-98).[4] The parties also indicated a desire to have a Recommended Decision issued by May 23, 2008, and that there be one round of briefs on exceptions due within 10 days of issuance of the Recommended Decision (Tr. 1897).

III. STANDARD OF REVIEW

Before approving the Proposed Transaction, the Commission must find that it meets the legal standard set forth in Section 70 of the PSL, which states in relevant part:

> No stock corporation of any description, domestic or foreign, other than a[n]… electric corporation…shall purchase or acquire, take or hold, more than ten per centum of the voting capital stock issued by any gas corporation or electric corporation…. No consent shall be given by the [C]ommission to the acquisition of any stock in accordance with this section unless it shall have been shown that such acquisition is in the public interest.[5]

The Joint Petition and the testimony sponsored by the Joint Petitioners clearly demonstrate that the Proposed Transaction will greatly benefit NYSEG and RG&E customers

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3 Portions of the record include confidential information subject to protective measures.

4 *See also* Case 07-M-0906 - *Procedural Ruling on Scheduling* (Apr. 2, 2008).

5 N.Y. Pub. Serv. Law § 70 (McKinney 2007).

and the State of New York. In addition to these benefits, on March 14, 2008, the Joint Petitioners accepted a number of the parties' positions in an effort to narrow the issues in this proceeding (the "Partial Acceptance") (Exh. 50), and thereby committed to provide customers and the State of New York with numerous tangible benefits including: significant immediate rate reductions to ratepayers, generation divestiture, substantial investment for the development of renewable generation in the State, resolution of the electric cooperatives' as well as the City of Rochester's concerns, and conditions to mitigate any perceived risks of the Proposed Transaction. Together these substantial benefits unquestionably demonstrate that the Proposed Transaction is in the "public interest" under Section 70.

Although the Partial Acceptance provides for delivery rate reductions, such rate reductions are *not* required to demonstrate that the Proposed Transaction satisfies the Section 70 public interest standard. This Commission has found that the public interest standard can be met in many different ways, including by showing benefits for ratepayers that are neither immediately quantifiable nor tangible. Here, the Joint Petitioners have demonstrated through evidence that cannot be credibly disputed that, with or without the rate reductions offered in the Partial Acceptance, customers of NYSEG and RG&E, as well as the State of New York, will receive substantial net benefits from the Proposed Transaction.

A critical distinction between the Proposed Transaction and some of the more recent electric and gas utility mergers in New York is the fact that Iberdrola does not currently own any U.S. regulated utility assets, and therefore this is not a synergy merger which results in immediately quantifiable synergy savings as a result of combining utility operations. This is Iberdrola's first proposed acquisition in the regulated utility area in North America and, therefore, the Proposed Transaction is properly viewed as a first-mover, non-synergy merger.

The Commission has experience with both synergy and non-synergy mergers and has found that each can provide benefits that satisfy the public interest standard.[6] Commission precedent makes very clear that non-rate benefits of the type that will be produced by the Proposed Transaction are sufficient to meet the Section 70 public interest standard.[7]

In approving non-synergy mergers, the Commission has found that the public interest standard can be satisfied through various intangible benefits that are provided to ratepayers and others, including the types of benefits that would be produced by the Proposed Transaction. For example, when Lyonnaise American Holding, Inc. ("LAH") proposed to acquire United Water Resources ("UWR"), although there were no rate reductions resulting from the merger, the Commission found:

> The public interest standard under § 89-h is satisfied here because SLDE—one of the world's largest water distribution and treatment companies—can provide enormous technological and financial

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6 The Commission has approved non-synergy mergers without the need to fabricate otherwise non-existent synergy savings for ratepayers. *See, e.g.,* Case 07-W-0176 - *Aquarion Water Co. of New York, Inc., et al., Order Approving Corporate Restructuring and Transfers Subject to Conditions* (Apr. 19, 2007) (hereinafter "*Aquarion/United Waterworks Order"*); Case 06-W-0244 - *United Water New York Inc. and United Water South County, Order Approving Merger and Adopting Three-Year Rate Plan* (Dec. 14, 2006) (hereinafter "*United Water/United Water South County Order"*); Case 02-W-1447 - *Philadelphia Suburban Corp., et al., Order Authorizing Stock Transfer* (Mar. 11, 2003) (hereinafter "*Philadelphia/AquaSource Order*"); Case 01-W-1949 - *Long Island Water Corp., et al. Order Adopting Terms of a Joint Proposal* (Nov. 27, 2002) (hereinafter "*Long Island Water/Thames Order*"); Case 01-W-1770 - *Aquarion Co. and New York-American Water Co., Inc., Order Adopting Terms of Joint Proposal and Approving Stock Transfer* (Apr. 17, 2002) (hereinafter "*Aquarion/New York-American Order*"); Case 99-W-1542 - *United Water Resources, Inc. and Lyonnaise American Holding, Inc., Order Approving Stock Acquisition* (July 27, 2000) (as modified by Errata Notice issued Aug. 1, 2000) (hereinafter "*UWR/LAH Order"*); s*ee also* Tr. 936-37.

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

> assets to help the subsidiary meet precisely those unique local challenges cited by opponents.[8]

Under the UWR/LAH case, and throughout other non-synergy merger cases, the Commission has recognized that non-synergy mergers can offer benefits to ratepayers to meet the public interest standard for approval. At times, sufficient non-synergy benefits have been shown by demonstrating that the acquisition of the utility by a large and sophisticated holding company with financial means and technical skills will enhance the utility's ability to serve the public well (such as here with Iberdrola).[9] In other instances, the Commission has found that an acquisition that has the *potential* for future savings can satisfy the public interest standard by demonstrating that there are likely to be future efficiencies that would then flow to ratepayers in future rate cases (such as here with Iberdrola).[10] Thus, a variety of non-rate benefits resulting from a merger may be sufficient to satisfy the "public interest" standard.[11] Here, the record shows that the Proposed Transaction will provide significant non-rate benefits, including Iberdrola's commitment to development of renewable resources in New York, which all parties appear to agree is of substantial interest to the State (*e.g.,* Tr. 1499-1500).

Staff takes the position that the Proposed Transaction may only be approved if Iberdrola pays an unreasonable entrance fee in the form of rate concessions to acquire Energy East. Staff's targeted level for this entrance fee is both arbitrary and extreme. Staff claims that

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8 *UWR/LAH Order*, *supra* note 6, at 7.

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

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

11 *See* discussion, *supra* note 6.

the level of its entrance fee is somehow tied to the levels of synergy savings that the Commission would normally find and allocate between customers and shareholders in a traditional synergy merger (*see* Tr. 1148-51; 1368-69). However, Staff manufactures numerous non-existent benefits that are unrelated to the merger to rationalize its requested rate concessions. Staff bases its position on its limited review and misapplication of four previous Commission orders (*see* Exh. 114 (IBER/EE IR. Nos. 2, 10)). These orders are inapposite. Each of the cases relied upon by Staff involved voluntary settlements among the parties in synergy merger proceedings where it was recognized that there would be anticipated synergy savings to be allocated between customers and shareholders.[12] By contrast, this is a first-mover transaction that creates no identifiable synergy savings, a fact which Staff ignores. A broader review of the Commission's past orders demonstrates that the Commission has approved prior non-synergy mergers based on its recognition of a wide range of meaningful and substantive benefits without requiring *any* particular level of quantifiable benefits, let alone the imposition, through the merger review process, of immediate rate reductions.

Indeed, even in synergy cases, the Commission has never found that the public interest would require the fabrication of non-existent synergies wholly unrelated to a merger

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[12] 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 115-22 (Sept. 17, 2007) (hereinafter "*NG/KS Order*") (discussion of the allocation of synergy savings); Case 01-M-0075 - *Niagara Mohawk Holdings, Inc., Niagara Mohawk Power Corp., National Grid Group plc and National Grid USA, Opinion and Order Authorizing Merger and Adopting Rate Plan*, at 6, 63 (Dec. 3, 2001) (hereinafter "*NIMO/NG Order*") (describing the allocation of synergy savings); Case 98-M-0961 - *Consolidated Edison, Inc., Consolidated Edison Co. of New York, Inc. and Orange and Rockland Utilities, Inc., Order Authorizing Merger*, at 1, 4-5 (Apr. 2, 1999) (hereinafter "*ConEd/O&R Order*") (anticipated synergy savings to be equitably distributed between customers and investors); Case 97-M-0567 - *Long Island Lighting Co. and The Brooklyn Union Gas Co., Opinion and Order Adopting Terms of Settlement Subject to Conditions and Changes*, at 13-15, 36-37 (Apr. 14, 1998) (hereinafter "*LILCO/BUG Order*") (cost savings made possible by synergies resulting from the merger to be shared by customers and shareholders).

transaction as a condition of Section 70 approval. In the synergy merger orders relied on by Staff, rate-related public interest benefits were funded out of *actual synergy savings* expected to result from the merger.[13] Based on Mr. Meehan's review of Commission orders in synergy and non-synergy mergers, Mr. Meehan testifies that "[t]he Commission has recognized synergy savings where they exist but has not attempted to manufacture merger savings where synergies are not present" (Tr. 942-43).

The record shows that the Proposed Transaction offers numerous benefits sufficient to meet the public interest standard. In addition to the rate reductions offered in the Partial Acceptance, the Joint Petitioners demonstrate other non-rate benefits similar to the ones found by the Commission to be sufficient in and of themselves in approving other non-synergy mergers. The Commission should include these important, non-quantifiable benefits in its assessment of the public interest standard. For the reasons discussed below, the record provides a compelling case of positive benefits that far outweigh the hypothetical risks identified by Staff and Intervenors. The Proposed Transaction should therefore be approved as in the public interest.

IV. BENEFITS OF THE PROPOSED TRANSACTION

While Commission precedent makes clear that the Joint Petitioners are not required to show tangible and quantifiable benefits in the form of rate reductions to meet the public interest standard, the evidence unquestionably demonstrates that the Proposed Transaction

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13 *NG/KS Order, supra* note 12, at 115-22 (discussion of synergy savings); *NIMO/NG Order, supra* note 12, at 6, 63 (describing the synergy savings); *ConEd/O&R Order, supra* note 12, at 1, 4-5 (anticipated synergy savings to be equitably distributed between customers and investors); *LILCO/BUG Order*, *supra* note 12, at 13-15, 36-37 (cost savings made possible by synergies resulting from the merger to be shared by customers and shareholders); *see also* Case 01-M-0404 – *Energy East Corp.*, *RGS Energy Group, Inc.*, *et al.*, *Order Adopting Provisions of Joint Proposal with Modifications*, at 4 (Feb. 27, 2002) (hereinafter "*EE/RGS Order*") (synergy savings included in rates established by the parties' Joint Proposal); Tr. 935-36.

will provide concrete and substantial benefits. Most notably, the Joint Petitioners commit to provide significant ratepayer benefits through the Partial Acceptance (Exh. 50), which eliminates any doubt that the Proposed Transaction provides tangible and quantifiable benefits to the State of New York and ratepayers, including immediate annual delivery rate reductions averaging 4.4%. Additionally, the Proposed Transaction provides many other significant long-term benefits that are not as easily quantified but are no less important, including a new parent company to Energy East and its operating subsidiaries with demonstrated superior financial strength, outstanding global expertise, and a firm commitment to bring new investment into the State of New York—particularly the upstate region (Exh. 41 at 2-3; Tr. 475-76; 504-06).

A. The Joint Petitioners Have Demonstrated That The Proposed Transaction Should Be Approved Under Section 70

1. The Joint Petitioners Have Committed To Provide Tangible And Quantifiable Benefits To New York Ratepayers

The Joint Petitioners' Partial Acceptance represents a commitment to provide additional positive benefits as a result of the Proposed Transaction, effective as of closing.[14] The Joint Petitioners' Policy Panel sponsored the Partial Acceptance and the panel was subject to cross-examination on the record about its contents (Tr. 605-12; 692-93; 698-99; Exh. 50). The Partial Acceptance includes commitments by the Joint Petitioners to provide the following material benefits: (1) acceptance of over $201 million in one-time permanent PBAs that will result in an immediate $54.8 million annual delivery rate reduction (averaging about 4.4%) that would be flowed through to ratepayers immediately following closing; (2) divestiture of the

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[14] While Joint Petitioners do not believe that the commitments in the Partial Acceptance are necessary in order for the Proposed Transaction to be approved pursuant to Section 70, the Joint Petitioners nonetheless have agreed to certain concessions that have been included in the Partial Acceptance (Tr. 447). The Partial Acceptance applies solely to, and is binding only in, the context of an order approving, and the actual closing of, the Proposed Transaction.

Russell Station, Allegany Station, Peaker Station 3, Peaker Station 9 and the Carthage Facility Peaking Unit with above-book proceeds from this sale to be shared with ratepayers in a manner and with allocated levels to be determined by the Commission in its discretion;[15] (3) a commitment to invest a minimum of $100 million for the development of renewable generation in New York State;[16] (4) enhanced reliability benefits and a resolution of the Cooperatives' concerns; and (5) a resolution of the City of Rochester's various concerns regarding certain properties and practices.

a. Joint Petitioners Have Accepted $201.642 Million Of Positive Benefit Adjustments

Staff alleges that the only benefits Iberdrola claims to bring to New York are illusory, "intangible, speculative, immaterial" and not enforceable (Tr. 1162; 1191; 1215). Staff ignores the many tangible benefits set forth in the Joint Petition and in the Direct Testimony of the Joint Petitioners' Benefits and Public Interest Panel (Tr. 474-76; 485-90) and, instead, demands $855 million in rate concessions that are unrelated to the Proposed Transaction (Tr. 1162; 1365), including $646 million in PBAs (consisting of write-offs of $286 million, reserve increases of $311 million, and absorption of IPP costs of $49 million) and $209 million of potential one-time rate adjustment write-offs (Tr. 1367-68; Exh. 121; 125). While Staff's rate concessions are unrelated to the merger and unjustifiably high, the Joint Petitioners have nonetheless agreed to accept $201.642 million of Staff's recommended PBAs in an immediate,

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[15] The proceeds in connection with the auction of the unregulated Carthage Peaking Unit will accrue to shareholders.

[16] This commitment is discussed in detail in Section IV.A.2, below.

one-time, but permanent write-off, to resolve any doubt that the Proposed Transaction provides quantifiable benefits to the State and to ratepayers (Exh. 50, p. 1 and Attach. 1).[17]

The Joint Petitioners commit to flow through to customers the rate impact of the $201.642 million in PBAs immediately after the closing of the Proposed Transaction (Tr. 614; Exh. 50), which equates to approximately $54.8[18] million in immediate annual delivery rate reductions for customers (Tr. 614). To be clear, what this commitment means is that ratepayers will *never* have that $201.642 million included on the utility's books, and ratepayers will never have to pay rates that would permit the utilities to recover these amounts. The significant rate reductions afforded by this write-off stand unchallenged. The over $201 million in one-time, permanent write-offs and the $54.8 million in immediate annual delivery rate reductions reflect real quantifiable benefits, which go well beyond what is required, and should put to rest any doubt that the Proposed Transaction is in the public interest.

b. Generation Divestiture

While Joint Petitioners submit that there are no real vertical market power issues in this proceeding, the Joint Petitioners nonetheless commit through the Partial Acceptance to divest all of Energy East's existing New York fossil generation facilities. Staff and the Independent Power Producers of New York ("IPPNY") argue that the Proposed Transaction should not be approved unless it is conditioned upon the sale of the Russell Station and other fossil units (Tr. 900; 1420). Through the Partial Acceptance, the Joint Petitioners accepted Staff's and IPPNY's proposed condition by agreeing to "competitively bid and auction (i)

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17 The PBAs accepted were identified as those making the most sense to the Joint Petitioners and producing the most benefit to ratepayers, taking into consideration specific adjustments and total dollar value of the benefit from these items (Tr. 611-12).

18 This figure was calculated based on the rate reduction occurring on July 1, 2008, which would be simultaneous with or very close to when the write-offs occurred.

Russell Station; (ii) the 63 MW Allegany Station; (iii) the 14 MW Peaker Station 3; and (iv) the 14 MW Peaker Station 9" (Exh. 50 at 1). Cayuga Energy, an unregulated subsidiary of Energy East, will also competitively bid and auction the 67 MW Carthage Peaking Unit (*Id.*). By agreeing to bid and auction these fossil facilities, the Joint Petitioners have eliminated the most significant vertical market power issue raised in this proceeding.

The Joint Petitioners have not sought to direct how the auction protocols should be defined or how any above-book proceeds would be shared with ratepayers (Tr. 607-08). In the Partial Acceptance, the Joint Petitioners commit that the auction will be subject to "reasonable protocols" to be determined by the Commission (Exh. 50 at 1). Additionally, the above-book proceeds from the auction of RG&E's regulated assets (*i.e.*, Russell, Allegany and the Peakers) would be shared with ratepayers in a manner and amount to be determined by the Commission (Tr. 606-07; Exh. 50, p. 1, fn. 3). This provides the Commission with maximum flexibility to structure the auction in whatever manner it deems appropriate in a subsequent proceeding following the closing of the Proposed Transaction (Tr. 607). Additionally, as the Joint Petitioners' Policy Panel testifies, given the relatively low book values of the assets, combined with sufficient flexibility in how the auction is to be conducted, the auction process could be expected to produce substantial economic value to customers (Tr. 608-09).

c. Resolution Of The Electric Cooperative Matters Enhances The Reliability Benefits Of The Proposed Transaction

The Cooperatives have raised reliability matters in this proceeding (Tr. 87; 92-93; 98). Although the Cooperatives' concerns were unrelated to the Proposed Transaction, and the Joint Petitioners do not agree that the Cooperatives experienced sub-par levels of reliability as alleged, the Joint Petitioners have addressed and resolved those issues in detail in the Partial

Acceptance, and thus are providing additional tangible public benefits, including enhanced reliability for the Cooperatives (Exh. 50).

Among other things, the Joint Petitioners have agreed to form a "task force" consisting of the Cooperatives' and NYSEG personnel to address various issues, including identifying capital investments and improvements to enhance system reliability. NYSEG also has agreed to conduct a transmission study within ninety days after closing that would focus on the facilities serving the substations owned and controlled by the Cooperatives. The task force will review outage history and line performance, as well as specific plans and schedules associated with the maintenance of transmission and sub-transmission facilities that serve the Cooperatives. In addition, a specific communications protocol will be jointly developed by NYSEG and the Cooperatives.

NYSEG also has committed to prioritize its response to any outage affecting Cooperative customers in the same manner as an outage affecting a similar number of NYSEG's own retail customers (Exh. 50). Finally, the task force will consider the development of guidelines intended to lead to development of a penalty and enforcement protocol in the event NYSEG fails to meet certain minimum employment levels related to the reliable operation and maintenance of transmission and sub-transmission facilities or exceeds a maximum response time for outages (Exh. 50).

d. The Commitments To The City Of Rochester Will Provide Further Tangible Public Interest Benefits

The City of Rochester ("Rochester" or "City") stated that it could support the Proposed Transaction, but raised several concerns related to above-ground wiring, the sale of street lighting facilities, the remediation or disposition of RG&E's Beebee Station and Andrews

Street Facility, and access to RG&E's 81 South Avenue Facility (Tr. 1766; 1768-69).[19] While these matters are unrelated to the Proposed Transaction, the Joint Petitioners have nonetheless addressed Rochester's concerns.

The Joint Petitioners have agreed that RG&E will work with Rochester on a project-by-project basis, consistent with its filed tariffs, to accommodate the City's development interests, including specific requests for underground wiring (Tr. 573). The Partial Acceptance also addresses Rochester's concerns related to the sale to the City of certain street lighting assets owned by RG&E. In its testimony, Rochester requests that this sale transaction be "resolved promptly" (Tr. 1766), and RG&E has been in regular communication with the City on this issue (Tr. 573).

The Joint Petitioners have further addressed Rochester's concerns related to the timing of environmental remediation and the disposition of two large sites located in the City (Tr. 1766), Beebee Station and the Andrews Street Facility. The Beebee Station site, along with other similar sites, is the subject of a voluntary clean-up agreement entered into in 2003 by RG&E and the DEC (Tr. 574). The Andrews Street and Beebee Station sites both date from the 1800's (Tr. 575-76). While it is an extremely complex and expensive process to remediate old manufactured gas and generation facility sites for new commercial use (Tr. 574-76), RG&E has been actively working on moving remediation of these sites forward, and Beebee Station and Andrew Street Facility are in the DEC "queue." The Joint Petitioners have addressed Rochester's concerns regarding these facilities by committing to sharing schedule and milestone

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[19] The City of Rochester "recognizes potential positive impacts from the merger" and is particularly supportive of Iberdrola's commitment to retain the current corporate headquarters in Rochester and its statements that the Proposed Transaction will not result in any job losses. Rochester also recognizes Iberdrola's strong history and commitment to renewable energy sources, particularly, its global leadership in wind power (Tr. 1764).

data and providing progress reports to make the process more transparent and to address concerns regarding perceived delays (Exh. 50 at 3-4). Similarly, the Joint Petitioners have agreed to initiate additional discussions to review schedules for environmental remediation of the Beebee Station and the Andrews Street Facility, as well as necessary safety enhancements required for public access to the 81 South Avenue Facility (Exh. 50 at 3-4).

Although Rochester's concerns are not caused by or related to the Proposed Transaction, the Joint Petitioners have addressed them and provided additional environmental and other tangible public benefits that support approval of the transaction.

2. The Proposed Transaction Will Benefit The State Through Renewable Development Benefits, Upstate Economic Development And Job Retention

The Proposed Transaction will provide substantial benefits through Iberdrola's vast experience in successful renewables development, and commitment to support and encourage investments by Iberdrola Renovables, S.A. ("Iberdrola Renewables") (through its upstream voting interest in Iberdrola Renewables) in excess of $100 million in the development of wind generation in New York State within the next three years (Exh. 50 at 2). While Iberdrola's expectation is that approval of the Proposed Transaction will result in substantially more investments in New York State, this pledge of no less than $100 million provides assurance to the Commission and to the State that Iberdrola's commitment to renewable development in New York State is real and substantial.

Iberdrola's commitment to invest in wind generation in New York and its considerable expertise in renewables development will directly further the State's public policy goals. Under New York's Renewable Portfolio Standard ("RPS") program, the major investor-owned utilities collect certain revenues from ratepayers earmarked for the purpose of achieving a mandatory RPS target set at 24% of retail electricity consumption, with the remaining 1% to come from voluntary purchases made by retail customers (Tr. 515).[20] In April 2007, the State announced the "15x15" clean energy strategy to reduce the State's electricity consumption by 15% from forecasted levels by 2015 (Tr. 516). This strategy recognizes the need to phase out less secure and dirtier power plants and outlines a plan to make New York an ideal environment for investment in renewable energy projects (*Id.*). Most recently, the New York Renewable Energy Task Force, which includes several representatives from the Department of Public Service, issued a report highlighting the importance of renewable generation development in the State of New York (Exh. 112; *see also* Tr. 1500-05). Staff readily acknowledges the importance of the development of renewable generation to the State (Tr. 1166-67).

For the goals of these programs to materialize, the State of New York needs the presence of companies, like Iberdrola, with successful track records in renewables development. Iberdrola is the world's leading producer of electricity from wind energy, with approximately 7,000 MW of capacity installed. Nearly 50% of Iberdrola's 41,000 MW of total installed capacity is emissions-free (Tr. 505). Iberdrola has indicated its willingness to work with the State of New York to further the State's renewable energy goals, including meeting its aggressive RPS targets. Indeed, Iberdrola has substantial expertise, capacity and resources at its disposal, and is therefore uniquely positioned to help the State meet these goals.

In conjunction with Iberdrola's renewable energy development commitments and goals, Iberdrola will bring new jobs and related investment in the renewable generation industry to New York (Exh. 50). Additionally, Iberdrola has a strong history of regional investment in

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[20] *See* Case 03-E-0188 - *Proceeding Motion of the Commission Regarding a Retail Renewable Portfolio Standard, Order Regarding Renewable Portfolio Standard*, at 6 (Sept. 24, 2004) (hereinafter "*RPS Order*"). New York's 2002 State Energy Plan warned of the possible consequences of the State's heavy dependence on fossil fuel (Tr. 515). On September 24, 2004, the Commission adopted the RPS (Tr. 515; *RPS Order*). The RPS establishes the State's goal of increasing the proportion of renewable electricity used by New York consumers to at least 25% by 2013 (Tr. 515; *RPS Order* at 3).

those areas where it has completed major acquisitions, which should further contribute to economic development in upstate New York (Tr. 640-42). The Commission recognizes that economic development is a benefit when evaluating potential utility merger transactions.[21] Moreover, as Staff acknowledges (Tr. 1499-1500), the State of New York has determined that the development of renewable energy and the reduced use of fossil-fuel generation in the State are top priorities, including increasing the proportion of renewable electricity used by New York consumers to at least 25% by 2013. The Proposed Transaction will further economic development and job retention in upstate New York while also helping the State to satisfy its renewable energy goals.

Other parties to this proceeding recognize the economic development opportunities that the Proposed Transaction could bring to upstate New York. Greater Rochester Enterprise notes that Iberdrola's position as a global energy leader will help upstate New York to compete on the global stage for jobs and investment, recruit new companies to the region, and provide financial stability for continued infrastructure investments (Tr. 1778-80), and Empire State Development states that potential investment in NYSEG and RG&E by a leading international energy company presents a "key opportunity to assist the State in the implementation of upstate economic development objectives" (Tr. 525). Moreover, the NRDC, the DEC, the City of Rochester, and others have filed direct testimony that recognizes the renewable benefits that Iberdrola brings to the State (*see* Tr. 1029-30 (NRDC); 1764 (Rochester); 108 (NYDEC)).

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[21] *See LILCO/BUG Order*, *supra* note 12, at 8 (recognizing settlement's stimulation of economic development as a benefit); *see also* Case 96-C-0603 - *New York Telephone Co., et al., Order Approving Proposed Merger Subject to Conditions*, at 28 (May 30, 1997) (finding maintenance of the corporate headquarters in New York as one of the benefits that made the NYNEX/Bell Atlantic merger to be in the public interest).

In addition to these renewable and economic development benefits, the Joint Petitioners have stated that there will be no job losses in connection with the closing of the Proposed Transaction (Tr. 524; *see also* Tr. 636; 665-66).[22] Typically, when a merger results in synergistic savings, a component of those savings stems from the elimination of jobs (Tr. 524).[23] By contrast, Iberdrola does not own any regulated utilities in the U.S., and therefore the Proposed Transaction does not involve the combination or elimination of corporate or utility operating functions, which are necessary to produce such savings and often result in job losses (*Id.*). Additionally, Iberdrola commits that the headquarters of NYSEG and RG&E will not move out of upstate New York as a result of the Proposed Transaction (Tr. 669).

3. Financial Strength And Stability

The Proposed Transaction offers several important financial benefits to NYSEG's and RG&E's customers resulting from the fact that Iberdrola is a larger, stronger and more diversified holding company than Energy East (*see, e.g.*, Exh. 41 at 2-5; Tr. 490-91; 505; 507-08). In particular, the Proposed Transaction should provide NYSEG and RG&E with greater access to capital at a lower cost than they would have on a stand-alone basis as subsidiaries of Energy East (Tr. 508). As discussed below, it is consistent with the Commission's merger precedent to treat the financial strength and stability of an acquiring entity as a benefit when

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22 Iberdrola also has committed that existing employee compensation and benefits will remain substantially unchanged for a period of at least eighteen months after consummation of the Proposed Transaction (*see* Tr. 524).

23 Indeed, in each of the synergy mergers cited by Staff, concerns regarding the loss of jobs and employee benefits were raised to and addressed by the Commission. *See NG/KS Order*, *supra* note 12, at 154; *NIMO/NG Order*, *supra* note 12, at 17-18, 38-41; *ConEd/O&R Order*, *supra* note 12, at 2; *LILCO/BUG Order*, *supra* note 12, at 8.

evaluating a potential utility merger under the PSL.[24] Accordingly, the Commission should recognize Iberdrola's demonstrated financial strength, stability and strong "A" category credit ratings as a benefit of the Proposed Transaction.

The Commission has recognized that improvements in financial strength and stability resulting from a merger or acquisition are a benefit when evaluating whether a potential utility merger is in the public interest under the PSL. For example, in the Long Island Lighting Company/Brooklyn Union Gas Company merger, the Commission found that the merger would improve the utilities' financial integrity and access to capital.[25] Similarly, in the Thames/Long Island Water transaction, the Commission found that the financial standing of Thames was expected to provide the utility with better access to the capital markets on more favorable terms[26] and, in the Kelda/Aquarion transaction, the Commission treated Kelda's financial strength as a merger benefit.[27] Staff acknowledges that the Commission has treated an acquirer's financial strength as a benefit to New York utilities and their ratepayers in previous merger proceedings (Exh. 114 (IBER/EE IR No. 157)).

Here, Iberdrola is a $67 billion company carrying senior unsecured debt ratings/outlook from S&P, Moody's and Fitch of A-/Stable, A3/Stable and A/Negative, respectively (Tr. 507). Iberdrola's "A" category credit ratings were affirmed by Moody's in its recent February 2008 report (*see* Exh. 70). By contrast, Energy East's senior unsecured debt

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[24] *See Long Island Water/Thames Order, supra* note 6, at 6 (providing the utility with better access to capital markets was one of the benefits contributing to the satisfaction of the public interest standard).

[25] *See LILCO/BUG Order, supra* note 12, at 8, 37 (finding that the settlement improves the merged companies' financial integrity and access to capital).

[26] *Long Island Water/Thames Order, supra* note 6, at 6.

[27] Case 99-W-1128 - *Kelda Group plc and Aquarion Company, Order Approving Stock Acquisition and Merger*, at 7 (Dec. 20, 1999) (hereinafter "*Kelda/Aquarion Order*").

ratings/outlook from S&P, Moody's and Fitch are BBB/Negative, Baa2/Negative and BBB/Stable, respectively (Tr. 507). Additionally, Iberdrola's successful issuance of $4.5 billion of equity to fund the acquisition of Energy East is a good example of Iberdrola's ready access to the capital markets (Tr. 489; 507). Iberdrola's issuance of equity to fund the Proposed Transaction protects ratepayers from the risks of debt financing utilized in other transactions, such as the risks that accompanied the wholly debt-based financing of the National Grid/KeySpan merger (Tr. 507).[28]

The Proposed Transaction should provide NYSEG and RG&E with greater access to capital at a lower cost than they would have obtained on a stand-alone basis as subsidiaries of Energy East. Because the credit rating of a parent company can affect the credit rating of its subsidiaries (Tr. 508), it is reasonable to assume that the cost of debt capital for NYSEG and RG&E should be lower if they are subsidiaries of Iberdrola, which maintains a stronger credit rating than Energy East (Tr. 508; 944-45; 982). These lower debt costs are likely to translate into measurable capital cost savings for NYSEG and RG&E and its ratepayers as a result of the Proposed Transaction (Tr. 508).

4. Global Utility Expertise And Sharing Of Best Practices

Customers of NYSEG and RG&E will benefit from Iberdrola's extensive global utility expertise and the opportunity to share information regarding best practices with Iberdrola's other operating utility subsidiaries. While it is not possible to quantify with precision the direct benefits associated with sharing information about best practices, it is reasonable to assume that NYSEG and RG&E and their customers will benefit from this information sharing

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[28] *See* Case 07-M-0906 - *Staff Transcript Requests and Corrections* (Apr. 3, 2008). *See also* Tr. 1506. In remarks to Lehman Brothers on November 13, 2007, Commissioner Acampora emphasized the financial risk raised by debt financing in the National Grid/KeySpan merger as justification for the financial protection conditions imposed in that transaction (*see* Exh. 43).

over the long term. Here, the Commission should recognize Iberdrola's global utility expertise and the opportunity for NYSEG and RG&E to share information regarding best practices with Iberdrola's other operating utility subsidiaries as benefits of the Proposed Transaction (Tr. 253).

The Commission has regularly treated the global utility expertise of an acquiring entity as a benefit when evaluating a potential utility merger under the PSL. For example, in the Long Island Water/Thames transaction, the Commission found that the fact that Thames was an international firm with vast holdings in forty-four countries would provide its "American affiliates and subsidiaries the benefits of the knowledge, research and development it acquires elsewhere."[29] In the Kelda/Aquarion transaction, the Commission recognized the potential for sharing of best practices among U.S. and U.K. water utilities as a significant benefit, as well as the fact that the utility would obtain access to Kelda's ongoing research and development efforts.[30]

The record shows that Iberdrola will bring global utility expertise benefits to NYSEG and RG&E and their customers. Iberdrola is an innovative and diversified holder and manager of utility and other energy assets with 100 years of experience in the utility business (Tr. 512-13). Iberdrola provides high-quality, reliable and environmentally friendly distribution service to 22 million electric points of supply and 2 million gas points of supply in Europe and the Americas (Tr. 512-13; 485). Iberdrola's focus on service quality and operational excellence is evident in its superior performance as measured by the Customer Average Interruption Index ("CAIDI") and the System Average Interruption Frequency Index ("SAIFI"). Relative to U.S. benchmarks, Iberdrola over the last three years has delivered results that would rank in either the first or second quartile of U.S. utilities (Tr. 513; 490-91).

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29 *Long Island Water/Thames Order*, *supra* note 6, at 6.

30 *Kelda/Aquarion Order*, *supra* note 26, at 7.

Iberdrola has a good track record of sharing information about best practices among its operating utility subsidiaries and will continue to do so with Energy East, NYSEG and RG&E after the closing of the Proposed Transaction. For example, Iberdrola has had a measurable and positive influence on the operations of its utility subsidiaries in Brazil and Guatemala, where local management at those utilities instituted various programs and upgrades as a result of Iberdrola's practice of sharing information about best practices among its operating subsidiaries (Tr. 514). It is reasonable to assume that NYSEG and RG&E and their customers also will benefit from this information sharing over the long term (Tr. 943-44; *see also* Tr. 982).

5. No Recovery Of Transaction Costs Or Acquisition Premium From Ratepayers

The Joint Petitioners commit that there will be no recovery of costs incurred to consummate the Proposed Transaction from NYSEG's or RG&E's ratepayers (Tr. 491). Instead, all transaction costs associated with the Proposed Transaction will be borne by the shareholders of Iberdrola and Energy East. Thus, NYSEG's and RG&E's customers will be able to enjoy the aforementioned benefits of the Proposed Transaction (*e.g.*, rate reductions, economic development, Iberdrola's financial strength and stability, and global utility expertise) without incurring any additional costs.

Additionally, the Joint Petitioners commit that there will be no recovery in rates from NYSEG's or RG&E's ratepayers of the acquisition premium associated with the Proposed Transaction. Staff acknowledges that the commitment by Central Maine Power Company ("CMP") to forgo recovery of the Energy East acquisition premium incurred in its acquisition of CMP was treated by the Maine Public Utilities Commission as a significant ratepayer benefit of the Proposed Transaction, regardless of the fact that this acquisition premium was not likely one that would have been allowed to flow to ratepayers (Tr. 1458-60; *see also* Exh. 51 (Order

Approving Maine Stipulation) and Exh. 52 (Maine Stipulation)). Logically, the same should hold true here. The Joint Petitioners' commitment to forgo any recovery of the acquisition premium associated with the Proposed Transaction should be treated as an additional benefit to ratepayers resulting from the Proposed Transaction.

B. Staff Improperly Attempts To Create Hypothetical "Benefits" To Justify Its Proposed Rate Mitigations

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

Nonetheless, Staff creates a wish-list of extraordinary concessions reflected in its proposed PBAs that it would like the Joint Petitioners to give to ratepayers in this proceeding, regardless of the fact that those items are unrelated to any claimed synergy savings resulting from the Proposed Transaction. Indeed, these rate concessions lack any substantive record support as evidenced by Staff witness Mr. Haslinger's concession that the PBAs proposed by Staff would not be adopted if presented in a rate case (Tr. 1704-05). Staff then assembles another list of purported "benefits" to attempt to rationalize its enormous proposed ratepayer concessions (Tr. 1367; 1371-72). However, as explained below, this second list of so-called justifications (or "proxy" benefits) does not reflect synergy savings or any other actual benefits to Iberdrola resulting from the Proposed Transaction and provides no basis for any proposed mandatory concession or condition.

Staff does not hide its reason for using this approach. On cross-examination, Staff has admitted that "there really isn't any guidance in the precedents we looked at as to how to develop positive benefits to ratepayers" (Tr. 1510). It is not surprising that Staff finds no guidance, because, by its own admission, it looks only to synergy merger cases for precedent (*see* Exh. 114 (IBER/EE IR. Nos. 2, 10)). This Commission has never relied upon non-existent synergy benefits in a Section 70 merger proceeding in an effort to reach targeted rate concessions.[31] The Commission should not begin such an unprincipled practice now.

Merger conditions need to be related to the merger transaction itself, and if rate conditions are required, they should be extracted from or offset by real quantifiable merger synergies created by the transaction: "Rate conditions are not a form of legalized extortion or a ransom to be paid to customers[,]" (Tr. 955-56), but instead have a "principled foundation" (Tr. 955), as Mr. Meehan advises.

Additionally, Staff's recommended approach would be bad public policy. Requiring merging parties to pay a cost above those necessary to consummate a merger is tantamount to levying an entrance fee or toll to conduct business in New York (and the revenue impact of the PBAs on NYSEG and RG&E would be significant, as discussed in Section VI below). This approach would deter future mergers, including those that provide benefits such as

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[31] In the synergy merger cases identified by Staff, rate reductions were the result of synergy and/or efficiency savings that the parties stated were anticipated to result from the transaction. *See* discussion, *supra* notes 12 and 13. In non-synergy merger cases like the Proposed Transaction, however, the Commission has not conditioned its approval on upfront rate concessions or reductions (Tr. 937), and in fact approved at least one non-synergy merger that was accompanied by a rate plan which resulted in significant rate *increases*. *See United Water New York/United Water South County Order*, *supra* note 6, at 12-14, 38 (discussion and approval of increases). The Commission has never previously attempted to impute synergy savings where none exist - such as Staff recommends it do here. *See, e.g.*, *United Water New York/United Water South County Order*, *supra* note 6, at 36; *Philadelphia/AquaSource Order*, *supra* note 6, at 6; *see also* Tr. 942-43 ("[t]he Commission has recognized synergy savings where they exist and has not attempted to manufacture merger savings where synergies are not present.").

the ones available here and recognized by the Commission (Tr. 958; 1000-01). Staff's desired policy would be particularly detrimental at this time, given the large amounts of investment in electric generating, transmission and distribution infrastructure that will be required[32] in coming years.[33]

1. The Hypothetical Benefits Staff Asserts To Justify Its PBAs Are Illusory And Unsupported By The Record

In its testimony, Staff cobbles together a list of purported proxy "benefits," totaling over $1.6 billion, which allegedly justify the PBAs requested as proposed conditions (Tr. 1210-21; Exh. 106). Staff's proxy "benefits," however, fail to provide an independent justification for the level of PBAs Staff advocates because they are unsupported by the record, lack a legal, theoretical or factual basis, and suffer from fundamental computational errors. And, most of the so-called "benefits" Staff identifies are in fact costs that Iberdrola is required to bear in order to consummate the Proposed Transaction.

a. Payments To Energy East Shareholders

Based on the above-market premium being paid by Iberdrola for the shares of Energy East, Staff asserts that the Proposed Transaction will result in $930 million in benefits to Energy East's shareholders that justify Staff's PBAs (Tr. 1219; 1368-69). This argument is baseless.

As a practical matter, as Mr. Meehan explains, the acquisition premium to be paid to Energy East shareholders is not a "benefit" as Staff would suggest, but instead reflects a *cost*

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[32] The Edison Electric Institute forecasts that, on average, $14 billion per year will have to be spent on distribution investment over the next 10 years, and that another $400 billion in generating plants will be required between 2006 and 2030 (Tr. 958).

[33] Regardless of whether synergy benefits have been identified or quantified, ratepayers would still obtain the value of any future opportunities for operational savings, should they materialize. Any savings in the future would be passed on in their entirety to ratepayers in the ordinary course of ratemaking (Tr. 956-57; 996).

that will be incurred by Iberdrola's shareholders in order for the Proposed Transaction to occur (Tr. 953; *see also* Tr. 542). Staff ultimately admitted at hearing that this premium is not something that NYSEG, RG&E or even Energy East would receive or retain following closing, but rather reflects a cost for Iberdrola (Tr. 1507-08). The Joint Petitioners commit that they will not attempt to recover any of this premium from New York ratepayers (Exh. 41 at 3, 16; Tr. 562). Thus, the payments will not affect the New York utilities or their ratepayers, and therefore they fall outside the concern of the Commission (Tr. 953).

Staff concedes that it is not aware of any instance where the Commission has previously found that an above-market premium represents a benefit to be shared with ratepayers (Tr. 1509-10). Nevertheless, in an attempt to support Staff's argument that the acquisition premium paid to Energy East shareholders justifies its proposed PBAs, Staff argues that the instant case is comparable to RG&E's recent sale of its Ginna facility "in that Energy East is essentially selling all of its assets to Iberdrola[,]" and further states that in RG&E's recent sale of its Ginna facility, "customers received over 95% of the gain on that sale" (Tr. 1369). This comparison has no merit.

A sale of a regulated asset out of rate base of a utility is not the same as a sale of the stock of a parent corporation of a utility. In the case of the ConEd/O&R merger, the Commission rejected precisely the same argument, and found that stock sales should not be treated as analogous to an asset sale.[34] In that case, contrary to Staff's position here, Staff made the following principled points in support of the settlement at issue:

> [The] argument that ratepayers have a claim on a portion of the stock premium proposed to be paid by CEI shareholders to O&R shareholders is not borne out by the authorities cited. . . . What

[34] *See ConEd/O&R Order*, *supra* note 12, at 21 (distinguishing asset transfer cases from those involving stock acquisitions and mergers).

> Rockland [County] proposes is in essence a tax on the stock transfer even though the regulated entity has not given up a single asset. Staff knows of no precedent for such a proposal and sees no regulatory principle that would justify such a proposal as the ratepayer interest in the assets remains unaffected by the merger and stock transfer.[35]

Staff's prior analysis in that case remains correct. The Commission should reject Staff's claim here that the above-market premium to be paid by Iberdrola is a "benefit" to Iberdrola that somehow justifies its proposed level of PBAs.[36]

b. Payments To Third Parties And Energy East Executives

Staff also makes the far-fetched claim that payments by Iberdrola to third parties (*e.g.*, investment bankers, advisors and attorneys) and Energy East executives are benefits that justify its proposed PBAs (Tr. 1219-21).[37] The Joint Petitioners' Policy Panel and Mr. Meehan explain what should be plainly evident: payments made by Iberdrola to third parties and executives are *costs* necessary to effectuate the Proposed Transaction, not "benefits." (Tr. 542; 952-53). Neither Iberdrola nor Energy East will in any way benefit from or retain these payments, and the level of these payments is also not related to, or based on, synergies or efficiencies resulting from the Proposed Transaction (Tr. 949). Staff admitted at the hearing that NYSEG, RG&E and Iberdrola do not retain these payments (Tr. 1554-56). Accordingly, there is

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

[36] In addition, Staff errs in assuming that the entire above-market premium resulting from the Proposed Transaction is related to the acquisition of NYSEG and RG&E (*see* Tr. 948; 955). Staff's calculation of the alleged acquisition premium benefit is also flawed because Staff acknowledges that acquisition premiums paid to Energy East shareholders would be subject to capital gains taxes (Tr. 1527). Nonetheless, Staff simplistically assumes that the full amount of such payments can be classified as "benefits" to shareholders (*see* Exh. 106).

[37] As with its above-market premium calculations, Staff makes critical errors in calculating the benefits to Energy East executives and third parties. Not only does Staff assign the entirety of such payments to New York (*see* Tr. 948), but Staff also assumes that the full amount of payments to executives and third parties should be classified as benefits despite acknowledging that the payments would be taxable (Tr. 1557-58).

no basis for attempting to characterize payments to executives and third parties as benefits that can be shared between ratepayers and Iberdrola, or that can be used to justify Staff's proposed PBAs.

Moreover, there is no legal basis supporting Staff's suggestion that payments can somehow be classified as "benefits." The Commission has never found that payments to third parties constitute benefits from an acquisition. Indeed, Staff transparently conceded at hearing that they pointed to these payments only because "[w]e don't have any other way of evaluating the benefits that Mr. Benedict and Mr. Haslinger presented" (Tr. 1511; *see also* Tr. 1556-57). Staff's argument that such costs should be treated as benefits, if accepted, would result in Iberdrola being double charged for its transaction costs (Tr. 953). Such an approach would likely deter future investment in New York (Tr. 957-58).

c. Production Tax Credits

Production tax credits, or "PTCs" are provided under federal law to developers of certain renewable generation projects.[38] As part of its proposed PBAs, Staff purports to identify certain "non-traditional synergistic tax benefits" resulting from the Proposed Transaction, including benefits in the form of PTCs that may be available to Iberdrola's affiliated wind generation in the U.S. (Tr. 1207; 1210-15).[39] Staff claims that, "[t]hrough the acquisition of Energy East, [Iberdrola] will acquire taxable income sufficient to enable it to utilize at least some

[38] The amount of the federal PTC for qualifying wind facilities is currently 2.0 cents/kWh of electricity produced in the U.S. from wind and sold to an unaffiliated third party (Tr. 527). Because PTCs result in a reduction of U.S. federal tax liability, the entity (or consolidated tax group of entities) claiming such benefit must have sufficient offsetting U.S. federal tax liability to fully utilize the PTC from affiliated wind projects (Tr. 528). The PTC mechanism is currently scheduled to expire at the end of 2008, unless extended by Congress (*Id.*).

[39] Staff's statement that Iberdrola owns wind projects in the U.S. that are eligible for PTCs is misleading (Tr. 1213). In fact, each wind project in the U.S. that is affiliated with Iberdrola is a wholly- or partially-owned indirect subsidiary of Iberdrola Renewables, an independent company (Tr. 622-24), which is owned only 80% by Iberdrola; the remaining 20% of Iberdrola Renewables' shares are traded on the Spanish stock exchanges (Tr. 528; 670).

and perhaps all of the PTCs that it has generated" (Tr. 1214). Staff attributes up to $50 million of value to Iberdrola Renewables' PTCs based on Iberdrola Renewables' existing ownership of wind power facilities, and up to $150 million if Iberdrola constructs all planned generation for 2007-08 (Tr. 1214 (citing Exh. 93)).

As an initial matter, Staff ignores that the purpose of PTCs is to put renewable generation on a competitively-level playing field with investment in non-renewable generation (Tr. 527; 532). Congress created the PTC mechanism as part of the Energy Policy Act of 1992 to provide incentives for the development of renewable generation, and these incentives would be dampened if the tax benefits do not flow to the intended party (Tr. 527-28).[40] In its report, the Ways and Means Committee of the United States House of Representatives stated "that the development and utilization of certain renewable energy sources should be encouraged through the tax laws."[41] The Committee further noted that "[t]he credit is intended to enhance the development of technology to utilize the specified renewable energy sources and to promote competition between renewable energy sources and conventional energy sources."[42] By ignoring the public policy and economic purpose of the PTC mechanism, Staff ignores the fact that, if PTCs provided by the federal treasury are siphoned away through regulatory processes, such as through PBAs, associated investments in renewable generation simply will not happen (Tr. 651-52).

Moreover, Staff does not provide any support for its calculations of the PTC-related "non-traditional synergistic tax benefits" that it attributes to the Proposed Transaction.

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40 *See generally* Energy Policy Act of 1992, Pub. L. 102-486, § 1212, 106 Stat. 2776, 2970 (1992) (prior to 2005 amendment).

41 H.R. Rep. No. 102-474(VI), at 42 (1992).

42 *Id.*

Staff assumes that all of the MWs from Iberdrola Renewables' operational wind projects, plus wind projects under development by Iberdrola Renewables' subsidiaries (identified in the Hieronymus FERC analysis that was attached to the Joint Petition; *see* Exh. 19 of Exh. 41) are eligible for PTCs (Exh. 93). Staff then applies a value of $0.019 PTC/kWh to such projects (*Id.*). Even assuming that it would be appropriate to treat Iberdrola Renewables' PTCs as benefits for purposes of attempting to justify Staff's proposed PBAs (which it is not), Staff makes a number of erroneous assumptions in its calculations to estimate such benefits.

First, the record shows that PTCs associated with Iberdrola Renewables' operational wind projects in the U.S. have already been utilized by third-party equity investors (Tr. 529-30; Exh. 19, IBER-388/DPS-186).[43] Staff ignores the fact that existing tax equity structures are in place for these projects by including those projects in its calculation of so-called "benefits" from the Proposed Transaction. This oversight is a critical mistake. While Staff claims it has no information to evaluate whether and the extent to which tax equity structures are in place (Tr. 1535-37), the record evidence proves otherwise. For example, on October 19, 2006, the Commission issued an order determining that a tax equity structure for Flat Rock Wind Power LLC and Flat Rock Wind Power II LLC, which own Iberdrola Renewables' operating wind projects in New York, did not require approval under PSL Sections 69 or 70.[44]

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43 Under so-called "tax equity" structures, a non-affiliated equity investor that is a partial owner of the project can utilize the PTCs to offset its own U.S. federal taxable income (Tr. 529). These structures facilitate Iberdrola Renewables' wind growth beyond its own tax capacity (*Id.*). There is a strong demand for such tax-advantaged investments in the U.S. market, and numerous entities in the financial community are involved in providing tax equity investment for renewable projects (Tr. 530; 725). In fact, tax equity structures are so common in the wind industry that the U.S. Internal Revenue Service recently issued special rules for these structures (Tr. 530).

44 *See* Case 06-E-1106 - *PPM Energy, Inc., PPM Wind Energy LLC, Atlantic Renewable Projects LLC, and Aeolus Wind Power II LLC, Declaratory Ruling on Regulation of Intra-Corporate and Other Transactions* (Oct. 19, 2006).

Second, even if there were any PTCs available with respect to Iberdrola Renewables' wind projects in the U.S., those PTCs are wholly unrelated to the Proposed Transaction. PTCs exist regardless of whether the Proposed Transaction is consummated and regardless of Energy East's tax liability (Tr. 528). PTCs are designed to encourage the development of wind resources (Tr. 532; 626), a goal that would be undermined by treating PTCs as justification for Staff's proposed PBAs.

Third, Staff's calculations include projects that are still under development. Any attempt to determine the availability of PTCs for wind projects that Iberdrola Renewables may develop in the future is simply an exercise in speculation for a number of reasons:

- The completion of any wind development project depends upon a variety of development risks and other factors (Tr. 530). As the completion of and operation of development projects are not certain, the availability of any PTCs associated with those projects is also uncertain.

- The availability of PTCs for any future Iberdrola Renewables wind projects is uncertain given that the PTC mechanism is currently scheduled to expire on December 31, 2008 (Tr. 528). While the Joint Petitioners anticipate that Congress may extend the PTC mechanism beyond 2008, there is no guarantee that this will happen (Tr. 530-31).

- The value of a PTC is based on the amount in kWh of electricity actually generated by a project (Tr. 531). Given the intermittent and unpredictable nature of wind, the amount of PTCs available to any future project (assuming that the project is actually constructed and eligible for PTCs) would also be uncertain. Moreover, the decision as to how to utilize any future PTCs that may become available will be made by Iberdrola Renewables, taking into consideration its tax liability and the tax liability of those entities with which it is consolidated for tax purposes (Tr. 531).

Thus, it is not appropriate for the Commission to rely on speculative PTC benefits as proxies to rationalize Staff's proposed PBAs.[45]

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[45] Furthermore, undercutting Staff's own calculations, Staff implicitly acknowledges that only a portion of the PTCs for Iberdrola Renewables' wind projects potentially could ever be used to reduce the U.S. federal tax liability of Iberdrola Renewables and those entities with which it is

For all these reasons, Iberdrola correctly excludes any PTC benefits associated with Iberdrola Renewables' wind projects when valuing the Proposed Transaction (Tr. 652).

d. Spanish Tax Deferrals/Amortizations

Staff also includes certain Spanish tax benefits potentially accruing to Iberdrola after the Proposed Transaction as proxy benefits to justify its proposed PBAs. These tax benefits are speculative at best and using them to justify Staff's proposed PBAs contradicts the policy objective underlying their design. Indeed, Iberdrola did not consider any Spanish tax savings or benefits in its valuation of the Proposed Transaction (Tr. 536).

Staff claims that Iberdrola will reap significant Spanish tax benefits associated with the acquisition premium as a result of the Proposed Transaction (Tr. 1210). In so doing, Staff relies on one of Iberdrola's responses to an information request to calculate the tax benefits accruing to Iberdrola. In that response, Iberdrola states that Article 12(5) of the Spanish Corporate Income Tax law provides that the financial Goodwill connected with the acquisition of shares in qualifying foreign subsidiaries may be amortized for tax purposes at a maximum yearly rate of 5% over 20 years (Exh. 88). Staff manipulates this response to calculate that tax benefits to Iberdrola at the 30% Spanish tax rate could range from $125 million to $476 million in nominal dollars (Tr. 1211). Staff then takes the high end of that range to inflate its artificial calculation of total imputed benefits to Iberdrola, Energy East and others (Exh. 106).

It is inappropriate to consider these speculative Spanish tax "benefits" as a proxy for synergies in this proceeding. As an initial matter, this is a Spanish tax deferral that is unrelated to NYSEG and RG&E. The Petitioners have agreed that ratepayers will never have to pay the acquisition premium, and therefore any potential tax savings related to the acquisition

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consolidated for tax purposes (Tr. 1214). However, Staff's calculations do not exclude any of its PTC calculations to account for this acknowledgement (Exh. 93).

premium should likewise not be available for customers. Potential tax savings or deferrals offered by the Spanish government to holding companies should not be treated as a proxy for synergies in any proposed acquisition, including this one (Tr. 536; 949-50). Staff and Multiple Intervenors' attempt to claim that these tax credits would improperly shift benefits, if any, from the holding company to New York ratepayers (Tr. 949-50; 656-57), even though these benefits have *nothing to do with the cost of service of New York regulated electric and gas utilities* (Tr. 949-50; 656-57). Governments create tax benefits to provide incentives to encourage investment which would be dampened if the benefits do not flow to the intended party. In this case, the principle is particularly clear: the tax benefits, if any, are intended to go to Spanish companies to give them an incentive to invest abroad (Tr. 657; 950).

Furthermore, there is no certainty that Iberdrola will ever be able to obtain any tax offset or Goodwill amortization associated with the Proposed Transaction under Spanish law (Tr. 536). The amortization of Goodwill pursuant to Article 12(5) is subject to significant legal restrictions imposed by tax authorities in Spain. In particular, recent rulings by these authorities hold that the acquisition of a holding company (*i.e.*, where the top tier entity is not the operating utility company, as is the case with Energy East) may not generate Goodwill eligible for amortization (Tr. 534-35; 655). Therefore, it is uncertain, if not unlikely, whether any or all of the Goodwill associated with the Proposed Transaction would ever be eligible for amortization under Article 12(5). By way of example, Iberdrola has not yet been able to determine whether any or all Goodwill from its ScottishPower acquisition, which closed in April 2007, will be eligible for amortization under Article 12(5) (Tr. 535). Moreover, if and to the extent that Article 12(5) applies (which is unlikely in this case), it operates as a tax deferral, rather than as a straight deduction (Tr. 536; 654). If and when an acquired company is sold, the amount of the financial Goodwill which has been amortized pursuant to Article 12(5) may be recaptured in the taxable base of the seller.

Staff also suggests that Iberdrola may be eligible for other Spanish tax credits. Again, Staff relies on a response by Iberdrola to an information request to calculate these benefits. In that response, Iberdrola states that Article 37 of the Spanish Corporate Income Tax law, as originally enacted, allowed companies purchasing shareholdings in foreign companies directly to offset up to 15% of the price paid against tax to the extent to which the purchase leads to increased export activities (Tr. 1212). Since that response was provided, however, Iberdrola has clarified on the record that no tax benefits are possible under this provision (Tr. 535-36).

2. Staff's Claim That Opportunities For Synergies Exist Has No Basis In Fact And Would Not Be Permitted Under Staff's Recommended Conditions For Approval Of The Proposed Transaction

Nothing more clearly demonstrates Staff's extreme positions in this proceeding than its claims regarding synergy opportunities. While Staff claims that Iberdrola and Energy East should be able to find synergies as a result of the Proposed Transaction (Tr. 1206-10), Staff's proposal regarding affiliate transactions would preclude all opportunities to achieve any such savings.

Because the Proposed Transaction is a non-synergy merger, Iberdrola has not identified any opportunities for synergy savings resulting from the Proposed Transaction (Tr. 526-27; 935-936). This is very different from more traditional synergy-driven mergers in which combinations of regulated utility systems created opportunities for synergy savings (Tr. 526-27; 934-936). In addition to claimed "proxy" benefits and notwithstanding the fact that there are no synergies to be obtained in this transaction, Staff claims that Iberdrola should have been able to identify synergies from the Proposed Transaction (Tr. 1206-10). Specifically, Staff claims that Iberdrola should have been able to consolidate certain service and administrative functions for use throughout Iberdrola's regulated and unregulated operations in the United States (Tr. 1208; 1228-30). As discussed below, no such synergy savings will result from the Proposed Transaction, nor would Staff's recommended affiliate transaction rules permit any such savings to occur.

a. Synergy Savings Have Not Been Identified And Would Not Result From The Proposed Transaction

Iberdrola did not identify or take into consideration any integration or other types of synergy savings in evaluating the Proposed Transaction (Tr. 536-37). As the Joint Petitioners explained in detail, such synergies would not be expected to result from a first-mover non-synergy driven merger (Tr. 526-27; 935-936). Furthermore, all ascertainable integration savings associated with Energy East were already realized beginning in 2002 when it acquired the last of its various operating companies, RG&E, and ending in 2004 with the consolidation of administrative functions, including IT, accounting, payroll, HR, finance, and supply chain followed by the implementation of the SAP system to support these centralized shared services (Tr. 536-37).[46] These synergy savings were recognized and reflected in the NYSEG and RG&E rate cases in 2002 and 2003.

Non-synergy mergers do not provide significant opportunities for integration savings. For example, even though SAP application consolidation was involved in Iberdrola's acquisition of Scottish Power, it provided only €3 million in synergy benefits related to ScottishPower's regulated transmission and distribution ("T&D") operations in that transaction.[47]

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[46] Energy East consolidated its regulated operations on a single IT platform from 2002-2005 when it created a new shared service organization to support just its regulated utility operating companies (Tr. 537). The Joint Petitioners' Policy Panel explained the four steps required for IT consolidation among Energy East's utilities (Tr. 538-39).

[47] While Staff asserted in testimony that the Iberdrola synergies from acquiring ScottishPower were significantly in excess of this €3 million, Staff did not dispute that the portion of such

In addition, it would be unrealistic to think that the Joint Petitioners would be permitted to consolidate shared administrative services among Energy East, NYSEG, RG&E and Iberdrola's unregulated generation and natural gas affiliates in the U.S. because of the significant regulatory barriers to combining the functions of regulated and non-regulated affiliates (Tr. 537). Indeed, as explained below, Staff proposes to prohibit any such combining of functions as part of the affiliate rules proposed in this proceeding.

b. No Synergies Among Regulated And Unregulated Entities In The United States Would Be Possible Or Permissible Under Staff's Recommended Standards Pertaining To Affiliates

Staff proposes affiliate transaction rules (Exh. 111 – "Standards Pertaining to Affiliates and the Provision of Information") that would prevent Iberdrola from achieving any synergies via the combination of its U.S. businesses, including any hypothetical IT consolidation. Staff requests that the Commission condition any approval of the Proposed Transaction on the adoption and inclusion of Staff's proposed affiliate transaction rules as part of the Commission's order (Tr. 1425-32; 1498; Exh. 111). Staff's proposed prohibition on affiliate transactions states as follows:

> Corporate services such as corporate governance, administrative, legal, purchasing and accounting currently provided by Management Corp. or another affiliate of Energy East including RGS for the DISCO and other affiliates on a fully loaded cost basis may continue. *Iberdrola or its affiliates may not provide goods and services to the DISCO*.

(Exh. 111 at 13; Tr. 1497) (emphasis added). Upon cross-examination, Mr. D'Ambrosia of the Staff Policy Panel acknowledged and asserted that this particular proposed prohibition would prevent Iberdrola or any of its affiliates from providing *any* goods or services to NYSEG or RG&E, including IT services:

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combination attributable to ScottishPower's regulated T&D operations was limited to €3 million (Tr. 541).

> Q. You were requesting as a condition of this merger that this document, in Appendix B, this Exhibit 111, be adopted and included as part of the conditions associated with approval of this acquisition if this acquisition is approved by the Commission; is that right?
> A. (D'Ambrosia) That is correct.
> Q. Thank you.
> And in that last sentence you read which states that Iberdrola or its affiliates may not provide goods and services to the disco, what types of goods and services do you think that includes?
> A. (D'Ambrosia) From Iberdrola?
> Q. What types of goods and services do you think is meant by that sentence?
> A. (D'Ambrosia) Any service.
> Q. Any service. Thank you. Does that include any services -- does that include O&M services?
> A. (D'Ambrosia) Yes.
> Q. How about back office services?
> A. (D'Ambrosia) Yes.
> Q. How about accounting services?
> A. (D'Ambrosia) Yes.
> Q. How about information technology services?
> A. (D'Ambrosia) Yes.

(Tr. 1498-99). As Mr. D'Ambrosia admits, 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, including IT services, for NYSEG or RG&E. Staff's criticisms about Iberdrola's inability to identify synergies between its unregulated Iberdrola Renewable operations and Energy East's regulated utilities are disingenuous in light of Staff's own requested prohibition against such services.

3. Staff's Attempts To Justify Its Proposed PBAs Based On Rate Concessions Adopted In The National Grid/KeySpan And Energy East/RGS Mergers Are Fundamentally Flawed

In addition to its fabrication of proxy benefits, Staff tries to justify its recommended PBAs by relying on comparisons to rate concessions in the National Grid/KeySpan and Energy East/RGS mergers (Tr. 1370; Exh. 107). Staff's attempt to compare the Proposed Transaction to these mergers is severely flawed. As an initial matter, unlike the Proposed Transaction, both the National Grid/KeySpan and Energy East/RGS mergers were synergy mergers that allowed for delivery rate reductions funded from synergy savings (Tr. 961). The Energy East/RGS case involved NYSEG and RG&E, two neighboring New York utilities with clear opportunities for synergy savings (Tr. 960). Similarly, prior to its merger with KeySpan, National Grid already owned a New York utility (Niagara Mohawk), and had also previously acquired other utility assets in New England (Tr. 961).

In addition, Mr. Meehan explains that, even if it were appropriate to look to National Grid/KeySpan for guidance (which it is not), Staff's references to calculations from rate mitigations from the National Grid/KeySpan merger are flawed.[48] For example, Staff asserts that that merger resulted in \$602.8 million in rate mitigations over five years; however, in its Order, the Commission rejected this figure, finding that a portion of the \$602.8 million would have been achievable even absent the merger and only found \$407.88 million in benefits (Tr. 962). Because the Proposed Transaction is a non-synergy merger, Staff should have, but failed to, subtract synergy savings that were shared between ratepayers and National Grid shareholders (Tr. 962-63). Mr. Meehan also explains that because LIPA and Niagara Mohawk received a share of the merger benefits in the National Grid/KeySpan merger, Staff should have, but failed to, divide non-synergy rate mitigations by a delivery revenue value that includes LIPA and Niagara Mohawk revenue (Tr. 963). Correcting for these errors, Mr. Meehan shows that "[i]f the correct non-synergy rate mitigation of \$317.6 million is divided by aggregate New York delivery revenues for Niagara Mohawk and LIPA, the percentage of non-synergy rate reductions . . .

48 Mr. Meehan explains that he focused his analysis on the National Grid/KeySpan merger because in that case, there was a detailed settlement and a Commission order describing the adopted rate reductions (Tr. 961).

would be 1.34 percent. Applied to the Proposed Transaction, this would yield non-synergy rate mitigation of $87 million" (Tr. 963; Exh. 79).[49] Staff, however, is requesting non-synergy rate concessions in excess of approximately $855 million (*see* Exh. 28).[50]

V. STAFF'S PERCEIVED RISKS ARE OVERBLOWN AND UNSUPPORTED

A. Vertical Market Power

The Proposed Transaction raises no vertical market power concerns. As discussed, Joint Petitioners commit to divest all of Energy East's fossil generation facilities in New York, thereby eliminating alleged vertical market power concerns raised by certain parties in this proceeding. Moreover, as described below: (1) affiliates of Iberdrola Renewables currently own and plan to construct amounts of wind generation in New York that do not raise market power concerns, particularly given that all of this generation consists of intermittent wind power projects unable to influence market-clearing prices or congestion in the New York Independent System Operator, Inc. ("NYISO") markets; and (2) any lingering vertical market power concerns regarding this intermittent wind generation are fully addressed by the robust measures implemented by the NYISO and the FERC.

Staff claims that if the Commission approves the Proposed Transaction the Commission's 1998 Vertical Market Power Policy Statement (the "VMP Policy Statement") requires that Iberdrola Renewables divest its New York wind generation projects (Tr. 1247-49;

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49 Although Mr. Meehan attempted to correct Staff's computational errors with respect to the National Grid/KeySpan rate mitigation, Mr. Meehan states that even his corrected calculations may be overstated because a large portion—$261.5 million of the $317.6 million—in rate concessions was not a result of the merger. Instead, this $261.5 million resulted from resolution of various disputes (Tr. 964). Because these issues were resolved through settlement rather than being fully litigated, Mr. Meehan states that "[i]t is impossible to judge what portion of that $261.5 million should be used in a comparative analysis, but the Staff Policy Panel blindly attributes all $261.5 million to the merger and this is a clear overstatement" (*Id.*).

50 Staff also made claims that sought to disallow recovery of certain items permitted in the EE/RGS merger proceeding (*see* Exh. 107). The Joint Petitioners' Policy Panel rebuts each of these items in its rebuttal testimony (Tr. 570-72).

1420). IPPNY also argues that the VMP Policy Statement requires a commitment by Iberdrola Renewables not to construct or otherwise acquire any electric generating facilities that are located in the service territory of NYSEG or RG&E (Tr. 900; 923).[51] The VMP Policy Statement does not create an absolute prohibition against a transmission owner ("TO") acquiring or being affiliated with generation in New York State, but rather establishes that "a rebuttable presumption will exist for purposes of the Commission's Section 70 review of the transfer of generation assets, that ownership of generation by a [TO] affiliate would unacceptably exacerbate the potential for vertical market power."[52] Here, the record shows that the VMP Policy Statement's presumption is inapplicable or has been satisfactorily rebutted.

1. Renewable Generation Of Iberdrola Renewables' Affiliates Does Not Raise Market Power Concerns, Particularly Given Its Intermittent Characteristics And Location On The West Side Of The Major Transmission Constraint In New York

Renewable generation currently owned or controlled by Iberdrola Renewables in New York State does not raise market power concerns (Tr. 808; 813-14).[53] All of Iberdrola Renewables' operating and planned capacity in New York is wind-powered and located west of

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51 Because Iberdrola Renewables' electric generation projects will interconnect with a TO's transmission facilities, and not with a TO's service territory, IPPNY appears to be seeking a prohibition against the interconnection of affiliated generation projects to NYSEG's or RG&E's transmission facilities (Tr. 521-22).

52 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, et al.*, *Statement of Policy Regarding Vertical Market Power*, at Appx. I, p. 1-2 (July 17, 1998) (hereinafter "*VMP Policy Statement*").

53 Iberdrola Renewables' ownership interest in operating wind generation facilities in New York is only 160.9 MW (Tr. 814). This ownership interest represents an indirect 50% interest in the Maple Ridge wind farm in Lewis County, which has a nameplate rating of 321.8 MW. The remaining 50% interest in the Maple Ridge wind farm is held by Horizon Wind Energy, which is owned by Energías de Portugal, S.A. ("EDP"). Iberdrola, through its wholly-owned subsidiary IBERDROLA Portugal Electricidade e Gas, S.A., holds a 9.5% equity interest in EDP, but does not exercise voting rights associated with more than 5% of EDP's share capital. Iberdrola does not have any directors on EDP's board, and does not otherwise participate in EDP's management (Tr. 814).

the major upstate transmission constraint (Tr. 819-20). As a result, this generation will be unable to influence market-clearing prices or congestion in the NYISO markets.[54]

Iberdrola Renewables' wind generation produces energy on an intermittent and unpredictable basis (Tr. 818; 863-64). As a result, energy from these wind projects cannot reasonably be sold in NYISO's day-ahead market, in which the substantial majority of New York electricity is bought and sold (Tr. 818; 863). If a wind generator were to sell into the day-ahead energy market, it would have to assume the risk of paying the unpredictable real-time price to cover the financially firm energy that it sold in the day-ahead market in the quite common event that it cannot produce the committed energy (*i.e.*, if the wind is not sufficient to run its turbines) (*Id.*). Instead, wind projects must participate in NYISO's much smaller real-time market (Tr. 863). In addition, because Iberdrola Renewables' projects are all wind-powered units, they have zero fuel costs. It would be economically costly, and thus irrational and self-defeating, to withhold wind-powered energy from the real-time market (Tr. 818; 864).

None of Iberdrola Renewables' wind projects is located in a transmission constrained area (also known as a load pocket) (Tr. 819). As described by the NYISO Market Monitor in its 2006 State of the Market Report, one of the most important constraints in New York is the Central-East constraint (Tr. 819-20). All of Iberdrola's affiliates' existing and planned generation is located in Zone E in central New York, which is not constrained (Tr. 820). Iberdrola's lack of affiliated generation inside of transmission constrained areas means that it cannot benefit from higher locational prices (*Id.*). This means that, after the Proposed

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[54] Even if, after the closing of the Proposed Transaction, Iberdrola Renewables were to develop all of its additional planned or pipeline generation that is currently scheduled to come on line within the next 5 years, Iberdrola Renewables' interest in affiliated wind generation in New York would constitute a very small portion of the 39,000 MW of installed capacity in the State (*see* Exh. 19 to Exh. 41).

Transaction occurs, NYSEG and RG&E will have no incentive to maintain or worsen these known constraints to benefit Iberdrola Renewables' existing or planned generation since such generation is not located on the high-price side of these constraints (*Id.*). Iberdrola's proposed affiliation with NYSEG and RG&E does not raise the concerns identified in the Commission's VMP Policy Statement. Iberdrola Renewables' existing and planned generation is on the low-price, unconstrained side of the Central-East constraint, and the Commission's concerns are therefore not present with respect to the proposed affiliation between Iberdrola and Energy East's TOs in New York (Tr. 820-21).

2. Robust Measures Implemented By FERC And NYISO Subsequent To The VMP Policy Statement Eliminate Any Potential Vertical Market Power Concerns Associated With The Proposed Transaction

Since the VMP Policy Statement was issued a decade ago, there is now a robust array of mitigation mechanisms (*e.g.*, strong market rules, tariffs and enforcement measures at the NYISO and FERC) to protect against the possibility that a transmission owner will favor its affiliated generation projects. When the Commission first issued its VMP Policy Statement in 1998, the Commission questioned whether NYISO and FERC would have sufficient control over the New York TOs to prevent the exercise of vertical market power (Tr. 811-12); *see also* VMP Policy Statement at 3).[55] Today, both NYISO and FERC have broad powers—established subsequent to the issuance of the VMP Policy Statement—to ensure open access and prevent undue discrimination by TOs with respect to transmission service, standardized interconnection procedures and standards of conduct.

55 Indeed, as shown in *Central Hudson Gas & Electric Corp.*, 83 FERC ¶ 61,352 (1998), *order on reh'g*, 87 FERC ¶ 61,135 (1999), when the Commission issued its VMP Policy Statement in 1998, NYISO had only recently been conditionally established by FERC and was not yet fully operational. In addition, FERC had not yet accepted NYISO's Open Access Transmission Tariff ("OATT") or market rules (Tr. 826).

Pursuant to its OATT and Market Administration and Control Area Services Tariff ("NYISO Services Tariff"),[56] NYISO offers open access to its transmission system to all market participants on a non-discriminatory basis (Tr. 826-27). Additionally, all planning for new transmission required for the New York Control area is controlled by NYISO (Tr. 827). Thus, NYSEG and RG&E do not have the same discretion over those transmission assets that existed when the VMP Policy Statement was issued (*Id.*).

The Agreement between NYISO and Transmission Owners (the "TO Agreement") also contains provisions that prevent TOs from engaging in unduly discriminatory actions with respect to the operational control of lines and outage and maintenance scheduling practices:

- Under Article 2.01 of the NYISO/TO Agreement, NYISO has day-to-day operational control over specified TO facilities ("Transmission Facilities under ISO Operation Control" or "A1 List") and each TO must notify NYISO regarding its actions related to these facilities ("Transmission Facilities Requiring ISO Notification" or "A2 List"). NYSEG and RG&E have placed all critical facilities, including those facilities that connect existing generation to the system, on these designated facilities lists (Tr. 828).

- Under Article 2.08 of the NYISO/TO Agreement, NYISO controls when any TO may schedule maintenance and outages of its facilities that are under the operational control of NYISO. NYISO considers outage impacts on system transfer capability which is directly related to market impacts and system congestion associated with transmission outages (Tr. 829).

- In addition, NYISO maintains an Open-Access Same Time Information System ("OASIS") where it posts outage schedules, actual outage execution timelines, and the associated impacts of those outages on system transfer capability (*Id.*). To ensure that NYISO does not favor a particular market participant as a result of its maintenance schedule coordination practices and procedures, all criteria, procedures and

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[56] NYISO's OATT, based on FERC's *pro forma* OATT, was approved by FERC in *Central Hudson Gas & Electric Corp.*, 86 FERC ¶ 61,062 (1999), *order on reh'g*, 88 FERC ¶ 61,138 (1999) and is regularly updated in compliance with FERC orders. FERC recently issued *Preventing Undue Discrimination and Preference in Transmission Service*, Order No. 890, FERC Stats. & Regs. ¶ 31, 24 (2007), in order to further reduce opportunities for the exercise of undue discrimination in its *pro forma* OATT, make undue discrimination easier to detect, and further facilitate FERC enforcement.

implementation practices must be specific and available to market participants for audit (*Id.*).

In the VMP Policy Statement, the Commission expressed concern that ownership of generation "located in the same market as the T&D company" could give the TO an incentive to impede entry.[57] However, since the inception of NYISO, all of its interconnection procedures and agreements have become standardized to prevent any attempts at such unduly discriminatory treatment by a TO. For example:

- FERC's Order No. 2003 required all regional transmission operators, including NYISO, to adopt standard procedures and agreements for interconnecting with large generators in order to achieve additional transparency and to prevent transmission owners from favoring affiliated generators in the interconnection process.[58]

- FERC's Order No. 2003 also mandated that NYISO control the interconnection application processes and procedures, and specified certain cost allocation methods for interconnection costs. Order No. 2003 at P 35; *New York Indep. Sys. Operator, Inc. and New York Transmission Owners*, 108 FERC ¶ 61,159 at P 6 (2004). Order No. 2003 also mandated that NYISO conduct all reliability-related studies during the interconnection process. Order No. 2003 at P 36.

- NYISO administers the interconnection process under its Standard Large Facility Interconnection Procedures ("LFIP") and Large Facility Interconnection Agreement ("LFIA") as Attachment X to the NYISO OATT. *See* 108 FERC ¶ 61,159 (accepting same). Under the LFIP, NYISO "receives, processes and analyzes all Interconnection Requests … with independence and impartiality." Attachment X, § 2.2 of the LFIP.

Accordingly, NYISO's FERC-mandated interconnection rules, especially the LFIP and LFIA adopted pursuant to FERC's Order No. 2003, ensure that TOs are not able to exercise vertical market power by favoring affiliated generators in the interconnection process. Any abuse or exercise of vertical market power is further discouraged by NYISO's market

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57 *VMP Policy Statement*, *supra* note 51, at Appx. 1, p. 2.

58 *Standardization of Generator Interconnection Agreements and Procedures*, Order No. 2003, FERC Stats. & Regs. ¶ 31,146 (2003), *order on reh'g*, Order No. 2002-A, FERC Stats. & Regs. ¶ 31,171 (2004), *order on reh'g*, Order No. 2003-C, 109 FERC ¶ 61,287 (2004), *order on reh'g*, Order No. 2003-C, FERC Stats. & Regs. ¶ 31,190 (2005) ("Order No. 2003").

monitoring function and the broad and severe enforcement and remedial powers granted to FERC under the Energy Policy Act of 2005 (Pub. L. 109-58, 199 Stat. 679).

NYISO also employs a robust market monitoring program utilizing an in-house market monitoring unit as well as an Independent Market Advisor (Tr. 832). NYISO's market power mitigation measures, codified in Attachment H of the NYISO Services Tariff, provide NYISO with the ability to mitigate market effects of any conduct that would substantially distort competitive market outcomes in NYISO-administered markets. Attachment H also provides NYISO with the ability to impose financial penalties on parties that engage in physical withholding. These penalties are designed to negate the impacts on market price that result from the exercise of market power (Tr. 832-33).

FERC has significant protective and enforcement measures as well. FERC has issued "Standards of Conduct for Transmission Providers" (the "Standards of Conduct") that govern the relationship between public utility transmission providers, including NYSEG and RG&E, and their generation affiliates (Tr. 833-34).[59] These Standards of Conduct offer additional protections against the potential exercise of vertical market power by NYSEG and RG&E with respect to Iberdrola's affiliated generation resources (Tr. 834) through the requirement that a transmission provider's employees engaged in transmission system operations must function independently from the employees of its generation affiliates and that a transmission provider treat all of its transmission customers on a non-discriminatory basis (*Id.*).

Since enactment of the Energy Policy Act of 2005, FERC also has significantly enhanced authority to impose substantial civil penalties for violations of the FPA and FERC's

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[59] *See Standards of Conduct for Transmission Providers*, Order No. 2004, FERC Stats. & Regs. ¶ 31,155 (2003), Order No. 2004-A, FERC Stats. & Regs. ¶ 31,161 (2004), Order No. 2004-B, FERC Stats. & Regs. ¶ 31,166 (2004), Order No. 2004-C, FERC Stats. & Regs. ¶ 31,172 (2004) and a series of related orders.

regulations and rules promulgated thereunder.[60] FERC has established an Office of Enforcement to assist it in applying these greatly enhanced powers and has already taken significant enforcement action against a TO for, among other things, violating interconnection and OASIS-related Standards of Conduct.[61]

Dr. Hieronymus has testified that these mitigation mechanisms are more than sufficient to protect against the potential that TOs could favor affiliated generation projects (*See* Tr. 825-28). For these reasons, the Commission should find that there are no vertical market power concerns raised by the Proposed Transaction.

For these same reasons, the Commission should reject IPPNY's request to condition approval of the Proposed Transaction on Iberdrola Renewables' commitment not to construct or otherwise acquire electric generating facilities that are interconnected to NYSEG's or RG&E's transmission facilities. Given the intermittent nature of the wind projects developed by Iberdrola Renewables and the robust mitigation mechanisms that are in place to protect against the possibility that a TO could favor its affiliated generation projects, such a commitment is both unnecessary and inappropriate. Any restrictions on Iberdrola Renewables' development activities beyond those requirements that are generally applicable to wind generation developers within the State would be unreasonable and unacceptable to Iberdrola (*see* Tr. 618-19). Indeed, any such restrictions would be inconsistent with Iberdrola's renewable development goals in New York State and its specific commitment in this proceeding to support investments by

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60 Energy Policy Act of 2005, Pub. L. 109-58, § 1284(d)-(e), 119 Stat. 594, 980 (2005); *see also* 16 U.S.C. § 825m(a) (2000), *amended by* Energy Policy Act of 2005 (granting FERC authority to refer violations to the U.S. Department of Justice for criminal prosecution).

61 In particular, FERC is authorized to impose civil penalties of $1 million per day for violations of the FPA and FERC's regulations. 16 U.S.C. § 825o (2000) *amended by* Energy Policy Act of 2005; *see also In re Entergy Servs., Inc.*, 118 FERC ¶ 61,027 (2007) (imposing civil penalty of $2 million).

Iberdrola Renewables of at least $100 million in renewable generation resources in the State over the next three years (Tr. 618-619; 663; Exh. 50).

3. Energy East's Existing Hydroelectric Facilities Raise No Vertical Market Power Issues

As described above, the Joint Petitioners commit to divest all of the fossil generation facilities owned by Energy East in New York State, thereby eliminating alleged vertical market power concerns raised by certain parties in this proceeding. The only existing generation owned by NYSEG and RG&E that would not be divested consists of approximately 110 MW of primarily run-of-the-river hydroelectric generation (Tr. 847; Exh. 41). As these units are currently owned by NYSEG and RG&E, they are wholly unrelated to the Proposed Transaction and any vertical market power analysis associated with the Proposed Transaction. Moreover, even if such generation were related to the Proposed Transaction (which it is not), it would strain credulity to contend that NYSEG's and RG&E's continued ownership of this truly *de minimis* amount of primarily run-of-the-river hydroelectric generation, which by its nature is ill-suited to the exercise of vertical market power, would create any vertical market power concerns (Tr. 847).

B. Staff's Comparisons With National Grid/KeySpan To Support The Purported Need for Financial Protections Are Unjustified, And Staff Proffers No Other Valid Basis For Its Proposed Financial Protections

As Mr. Azagra explains, the recent Iberdrola Renewables' IPO raised $6.5 billion in equity and "fully addressed the leverage concerns" of ratings agencies (Tr. 555). Moreover, Iberdrola's Strategic Plan provides that up to 72% of Iberdrola's capital expenditure program will be financed by means of this IPO, "operational cash flow, and divestments of over three billion euros" with only 28% of the program financed by debt (*Id.*). The effect of this plan is a "net reduction" of Iberdrola's debt ratio (*Id.*). Despite this, Staff makes various speculative contentions that financial protections are required as a condition to approval of the Proposed Transaction and in doing so attempts to support many aspects of its criticism of the Proposed Transaction based on faulty comparisons with the National Grid/KeySpan merger transaction. As discussed below (and in Section VI.B.1.b) with regard to capital structure issues), the comparisons to National Grid/KeySpan are invalid. Similarly, the financial protections that Staff asserts are required have not been justified; however, Iberdrola nonetheless has agreed to several measures to provide further assurance that customers of NYSEG and RG&E will benefit from these protective mechanisms.

1. Staff's Comparisons To National Grid/KeySpan Are Fundamentally Flawed

Staff attempts to rely on the National Grid/KeySpan transaction to suggest that the Proposed Transaction should not be approved or that additional conditions—such as the financial protection conditions discussed below—are required in order to protect ratepayers (*see, e.g.*, Tr. 1405 (stating that Staff's recommended conditions related to credit quality are not any more stringent than those imposed in the Grid/KeySpan merger)). While Staff concedes that Moody's views National Grid as more risky than Iberdrola (Tr. 1158), Staff illogically insists that Iberdrola's financial and business risks are greater than National Grid's (Tr. 1376), and that declines in Iberdrola's credit quality could have a negative impact on the credit ratings of NYSEG and RG&E (Tr. 1155-56). Staff therefore asserts that conditions must be imposed on the Proposed Transaction to ensure the credit quality of the New York utilities after the merger (Tr. 1405).

Staff's concerns are misplaced. Unlike in National Grid/KeySpan, Iberdrola has higher credit quality than Energy East, NYSEG or RG&E (Tr. 506-07; 553; 742; 767; 1058). Iberdrola has "A" category credit ratings from all major credit ratings agencies while Energy

East, NYSEG and RG&E, have "BBB" ratings/negative outlook (Tr. 742). Thus, while KeySpan's standalone "A" rating fell to National Grid's lower "A-" rating as a result of the merger with National Grid (Tr. 553), in this case, affiliation with the "A" category rated Iberdrola might allow Energy East, NYSEG and RG&E to escape their negative outlooks and potentially improve their ratings (Tr. 767-68) or, at the very least, reduce their cost of debt (Tr. 508).

Furthermore, the National Grid/KeySpan transaction was financed entirely with debt, while Iberdrola has financed the Proposed Transaction entirely with equity (Tr. 507).[62] On June 27, 2007, Iberdrola successfully sold 85 million new shares of common stock through an accelerated private placement that was fully subscribed. Thus, the capital markets have already provided Iberdrola with the approximately $4.5 billion required to acquire 100% of the common stock of Energy East pursuant to the Merger Agreement. The success of this accelerated private placement demonstrates Iberdrola's capacity and ability to raise capital, the result of which is that the Proposed Transaction will not result in any increase in the debt of Energy East or Iberdrola, or any of their affiliates (Tr. 507-08). Moreover, Iberdrola's issuance of equity to fund the Proposed Transaction protects ratepayers from the risks of debt financing utilized in the National Grid/KeySpan transaction (*Id.*). There is no basis, accordingly, for the financial restrictions Staff proposes based on the National Grid/KeySpan transaction.

2. Staff's Proposed Financial Protections Have Not Been Justified

a. Dividend Restrictions

Mr. Azagra explains that Iberdrola's dividend policy is an integral part of its Strategic Plan that the credit agencies have assessed as part of their analyses that led to

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

Iberdrola's "A" category credit ratings (Tr. 555). Staff, however, raises concerns about Iberdrola's ability to finance the operations of NYSEG and RG&E effectively and asserts that Iberdrola continues to increase dividends in the midst of its investment program (Tr. 1295). Staff takes the position that a credit rating downgrade of the New York utilities and Iberdrola could be likely in part because there will be pressure on Iberdrola to raise dividends from NYSEG and RG&E to levels that may restrict the utilities' ability to provide safe and reliable service (Tr. 1300-01; 1311), and Staff proposes certain dividend restrictions (Tr. 1400-1401; 1406-08). This speculation completely disregards the Commission's ongoing ability to utilize its regulatory powers to ensure that the operating companies provide safe and reliable service. Moreover, the Joint Petitioners are not aware of any case (at least for the past eleven years) in which the Commission has required dividend restrictions of the kind proposed by Staff in any non-synergy transaction.

Although the dividend restrictions Staff proposes are unnecessary and unjustified, the Joint Petitioners commit to the following additional measures regarding the companies' dividend policies: NYSEG and RG&E will maintain their respective dividend policies with due regard for the financial performance and needs of NYSEG and RG&E, irrespective of the financial performance and needs of Iberdrola. Iberdrola will report to the Commission in the event that the dividend payout for any year is more than 100% of income available for dividends calculated on a two-year rolling (eight calendar quarter) average basis (Tr. 556-57). These measures adequately alleviate Staff's unjustified concerns.

b. Money Pools

Staff asserts that further financial protections are needed to provide for a money pool under rules that facilitate the delivery of capital to NYSEG and RG&E while providing protection for these companies from excessive siphoning of funds (Tr. 1400-01). Staff therefore recommends the following restrictions if Iberdrola institutes a money pool financial arrangement in the future: (i) NYSEG, RG&E, and any future domestic regulated entities should be allowed to participate in a money pool arrangement as a borrower or lender; (ii) Iberdrola should only participate in a money pool as a lender; and (iii) non-regulated or foreign entities should be prohibited from participating in a money pool with NYSEG or RG&E and indirect loans from NYSEG/RG&E to any affiliate through the money pool or other means should be prohibited (Tr. 1409). Staff also recommends that Iberdrola should pledge that there are no cross-default provisions for any affiliate of Iberdrola which affect NYSEG and RG&E and promise that Iberdrola and its affiliates will not enter into such arrangements in the future (Tr. 1410).

Although the Joint Petitioners view Staff's concerns as unwarranted, the Joint Petitioners commit to the following measures regarding the future establishment of any money pool arrangements: NYSEG and RG&E may participate in Iberdrola money pools provided the other participants in such money pools are limited to regulated utility affiliates of Iberdrola in the U.S., unless otherwise authorized by the Commission (Tr. at 556-57). Furthermore, Iberdrola will not borrow from money pools in which NYSEG and RG&E are participants (*Id.*). These commitments adequately address Staff's unwarranted concerns.

C. Iberdrola's Superior Credit Quality Is A Benefit, Not A Detriment

The evidence in this proceeding overwhelmingly demonstrates that Iberdrola's "A" category credit ratings from all three major rating agencies are significantly stronger than the "BBB" category credit ratings of Energy East, NYSEG or RG&E (Tr. 742). Iberdrola's senior unsecured debt ratings/outlook from S&P, Moody's and Fitch are A-/Stable, A3/Stable and A/Negative, respectively (Tr. 742; *see also* Exh. 70 (Moody's recent February 2008, report reaffirming its rating for Iberdrola)). These "A" category ratings contrast with the present "BBB" category ratings of Energy East. The simple fact is that Iberdrola has a demonstrated stronger credit quality than Energy East and its subsidiaries, and is characterized by Moody's as having strong cash flow, well-diversified global operations and a moderate financial profile (*see*, *e.g.*, Exh. 70 at 1). The Commission should reject Staff's attempt to recast Iberdrola's stronger credit rating as a "risk" to NYSEG and RG&E and affirm that Iberdrola's superior credit quality is a benefit of the Proposed Transaction.

1. There Is No Support For The Claim That Iberdrola Is Unlikely To Maintain Its Current "A" Category Ratings

Despite the uncontroverted fact that all of the ratings from major credit agencies for Iberdrola are one to three notches *higher* than those of Energy East, Staff makes the incredible claim that this *higher* credit quality actually poses a "risk" to NYSEG and RG&E if the Proposed Transaction is consummated (*see* Tr. 1295-98). Staff reaches this conclusion by ignoring *actual* credit ratings issued by the ratings agencies, cherry-picking one or two financial ratios (largely outdated) and asserting that if, hypothetically, the ratings agencies were to focus myopically on such financial ratios, Iberdrola could have a lower credit rating than it actually does. The Commission should reject Staff's attempt to interpret credit ratings reports in support of specious assertions about Iberdrola's credit quality that are directly contradicted by the credit rating agencies themselves.

The Joint Petitioners' Policy Panel explains the significant benefits associated with Iberdrola's higher credit quality. For example, it is reasonable to expect that after the Proposed Transaction is consummated the cost of debt capital for NYSEG and RG&E should be lower given Iberdrola's stronger credit rating (Tr. 508; 944-45; 982). Even Staff concedes that the Commission has on several occasions found "the acquirer's financial strength to be a benefit to the [acquired] New York utilities and their ratepayers" (Exh. 116 (Staff response to IBER/EE IR No. 157)).

Faced with these facts, Staff is constrained to try to create a purported risk by speculating that it is "unlikely that [Iberdrola] can sustain" its "A" category rating in the future (Tr. 1283). Staff relies on a selective review of certain financial ratios and a comparison of those ratios with outdated S&P guidelines. Using S&P guideline documents that date from 2004 and 1998 (*see* Exhs. 102 and 103, respectively), Staff focuses on the Total Debt/Total Capital ratio ("debt ratio"). Staff concludes that Iberdrola's debt ratio (which Staff erroneously claims is 58%) "puts downward pressure on its credit quality" because it is "more consistent with a BBB rated company." (Tr. 1282; *see also* Tr. 1288). Staff goes on to speculate that, if Iberdrola's Goodwill were to be written off in the future, the equity ratio could drop further. Staff's position suffers from at least two fatal flaws.

First, Staff wrongly places a singular focus on the debt ratio. This error was explained by Mr. Steven Fetter, former Group Head and Managing Director of the Global Power Group within the Fitch ratings firm (Tr. 737). As Mr. Fetter testifies, S&P views *three* financial ratios as most important: (i) funds from operations ("FFO") interest coverage; (ii) FFO/total debt; and (iii) the debt ratio (*i.e.*, total debt/total capital discussed above). Of these three, "the ratio most emphasized by the Staff Policy Panel – [the debt ratio] – is the ratio given the least emphasis by the rating agencies themselves" (Tr. 748). The rating agencies can and do "adjust" the primary ratios that they use to reflect company-specific situations, and the record shows that Iberdrola "has coverage ratios commensurate with an 'A' category rating" (Tr. 748; 757).

The second major flaw is Staff's reliance on outdated S&P ratings guideline documents. To support its view that Iberdrola's profile is purportedly more consistent with that of a "BBB" rated company, Staff relies on: (i) a 2004 S&P rating guidelines document which provided business risk profiles and debt ratio guidelines (Tr. 1286 (citing Exh. 102 "New

Business Profile Scores Assigned for U.S. Utility and Power Companies", dated June 2, 2004)), and (ii) an S&P guideline document concerning global utility companies that provided certain median debt ratios (s*ee* Tr. 1291 (citing Exh. 103 "Power Companies")). However, Mr. Fetter explains that these guidelines are no longer current (Tr. 781-83). As Mr. Fetter testifies, in a November 30, 2007 research document, S&P adopted new guidelines making clear it is including utility companies in its longstanding "Corporate Ratings" matrix (Tr. 749, and Exh. 66 "U.S. Utilities Ratings Analysis Now Portrayed in the S&P Corporate Ratings Matrix"), and is moving "away from its prior ranges for financial ratios" (Tr. 782). Thus, both the 2004 S&P guideline document provided in Exhibit 102 and the global utilities guidelines provided in Exhibit 103, which dates from 1998, are outdated (Tr. 1454).[63]

Moreover, Moody's financial ratio guidelines for global utilities confirm that Staff erroneously speculates that Iberdrola is somehow on the brink of further credit downgrades based on its financial ratios. As Mr. Fetter explains, Figure 5 of the Moody's document "Rating Methodology: Global Regulated Electric Utilities" dated March, 2005 and provided by Staff in Exh. 114 (in response to Information Request IBER/EE No. 164), shows that an "A" category rated electric utility may, under Moody's guidelines, have a debt ratio with a potentially wide range—anywhere from 40%-75% for "A" rated utilities.[64] Staff, however, ignores these

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63 *See* Case 07-M-0906 - *Joint Petitioners' Responses to On the Record Requests and Items Subject to Check* (Apr. 4, 2008) (response to subject to check question at Tr. 781).

64 *Id.* (discussing Exh. 114 at 8). Staff indicates in an information response that it found these 2005 Moody's guidelines "useful in developing Staff's testimony" (Exh. 114 (response to IBER / EE IR No. 164)). Thus, even if the 58% debt ratio of Staff is assumed, the Moody's guidelines show that Iberdrola would remain within the ratio guidelines for an "A" category company. Iberdrola notes, however, that its debt ratio remains approximately 50% and Moody's has noted Iberdrola's commitment to "maintain a leverage of 50%." *See* Exh.70 (Moody's February, 2008 Corporate Profile report for Iberdrola); *see also* (Tr. 777-78) (explaining that both S&P and Moody's have "indicated comfort with Iberdrola's debt level").

guidelines in its testimony, instead choosing to rely on 10-year old, obsolete guidelines from S&P.

In addition, Staff selectively relies on excerpts from S&P and Moody's credit analyses of Iberdrola to try to support the assertion that Iberdrola faces challenges to maintaining its credit quality. For example, Staff quotes Moody's statements regarding possible "'integration and execution risk'" as Iberdrola expands and cites comments that if the company fails to achieve targeted growth "'pressure could develop'" on certain financial ratios (Tr. 1292-93 (citing Exh. 104, Moody's December 13, 2007 credit opinion)). Mr. Fetter addresses these selective snippets and explains that, when read in their full context, both Moody's and S&P support their current "A" category ratings by their analysis of several positive features of Iberdrola's financial strength (Tr. 757-59). On December 13, 2007, for example, S&P observed that Iberdrola successfully completed its IPO of Iberdrola Renewables and that its ratings "reflect Iberdrola's strong position as one of Spain's dominant vertically integrated electric utilities" with "cash flow stability and predictability" and "increased earnings diversity" (Tr. 759 (citing S&P Research Update dated December 13, 2007)); *see also* Tr. 760-61).

Moody's also has cited several aspects of Iberdrola's financial strength as it has reaffirmed Iberdrola's "A" category rating. As Mr. Fetter described at hearing, in February, 2008, Moody's affirmed that Iberdrola is "large and diversified which should help mitigate the commodity and regulatory risks in its portfolio" and also that the company "has demonstrated a judicious use of equity to fund its acquisitions" and has "committed to maintain a leverage of 50 percent" (Tr. 793 (citing Exh. 70; *see also* Tr. 761-63 (citing excerpts from a December 13, 2007 report of Moody's that found, among other things, that Iberdrola "is well-placed to make good progress given its size, scale and diversified exposure"))).

Fundamentally, Staff's claims regarding Iberdrola's supposedly likely future slip in credit quality are clearly nonsensical because, in fact, Iberdrola's *actual* credit ratings with all three major ratings agencies continue to be in the "A" category—higher than Energy East—coupled with a "Stable" outlook from Moody's and S&P (*see* Exh. 67 (Moody's); Exh. 44 (S&P)).

2. Staff's Claims Regarding Possible Deterioration Of NYSEG/RG&E Credit Ratings Are Baseless

Staff also claims that NYSEG's and RG&E's *lower* credit ratings could be harmed as a result of consummation of the Proposed Transaction by a *higher* rated upstream owner, *i.e.*, Iberdrola. This claim is nonsense.

Staff asserts that "as a result of" the rating agencies' purported concerns over Iberdrola's leverage, S&P has designated the credit outlooks for NYSEG and RG&E as "negative" making a downgrade likely upon completion of the transaction (Tr. 1132). Mr. Fetter explains the fallacy in Staff's logic, noting that the negative outlook on NYSEG and RG&E occurred well before the merger announcement:

> when the merger was announced, both S&P and Moody's affirmed their ratings on Energy East, NYSEG, and RG&E and maintained the existing Negative outlooks – thus, there was *no change* to the companies' ratings following the transactions' announcement.

(Tr. 767) (emphasis in original). Indeed, both Moody's and S&P emphasized as a basis for their negative outlooks the Commission's "surprisingly unfavorable" decision in NYSEG's 2006 rate case (Tr. 1303 (quoting Moody's); *see also* Tr. 770-71 (citing S&P and Moody's reports); 1060 (explaining that the "harsh treatment" of one regulated subsidiary can affect another regulated subsidiary)). While the ratings agencies have cited some concern over uncertainty as to the final structure that Iberdrola uses to complete the planned acquisition, Mr. Fetter notes that "the clear precipitating event for the Negative outlooks was the August 2006 [NYSEG] rate order" (Tr.

771). This is evident from Moody's most recent February 2008 analysis of Iberdrola, in which Moody's devoted a full paragraph discussion explaining that the negative outlooks for "EEC and its subsidiaries" reflect various challenges stemming from state regulatory actions including: "financial and operating challenges resulting from [the NYSEG 2006 rate decision]"; "lingering questions" about whether the Commission's August 2007 approval of a modified fixed price option for NYSEG customers will provide impetus for overcoming "cash flow pressures created by the [Commission]'s September 2006 decision"; and that the Iberdrola transaction "is still subject to regulatory approval" and "it is not uncommon" for regulatory approvals of merger transactions "to be conditioned upon additional rate concessions" (Exh. 70 at 11).

Staff argues that the 30-basis point differential between debt issued by NYSEG and the debt issued by the three companies in Staff's proxy group in November 2007 was caused by "the risk of a potential relationship with Iberdrola" (Tr. 1308-09). The record, however, shows that this differential was caused by several factors, none of which had anything to do with the Proposed Transaction (Tr. 395). The $200 million NYSEG transaction was not index-eligible (*i.e.*, a deal over $250 million which opens up the issuance to more potential buyers and makes the deal more liquid in the secondary market) (*Id.*). Investors are willing to pay a price premium (*i.e.*, tighter spread) for this secondary market liquidity. The three debt issuances in Staff's proxy group, on the other hand, were "index eligible" deals over $250 million and would therefore all be expected to price tighter and have a more liquid secondary market than the NYSEG financing (*Id.*). In addition, the three comparables in the proxy group can command a slight price premium (*i.e.*, tighter spread than NYSEG) because they come to the market more frequently and are more familiar to investors (Tr. 396). Staff also disregards the ratings differences between NYSEG and the Staff proxy group—two of the three comparables were on review for a potential upgrade (*Id.*).

Staff's remaining claims amount to speculation and highly generalized concerns about "Iberdrola's massive planned capital program" (Tr. 1301). The Commission should ignore this speculation and focus on two key facts: (1) *prior* to the merger announcement, NYSEG and RG&E had negative outlooks associated with the adverse treatment NYSEG received in its 2006 rate case, and (2) Iberdrola continues to enjoy stronger credit ratings than either Energy East or its regulated subsidiaries. Mr. Fetter explains that the ratings notch differential between Iberdrola and NYSEG and RG&E "is significant" as is the fact that Iberdrola's cash flow coverages are "markedly stronger than those of Energy East" (Tr. 767-68). These significant differences can "serve to support improved ratings at Energy East" (Tr. 768-69). The Commission should affirm that Iberdrola's stronger credit ratings can be a benefit to Energy East, NYSEG and RG&E if the Proposed Transaction is consummated.

D. The Goodwill Associated With The Proposed Transaction Does Not Present Risks Or Other Regulatory Concerns

As Dr. Makholm explains, based on his extensive experience in utility merger and rate proceedings, "[t]he level of Goodwill estimated by Staff is not particularly unusual for a utility transaction of this size and I do not conclude that it will be a hazard" (Tr. 1054). Dr. Makholm's assessment is based on the fact that utility equities "that have always sold at premiums over book value" reflects investor expectations that "companies will grow and that share prices will increase" (Tr. 1054-55). Goodwill, therefore, reflects the "normal state of affairs in the United States, and it places no pressure on rates" given that rates are calculated based on rate base and "not the current market value of traded shares of utility equities" (Tr. 1055).

Staff, however, argues that the Goodwill (reflecting the value paid for Energy East in excess of underlying book value) poses a risk to ratepayers (Tr. 1314-15). Staff's claims concerning Goodwill include: (i) if there is an "economic downturn" the Goodwill on Iberdrola's books might cause its percentage of equity to decrease, its leverage to increase, and "impede Iberdrola's access to the capital markets" (Tr. 1323), and (ii) if there is further consolidation of Iberdrola/Energy East with another acquiring utility in a future transaction, "third generation Goodwill" will be created and "fewer hard assets will have to support relatively more Goodwill" (Tr. 1324). The evidence shows that these claims are unsupported.

It is undisputed that Iberdrola has committed to booking Goodwill associated with the Proposed Transaction at the Iberdrola holding company level, and that Iberdrola will not "push [] down" Goodwill associated with the Proposed Transaction (Tr. 547; *see also* Exh. 116 (IBER/EE IR No. 168)). Thus, there is no possibility that Goodwill associated with the Proposed Transaction will be recorded on the books of NYSEG or RG&E and it therefore can have no rate impact on their ratepayers. Dr. Makholm explains that Goodwill does not affect credit quality for regulated utilities because: "Regulated operating companies raise their own money, they raise their own debt, they set their own rates to pay for the interest and capital charges on the debt, and in that loop, goodwill does not appear" (Tr. 1109).

Staff also claims that Goodwill could be impaired, causing a reduction in the company's equity and increase in leverage, thus harming credit quality (Tr. 1323). The record, however, shows that Staff "has not prepared any studies addressing the likelihood that the Goodwill on Iberdrola's books will become impaired, given the company's individual circumstances" (Exh. 116 (IBER/EE IR No. 170)). On the contrary, Staff concedes that "*a write down of Goodwill seems unlikely*" (Tr. 1322 (emphasis added)). The Joint Petitioners' Policy

Panel confirms that given Iberdrola's "strong cash flow and earnings growth," there is no basis to assume that Goodwill would suddenly become impaired as suggested by Staff (Tr. 547).

Staff makes a strained argument that Goodwill could theoretically have an impact on ratepayers—although Staff performed no study for purposes of this proceeding—but that argument depends entirely on Staff's unsupported assumptions that following the Proposed Transaction: (1) rates for NYSEG and RG&E must be developed using a newly imposed consolidated capital structure, and (2) Goodwill on Iberdrola's books must be administratively "removed" by the Commission (Exh. 116 (IBER/EE IR No. 153) (asserting that an adverse impact could occur if Goodwill is removed from the consolidated capital structure and that it impacts the earnings sharing mechanism);[65] Tr. 1326; 1334). As discussed above, however, there has been no demonstration in this proceeding that a consolidated capital structure would be appropriate for purposes of establishing NYSEG or RG&E rates. Accordingly, Staff's concerns regarding Goodwill impairment and any impact on rates depend wholly upon Staff's unsupported claim that a consolidated capital structure must be used, and that an administrative "adjustment" must be made to remove Goodwill from Iberdrola's books. Based on the record, the Commission should find that Staff has made no demonstration of any adverse rate or service quality impact because of Goodwill resulting from the Proposed Transaction.

Given the lack of any proof that Goodwill will have an adverse rate or service quality impact on ratepayers of NYSEG and RG&E, and the absence of any study or other empirical evidence submitted by Staff to show that impairment is likely, the Commission should

[65] In the same data response, as well as in Exhibit 116 (IBER/EE IR. No. 27), Staff also argues that "another element" of Goodwill's impact on ratepayers is the negative effect Goodwill has on credit ratings. However, Staff cannot point to a single credit report discussing Iberdrola or this transaction that mentions Goodwill as having any impact, much less a negative impact, on the credit rating agency's assessment of Iberdrola's credit rating.

reject Staff's claims that Goodwill on Iberdrola's books is excessive and will be a "detriment" to ratepayers.

E. Financial Transparency And Reporting

Dr. Makholm explains that, with regard to transparency issues, nothing about the Proposed Transaction will change the Commission's ability to regulate the NYSEG and RG&E operating companies and "[t]he defense against illicit utility transactions lies with careful attention to the operating companies' books and records"—not those of the holding company (Tr. 1073; 1076). Nevertheless, Staff complains that there needs to be greater assurances regarding transparency and reporting, and the Joint Petitioners have made commitments to address these concerns as discussed in more detail below.

Staff states that differences in accounting standards and language, coupled with a complex organizational structure, and the unfamiliarity of Iberdrola with New York regulators and their policies all pose a risk for the customers of NYSEG and RG&E (Tr. 1156-57). Staff recognizes that after the Proposed Transaction has been consummated, Energy East will no longer be a registrant under the jurisdiction of the SEC (Tr. 1342). Yet Staff expresses concern that certain sources of information regarding the capitalization of the parents of NYSEG and RG&E will no longer exist (Tr. 1343). Staff worries that comparable financial information will not be available under IFRS accounting standards, which govern Iberdrola (Tr. 1346). Staff further claims that, with differences in IFRS reporting standards versus GAAP, the potential exists for the misinterpretation of Iberdrola's financial statements. Staff takes the position that "the number and scope of Iberdrola's unregulated subsidiaries and the complexity of its organizational structure make it difficult to accurately evaluate its financial strength and capitalization" (Tr. 1348). Finally, Staff expresses concern that the requirements of the Sarbanes-Oxley Act ("SOX") will no longer apply to Energy East after the Proposed

Transaction, which Staff believes will lead to a reduction of internal controls and regulatory oversight over the utilities (Tr. 1351-52).

The risks Staff hypothesizes are without foundation and unfairly disregard the track record of other stable and successful foreign utility investments in the United States (Tr. 548). Moreover, as Dr. Makholm explains, there is nothing about Iberdrola stepping in as the upstream owner of Energy East that "changes the way in which this Commission will continue to work to protect ratepayers" (Tr. 1076). The Commission will retain its established regulatory means for ensuring that money does "not cross" the barrier in either direction between regulated operating companies and upstream owners (Tr. 1076-77). The Joint Petitioners also point to the number of utilities within the State that are successfully operated by foreign companies, including United Water, American Water, Niagara Mohawk and KeySpan (Tr. 548). Furthermore, the SEC has recently made it clear that both U.S. GAAP and the IFRS, under which Iberdrola prepares and reports its financial statements, are high-quality accounting standards that are similar to one another in many respects and rapidly converging (*see* Exh. 48). Finally, although the requirements of SOX will not apply to Energy East after the Proposed Transaction is consummated since Energy East will no longer be an SEC registrant, Energy East will continue to assess and monitor controls and provide the attestation of management concerning the adequacy of controls, even though these attestations would normally only apply to SEC registrants (Exh. 19, IBER-0293).

Also without basis is Staff's contention that the translation of documents is an issue in connection with the Proposed Transaction. As a global company with significant existing operations in the U.S. and the United Kingdom, and given its numerous U.S. investors, Iberdrola already translates key documents into English in the ordinary course of business (Tr.

550). Indeed, a substantial amount of information, including all key financial information, is already routinely made available publicly in English on Iberdrola's website (*Id.*). Moreover, Iberdrola will need to communicate with Energy East, NYSEG and RG&E in English and documents related to the management of these entities will be prepared in and/or translated into English accordingly (*Id.*).

Nevertheless, the Joint Petitioners commit to the following additional financial transparency and reporting measures to address Staff's concerns:

- **Books & Records -** The Commission will have access, in English and in New York, to (1) the books/records of NYSEG and RG&E, and (2) any books/records of Iberdrola or any Iberdrola affiliates that are related to NYSEG or RG&E. The Commission will have access, in English and in New York, to any minutes of the Iberdrola Board of Directors, and any sub-committee thereof, to the extent that such minutes discuss Energy East, NYSEG or RG&E. Iberdrola also will translate such other documents as the Commission determines to be reasonably necessary to fulfill its statutory duties (Tr. 549).

- **Audit Reports** - The Commission will have access, in English and in New York, to all internal and external audit reports and recommendations for NYSEG and RG&E, and for any Iberdrola affiliate with respect to the provision of goods and services for compensation to NYSEG or RG&E (*Id.*).

- **Financial Statements** - Iberdrola's consolidated balance sheets, income statements and cash flow statements will be made available to the Commission, in English and in New York, on an annual basis and in a format that is mutually agreed to between Iberdrola and the Commission Staff. Audited financial statements will be in accordance with IFRS, as issued by the International Accounting Standards Board, consistent with SEC requirements. Additionally, Iberdrola will provide specific answers to particular questions raised by the Commission and its Staff with respect to IFRS (Tr. 550).

These commitments adequately address any concerns regarding financial transparency and reporting issues. Accordingly, Staff's concerns about the alleged financial transparency and reporting issues that could potentially arise from the Proposed Transaction are without merit.

F. Ring-Fencing/Golden Share

Staff's recommendation to require a limited purpose entity ("LPE") to shield NYSEG and RG&E from adverse consequences attributable to possible actions by Iberdrola after the Proposed Transaction is unnecessary and based on non-existent and exaggerated risks. Staff takes the position that an LPE device is a necessary condition to approve the Proposed Transaction because Staff believes it would isolate NYSEG and RG&E from the risks that Iberdrola may order the utilities into voluntary bankruptcy (Tr. 1414-17). Staff suggests that the LPE have a director independent from Iberdrola with special voting rights granted under a class of preferred stock having one share (a "golden share") (Tr. 1413). Staff further envisions that the independent director would vote based on the "public interest" under authority granted in the charter of the LPE. Given that the director's duty would be to customers and debt holders, Staff believes it is less likely that a subsidiary would ever be placed voluntarily into bankruptcy as a result of the actions of its parent (Tr. 1414). Staff also appears to suggest that the golden share be issued to a party to be determined by the Commission as was done in the National Grid/KeySpan case (Tr. 1415). This proposal should be rejected.

Neither LPEs nor golden shares are traditional elements of U.S. utility regulation (Tr. 1104), particularly where the control over the golden share is determined by regulators. As Dr. Makholm explains:

> A. …The golden share proposal is a redundant and unnecessary protection for the customers of NYSEG and RG&E. In Section VIII, above, I discussed at length why the SEC and the FERC (as well as Congress) concluded that the modern measures for dealing with affiliate transactions are sufficient to deal with the protection of ratepayers.
>
> Q. What is the harm in the golden share?
>
> A. The golden share has actual and potential costs and consequences that we cannot predict. As new layers of corporate governance, it will by necessity create direct costs. Furthermore, its novelty both in New York and in U.S. utility regulation generally creates uncertainties for Iberdrola (and possibly also for utility customers) that have no corresponding benefit. The idea, put forward by the Staff Policy Panel, that NYSEG or RG&E would voluntarily declare bankruptcy at the behest of Iberdrola, so that Iberdrola could "siphon assets out of its financially healthy subsidiary" simply is nowhere near a realistic possibility.

> Such "siphoning" is impossible as a realistic regulatory matter, as I discussed in Section VIII.

(Tr. 1099-1100) (internal citation omitted).

Staff asserts that such an intrusion into utilities' governance is not unusual, because in one lone instance the Commission previously compelled the creation of an LPE as a condition to approve a utility merger (Tr. 1414-15). In the National Grid/KeySpan proceeding, the Commission had specific concerns about National Grid's financial status that led it to require that the New York utilities in that case establish a golden share in order to prevent a bankruptcy of National Grid or any other affiliate from triggering the bankruptcy of an operating utility in New York. Under this condition, the utilities were required to establish a class of preferred stock having one share, subordinate to any existing preferred stock, and to issue such share to a party to be determined by the Commission who is supposed to protect the interests of New York by limiting the utilities' right to commence any voluntary bankruptcy, liquidation, receivership, or similar proceedings without the consent of the holder of that share of stock (Tr. 1415). However, the Commission's concerns in that case were unique to National Grid and were not intended to apply to all utility mergers regardless of the financial status of the acquirer. Indeed, former Chairwoman and current Commissioner Acampora specifically described the golden share in that case as an "unusual step" related to the unique facts involving National Grid (Exh. 43 at 5). As described above, there are many critical distinctions between Iberdrola and National Grid, in particular the stronger financial health of Iberdrola relative to Energy East, NYSEG and RG&E and the fact that the Proposed Transaction will be wholly financed by equity, which weigh strongly against adopting such extreme and unusual measures.

Staff cites only one other example in support of its golden share proposal. In the MidAmerican/PacifiCorp merger, Staff claims there was a ring-fencing plan that called for a "single purpose entity" ("SPE"), akin to what Staff describes as an LPE (*see* Tr. 1416). Significantly, however, in that case there was no involvement by the Public Utility Commission of Oregon in selecting a party that would become a part of the governance of the utility. Rather, the SPE was set up to include standard provisions for separating corporate entities, including provisions for separate books and records, financial statements, and arm's-length relationships with affiliates. This was a far less intrusive measure than Staff's proposal to establish a "golden share" to be held by a party determined by the Commission (Tr. 1101).

Staff's main justification for this invasive golden share – the idea that Iberdrola would for some reason order NYSEG and/or RG&E into voluntary bankruptcy – is far-fetched (Tr. 1099-1101). The bankruptcy of substantial utilities in the United States like NYSEG or RG&E is exceedingly rare (*i.e.*, two were caused by companies suffering from stranded, non-operating nuclear power plants post-Three Mile Island; one was a gas pipeline subsidiary of a larger holding company hobbled by take-or-pay contracts that arose with the one-time gas industry restructuring; and the last arose in the context of the unique and complicated California Energy Crisis of 2000-2001). None of those circumstances are present in the Proposed Transaction (Tr. 1102).[66] Nonetheless, it is noteworthy that even in these bankruptcy cases, authority over ratemaking and the traditional public service issues of service adequacy remained with the relevant regulatory commission throughout (Tr. 1103).

In the long run, the imposition of an LPE or golden share in this case could actually do more harm than good. The golden share proposal serves no purpose but to inject a

[66] Moreover, because Iberdrola maintains a stronger financial profile than Energy East and its operating subsidiaries, there is no basis from a credit quality perspective to require certain "ring fencing" provisions as a condition for merger approval, as suggested by Staff. As Mr. Fetter explains, "a financially strong holding company's ability to support a weaker performing subsidiary could be compromised" if inappropriate ring fencing were to be put into place (Tr. 772).

new class of preferred shareholder into the New York operating utilities' governance and financial picture, potentially tying their hands (or Iberdrola's) for no legitimate reason. The Joint Petitioners offer commitments that serve as more than sufficient protections (some of which are commonly viewed as standard "ring fencing" provisions) and make the imposition of an LPE or a golden share unnecessary (Tr. 558). These commitments include separate accounting and financial statements for NYSEG and RG&E, limitations on NYSEG and RG&E asset transfers, dividend restrictions, and prohibitions against guarantees, pledges or other credit support by NYSEG and RG&E in favor of Iberdrola or its affiliates (Tr. 558-60). These other commitments should be approved, and Staff's "golden share" proposal should be rejected as unnecessary and inappropriate.

G. Affiliate Transactions

Dr. Makholm explains that in any instance where regulated operating companies are in a holding company structure, there are "time-tested ways to deal with affiliate issues" and "there is nothing particularly unusual about this transaction" with respect to how a regulatory commission will deal with the rates and service obligations of operating companies (Tr. 1074; 1079). Staff voices concerns with the magnitude of Iberdrola's unregulated operations and the purported "complexity of its capital structure" (Tr. 1159), but these complaints are "a straw man, so to speak—to knock down by saying that the impossibility of regulating Iberdrola's internal operations leaves no choice but to object to the transaction" (Tr. 1079). Indeed, Staff proposes a number of revisions to the existing safeguards that are in place for affiliate transactions, and then goes on to claim they will be "inadequate since they may not be able to capture the nuances and unknowns related to the future dealings between Iberdrola, Energy East, and the utilities" (Tr. 1426).

Staff's affiliate issue complaints are simply without merit. Iberdrola's organizational structure is not particularly complex; it is similar to that of any organization with a variety of operating utilities and an unregulated entity that holds separately financed generation projects (Tr. 559). Moreover, Iberdrola has significant experience in the ownership of both regulated and unregulated operating companies, and will fully comply with the Commission's and the FERC's standards, regulations and policies with respect to the relationship between its regulated and unregulated affiliates (*e.g.*, Standards of Conduct, Codes of Conduct, etc.) (*Id.*). Nonetheless, in sworn testimony the Joint Petitioners commit to the following measures to ensure further that there are no potential incentives for cross-subsidization among NYSEG, RG&E and Iberdrola's unregulated affiliates:

- **Cost Allocations –** NYSEG and RG&E will continue to utilize Energy East's cost allocation methodologies and Energy East will allocate centralized costs from Iberdrola to NYSEG or RG&E only to the extent that such costs are properly chargeable to utility operations and accepted by the Commission. Costs charged by Iberdrola or its affiliates to Energy East and any of its U.S. affiliates that either directly or indirectly affect NYSEG's or RG&E's costs of service shall be based on Energy East's approved cost allocation methodology, unless otherwise permitted by the Commission (Tr. 560).

- **Separate Accounting and Financial Statements** - NYSEG and RG&E will maintain separate and independent accounting records and financial statements from those of Iberdrola and all other affiliates (*Id.*).

- **Asset Transfers** - NYSEG and RG&E will not transfer or sell material assets or facilities to Iberdrola or any affiliate without prior approval of the Commission. All asset sales to these entities will be on an arm's-length basis, and be subject to market vs. book value tests (*Id.*).

- **No Lending -** NYSEG and RG&E will not loan funds to Iberdrola or any unregulated affiliate, either through a money pool or otherwise, unless otherwise authorized by the Commission (*Id.*).

- **No Credit Support** - NYSEG and RG&E will not provide guarantees, collateral, or pledge or provide any other type of credit support for the benefit of Iberdrola or any affiliate (*Id.*).

These commitments should fully resolve any of Staff's potential concerns regarding chaining transactions, cost allocation or other affiliate transaction issues.

Staff has also proposed modifications to the Standards Pertaining to Affiliates and the Provision of Information, which were set forth as Appendix B to the 2002 Energy East/RGS Merger Joint Proposal, and which are commonly referred to as the "Code of Conduct" (Exh. 111.) Such modifications are neither necessary nor appropriate. As Staff acknowledges, the existing affiliate transaction rules are adequate to govern the relationship between Energy East holding and services companies, NYSEG, and RG&E (Tr. 1425-26). Staff's primary justification for seeking to change the Code of Conduct is that it "may not be able to capture the nuances and unknowns related to the future dealings between Iberdrola, Energy East and the utilities" (Tr. 1426). Given that Staff has not articulated any reason for revising the Code of Conduct with respect to Iberdrola, the Joint Petitioners disagree with the unilateral nature of the proposed changes and believe that they should be rejected. The existing Code of Conduct, which has already been approved by the Commission, should remain in place, with the modifications discussed above.

H. Data Security Concerns

The Joint Petitioners strongly dispute unsupported security concerns raised by Staff. Iberdrola has put robust protections in place to protect its information systems against unwanted access, either by authorized or unauthorized personnel, with the aim of ensuring the confidentiality and integrity of the information processed by those systems (Tr. 551). Staff, however, cites several unwarranted and unjustified data security concerns as a risk of the Proposed Transaction (Tr. 1423-24). Staff recommends that sensitive customer information should remain at NYSEG and RG&E and their transfer to Iberdrola or any of its other affiliates should be prohibited (Tr. 1424). Staff further asserts that the personal data NYSEG and RG&E

compile on their customers (names, addresses, telephone numbers, social security numbers, credit reports, etc.) should remain, in all media formats, within the headquarters or customer centers of NYSEG and RG&E. Staff claims, with no support, that after the Proposed Transaction, information on the vulnerabilities of the New York electric grid and the State's network of gas pipelines could become available in more locations, raising the possibility of a security breach (*Id.*).

Access to Iberdrola's information systems from the outside may only be obtained through safe, encrypted channels (Tr. 551). These measures apply to all office information systems, as well as to systems related to power production and gas and electric distribution. Iberdrola's information systems follow the most demanding practices in the world, including those in the United States (Tr. 551-52). In fact, Iberdrola participates with other U.S. electric utilities in the Electric Power Research Institute's Cybersecurity Assessment Program, which focuses on North American Electric Reliability Corporation security standards (Tr. 552). Iberdrola has no intention to merge its information control systems with those of Energy East (*Id.*).

The Joint Petitioners nevertheless commit to the following measures to ensure further that critical energy infrastructure information, as well as sensitive personal data of NYSEG and RG&E customers, remains secure: (1) information about vulnerabilities in the New York electric grid and the gas pipeline network, in all media formats, shall remain within the headquarters of NYSEG and RG&E; and (2) customer data (*e.g.*, names, addresses, telephone numbers, social security numbers, credit reports) shall remain, in all media formats, within the headquarters or customer service centers of NYSEG and RG&E. These measures adequately address Staff's data security concerns. Upon cross-examination during the evidentiary hearings, Mr. Barry of the Staff Policy Panel even acknowledged that the commitments offered by the Joint Petitioners are a “reasonable solution” to address Staff’s data security concerns (Tr. 1584).

I. Concerns Over Potential Future Changes In Control Of Energy East Are Unwarranted

In a letter to parties in this proceeding, ALJ Epstein has suggested that he believes it is necessary to present to the Commission, presumably as part of the Recommended Decision in this proceeding, his view of whether any possibility of a future change of ownership and control of Energy East should raise concerns to the Commission now in its consideration of this Proposed Transaction.[67] Specifically, the ALJ has asked the parties to consider addressing the following questions: (1) whether the Commission’s approval of the proposed acquisition in this case would diminish its regulatory authority over Energy East with respect to future transactions; (2) if so, whether such long-range effects on the Commission’s authority would have public interest implications; and (3) whether the Commission should address such implications, if any, by adopting protective measures or conditions as part of the decision in this case if the Joint Petition is approved.

Based upon the lack of factual basis for any concern, and the legal protections under Section 70 that provide for Commission review of any future transfer of ownership and control over Energy East, there is no basis for concern with respect to these issues. In fact, no party has indicated that this issue should be of concern to the Commission at this stage.[68] Moreover, Joint Petitioners believe that the consideration of such issues is unprecedented[69] and

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[67] Case 07-M-0906 - *Letter from ALJ Epstein to All Active Parties* (Apr. 4, 2008).

[68] In particular, Staff has withdrawn its previous motion to suspend the procedural schedule, and indicated that, absent further developments, it was not inclined to raise the motion again (Tr. 1901).

[69] Joint Petitioners are aware of no prior Commission proceeding under Section 70 or any similar law in which speculation as to possible future transactions has been made an issue.

unnecessary given the scope of Section 70 jurisdiction that would apply if any future change of ownership and control over Energy East were to occur. Nevertheless, the answers to the questions posed by the ALJ are straightforward and Joint Petitioners address these issues here.

If at some point in the future there is an upstream change of ownership and control over Energy East, the Commission's jurisdiction over such a transfer (or over Energy East) would be undiminished. Section 70 of the PSL provides that the Commission must review and approve any transaction for acquisition of ownership and control upstream from NYSEG, RG&E and Energy East.[70] Thus, Commission approval of the Proposed Transaction will not and cannot alter the Commission's statutory authority to review any potential future transfers of ownership and control. If any entity or group of entities were actually to seek to acquire a controlling interest upstream of Energy East, then that transaction would be subject to the requirements of Section 70. In such an event, the Commission and Staff would have the ability to fully evaluate the impact of any such proposed acquisition on Energy East, NYSEG and RG&E. In fact, there are no actions the Joint Petitioners can take to reduce the Commission's authority over NYSEG and RG&E. Furthermore, there are other provisions of the PSL that reinforce the Commission's ability to address a variety of ownership issues, including those that could arise in the context of any upstream change of ownership and control over Energy East.[71]

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70 N.Y. Pub. Serv. Law § 70 (McKinney 2007).

71 Section 110(1), for example, provides jurisdiction over holders of utility voting stock to permit the Commission to require disclosure of the interests of owners having an interest of one percent or more. Subdivision 2 of Section 110, giving the Commission jurisdiction over affiliated interests, extends to ownership of five percent or more and includes entities in successive ownership chains. Subpart g of that subdivision also permits the Commission to take an expansive view of affiliate relationships, even where such relationships do not fall squarely within the circumstances defined elsewhere in the statute. N.Y. Pub. Serv. Law § 110 (McKinney 2007). Section 111 provides for further disclosure of stockholdings. *Id.* § 111. The foregoing specific provisions, together with the Commission's general authority to conduct investigations and to take enforcement action (*see, e.g.*, Sections 66 and 26, respectively), provide fully adequate means for the Commission to address the circumstances identified by the ALJ.

Even if a question were to exist under the law, the Joint Petitioners have committed to make a filing with the Commission if an entity seeks to acquire a controlling interest that would constitute a change of ownership and control upstream from Energy East.[72] This commitment, together with the Commission's continued statutory authority under the PSL discussed above, should provide adequate assurance that the Commission's authority will not be negatively impacted by the Proposed Transaction.

Since the Commission's authority will not be diminished, there are no negative long-term public interest implications associated with the Commission's approval of the Proposed Transaction (raised in the ALJ's second identified issue). Thus, there is no need for the Commission to address these nonexistent implications by adopting protective measures or conditions as part of its approval in this proceeding (raised in the ALJ's third identified issue).

VI. STAFF'S ATTEMPT TO MITIGATE ALLEGED "RISKS" BY IMPOSING RATE ADJUSTMENTS IS OUTSIDE THE SCOPE OF THIS PROCEEDING; IF THESE RATE ISSUES ARE ADDRESSED IN A SUBSEQUENT PROCEEDING, THE COMMISSION SHOULD FIND THAT STAFF'S POSITIONS ARE MERITLESS

A. Staff's Rate Adjustments Are Outside The Scope Of This Proceeding

First and foremost, Staff's unilateral rate adjustments and modifications are beyond the scope of, and in no way necessary to, a public interest determination in this Section 70 proceeding. In arguing for these conditions, Staff proposes unilateral modifications to the currently-effective NYSEG Electric Order and the existing rate plans of NYSEG Gas and RG&E, which were the result of a litigated proceeding (NYSEG Electric) or negotiated and represent a package of provisions that were acceptable to the parties involved in the settlement process (NYSEG Gas and RG&E rate plans). Staff's "cherry-picking" and unilateral

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72 Case 07-M-0906 - *Joint Petitioners' Response to Staff's Motion to Postpone Hearings and Require Additional Filings and for Expedited Consideration*, at 3 (Feb. 7, 2008).

modification of certain rate plan provisions significantly alters the spirit of the negotiated agreements, the intentions of the parties and the understanding of the Commission when it approved the rate plans (Tr. 322; 411). Thus, Staff's attempt to introduce these rate issues here is not only inappropriate in the context of a Section 70 proceeding, it is also an improper attempt to collaterally attack those rate plans and the NYSEG Electric Order.

Moreover, there are substantial procedural defects in Staff's attempt to collapse this proceeding with a rate case. In a Section 66 rate proceeding, and under Part 61 of the Commission's regulations, applicants are allowed to present a fully adjusted cost of service which is then typically considered over an 11-month suspension period. These procedures, which provide for a thorough review of a utility's costs and revenues, stand in stark contrast to Staff's rate adjustment proposals in this case, which are designed only to reduce the revenues and earnings of RG&E and NYSEG.

Accordingly, the ALJ should recommend, and the Commission should find, that all of Staff's rate adjustments and modifications are beyond the scope of this proceeding. To the extent the Commission finds any of the proposed rate case matters worthy of attention, it should address such matters in a separate, general rate proceeding after the close of the Proposed Transaction.

B. Staff's Proposed Rate Adjustments—Even If Considered In This Proceeding, Which They Should Not Be—Should Be Rejected On Their Merits

Below, Joint Petitioners explain how Staff developed its rate adjustments (PBAs, one time adjustments and rate modifications) and why Staff's proposals have no support in either law or fact. The Joint Petitioners have provided a detailed response to all of Staff's rate-related arguments in their Rebuttal Testimony and have fully demonstrated that Staff's rate adjustments are neither appropriate nor necessary in this Section 70 proceeding (Tr. 319-411; Exh. 27-34).

The rate concessions Staff is seeking are excessive and do not belong in this proceeding. If they should be raised at all (and the Joint Petitioners disagree with the substance of these rate concessions), they should be raised, as appropriate, in a separate, subsequent rate proceeding after closing.

Staff arrives at its various rate adjustments through a multi-part process. First, as discussed above, Staff proposes certain PBAs with no policy or legal justification and no substantive evidence in the record other than an assertion that they would create "positive benefits" for customers. In doing so, Staff proposes that NYSEG and RG&E write-off a series of regulatory assets previously authorized by the Commission and increase their reserves for, among other items, environmental remediation, stray voltage and storm response, and absorb previously authorized independent power producer ("IPP") supply cost. Second, Staff proposes various one-time adjustments. Third, Staff utilizes a 9.0% ROE and an equity ratio of 38%, ignoring the stand-alone capital structure of NYSEG and RG&E and Iberdrola itself. After developing its proposed PBAs and one-time rate adjustments of $855 million (consisting of write-offs of $286 million, reserve increases of $311 million, IPP cost absorption of $49 million, and one-time adjustments of $209 million), its artificially low imputed equity ratio (38%) and a reduced ROE (9.0%), Staff provides an "analysis" purportedly demonstrating (not surprisingly) that NYSEG and RG&E are "over earning" (Tr. 1339-41).

To reduce these manufactured excess returns, Staff proposes a series of rate plan modifications, suggesting that NYSEG and RG&E either provide a drastic delivery rate decrease or immediately build up a huge customer liability through the implementation of an earnings sharing mechanism ("ESM"). Even if considered on their merits, the PBAs and proposed one-time adjustments and rate modifications are contrary to Commission precedent, long-standing rate making principles and sound regulatory policy (*compare* Tr. 1369 *with* Tr. 321-23). In each and every instance, Staff's proposed adjustments are flawed[73] and far exceed what is reasonable and warranted to demonstrate that the Proposed Transaction is in the public interest.

Staff has effectively compiled a "wish list" of potential rate adjustments to provide a windfall benefit for customers at the expense of NYSEG and RG&E shareholders. This "wish list" is flawed and, if accepted, would have a drastically adverse impact on NYSEG and RG&E. First, Staff wrongly relies on prior Section 70 proceedings to try to justify its excessive rate adjustments, as discussed above in Section IV.B.3. Second, Staff attempts to justify its rate adjustments by pointing out that (1) NYSEG and RG&E have deferred regulatory assets and reserves that will be funded by future rates and adjustments and (2) adjustments to NYSEG's and RG&E's books are common when a company is acquired; however, as discussed below, the various unilateral modifications to NYSEG and RG&E Rate Plans and the NYSEG Electric Order are unsupported by the record and factually deficient.

Third, as to impacts on NYSEG and RG&E, Staff's claim that the requested rate adjustments would have no adverse impact on NYSEG and RG&E is not supported by the record. Indeed, the impact of all of the Staff proposals is *$1.6 to $1.7 billion* over five years, and represents approximately 25% of delivery revenues (Tr. 330). Under Staff's proposals, NYSEG and RG&E would either have to provide immediate rate reductions or immediately begin creating a huge customer liability through earnings sharing that would require a cash outlay upon the resetting of rates (Tr. 323-24). Over a five-year scenario, Staff's proposed rate adjustments also would negatively impact NYSEG's and RG&E's returns on equity (Tr. 330; Exh. 31; 32).

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73 In the event the Commission does consider any of Staff's specific rate adjustments, they should each be set aside or modified in keeping with the detailed responses to those proposals provided in rebuttal testimony of the Rate Adjustment Panel (Tr. 331-411).

The extreme impact of Staff's rate adjustments is demonstrated by considering the amount of the proposed adjustments as a portion of each company's five-year delivery revenues (Tr. 330). The Staff Policy Panel acknowledges that the value of customer benefits provided in the National Grid/KeySpan merger represented 10% of the company's delivery revenues (Tr. 1370), and this percentage includes the merger synergies and utilizes a higher level of savings than were found by the Commission to exist in that case. By contrast, Staff's proposed rate adjustments in this proceeding would require the Joint Petitioners to provide customer benefits, or financial concessions (not based on merger synergy savings), representing *over 25% of the five-year delivery revenues of NYSEG and RG&E*. Based upon Staff's own metric, its proposed rate adjustments are excessive and should be summarily rejected.

1. Staff's Calculation Of The Proposed Rate Case Adjustments Are Erroneous

As discussed above, the issue of whether a utility's rates should be adjusted up or down for reasons that have nothing to do with a proposed merger should not be adjudicated in a Section 70 proceeding where the only relevant issue is whether the proposed merger is in the public interest. If the Commission finds, however, that further examination of Staff's rate issues is needed, then those issues can be addressed in a subsequent rate proceeding after closing the Proposed Transaction consistent with the Commission's regulations and procedures designed to ensure that the due process rights of all parties are protected.

Indeed, the very nature of Staff's arguments dictates that these rate issues should be addressed, if at all, in subsequent rate proceedings. For example, Staff has proposed that NYSEG and RG&E should be required to write-off $142 million of capitalized software investments, including the new Customer Care Systems ("CCS") despite the fact that the Commission specifically rejected Staff's argument to the same effect in NYSEG's last rate case

(Tr. 349). This issue should not be relitigated in a Section 70 proceeding. Another example is Staff's proposed regulatory adjustment involving a deferral of $4.2 million relating to the Voice Your Choice Program ("VYC") (Tr. 1689). Although Staff challenges this deferral because it is in excess of $2.0 million set out in the RG&E Joint Petition (Tr. 1665), Staff ultimately conceded that nothing in the RG&E Joint Proposal limits VYC deferral to $2.0 million and agreed that there were many other deferrals that exceeded $2.0 million (Tr. 1699). Staff's proposed VYC adjustment is particularly egregious given the passage of time. At least part of the VYC funds at issue were expended as far back as 2004 (Tr. 1690), yet Staff's concern over the level of VYC spending was never communicated to RG&E prior to this proceeding. Staff's position against deferral of VYC expenditures is particularly illogical given RG&E's close coordination with Staff to develop the program and Chairman Flynn's public statements that RG&E's VYC initiative was a "tremendous success" (Exh. 40).[74] Chairman Flynn also lauded the fact that RG&E through its implementation of VYC had achieved the second highest penetration rate of any utility service territory in the State (*Id*.). In light of the terms of the RG&E rate plan that allowed the applicable deferral, the demonstrated success of VYC, and the passage of several years, this issue starkly shows how arbitrary and inequitable it would be if the Staff could belatedly challenge RG&E's VYC expenditures.

Joint Petitioners address additional rate issues below, including flaws in Staff's analysis that would need to be considered to the extent Staff attempts to advance these positions in subsequent rate proceedings.

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[74] The accuracy of the quote of then Chairman Flynn contained in Exhibit 40 was acknowledged on the record by Staff Counsel (Tr. 1691).

a. Staff's Proposed 9.0% ROE Is Unwarranted

Staff proposes to apply a 9.0% Return on Equity ("ROE") to NYSEG and RG&E. Staff's proposal is beyond the scope of this Section 70 proceeding and is an issue that need not be determined in this proceeding by the ALJ and the Commission. Consistent with this approach, Dr. Makholm recommends that the appropriate ROE should not be established in this Section 70 proceeding, but rather in a separate litigated rate proceeding where evidence from the applicants can be presented (Tr. 1090). Nevertheless, to the extent this issue is raised in a subsequent rate proceeding, the Joint Petitioners note that there are significant flaws in Staff's proposal.

As Joint Petitioners' witness Dr. Makholm explains, this ROE is not an appropriate or reasonable rate and is far below ROEs granted by many other state commissions (Tr. 1066; 1090). More tellingly, Staff's proposal is significantly below the 9.8% ROE recently granted to National Grid/KeySpan (Tr. 1399).

b. Staff's Proposal To Mandate A Consolidated Capital Structure, With Arbitrary And Illogical Adjustments, Should Be Rejected

Staff raises the issue of the capital structure for setting rates (Tr. 1337; 1381), and assumes that a hypothetical consolidated capital structure for Iberdrola should be utilized for setting rates after the Proposed Transaction (Tr. 1326-27; 1381). This proposal is beyond the scope of this proceeding; nevertheless, the Joint Petitioners note that there are significant flaws in Staff's proposal.

As Dr. Makholm notes, Staff testifies that a hypothetical consolidated capital structure for Iberdrola should be used for setting rates "as if it is *required* to do so," (Tr. 1085) (emphasis in original), and then seeks to demonstrate that Iberdrola's *pro forma* capital structure would be over leveraged. Staff backs into a regulated capital structure for NYSEG and RG&E

"using a number of completely subjective and unsupportable adjustments" (*Id.*). If the Commission considers these issues in a subsequent proceeding, it should reject as unsupported the claim that a consolidated capital structure and the Staff-manufactured "adjustments" to the capital structure are required.

Staff's claim that NYSEG and RG&E rates will be based on the consolidated capital structure of Iberdrola rests on two decisions, Case 28947, *National Fuel Gas Distribution Corporation*, Opinion 85-15 (Sept. 26, 1985), and Case 05-E-1222, *New York State Elec. & Gas Corp.*, Order Adopting Recommended Decision with Modifications (Aug. 23, 2006) (Tr. 1326-27). In fact, the Commission has approved rates based either on the stand-alone capital structure of the regulated company, or on a hypothetical capital structure, in several instances where a regulated operating company is in a holding company structure.[75] Thus, what is clear from Commission precedent is *not* that a consolidated capital structure must be used, but rather that the Commission will analyze capital structure on a case-by-case basis.

Here, the facts do not support Staff's use of a consolidated capital structure. Dr. Makholm explains that it could be sensible to use a consolidated capital structure in instances, such as was the case in *National Fuel Gas Distribution Corp.*, in which a regulated parent company raises debt for its subsidiaries and "the broader company was almost totally a regulated entity" (Tr. 1086). However, a consolidated capital structure would *not* be justified where, as

[75] *See, e.g.*, Case 07-G-0141 - *National Fuel Gas Distribution Corp., Order Establishing Rates for Gas Service*, (Dec. 21, 2007) (establishing equity ratio based on risk profile of distribution business in New York); Case 06-W-0131, 06-W-0244 - *UWR, Order Approving Merger and Establishing Three-Year Rate Plan*, (Dec. 14, 2006) (approving a Joint Proposal in which UWR would use United Water New Jersey's capital structure, and not that of its ultimate parent Lyonnaise des Eaux); Case 99-G-1188 et al. - *St. Lawrence Gas Company, Staff Recommendation (Approved as Recommended and so Ordered by the Commission)* (Mar. 27, 2000) (requiring use of utility operating company's actual capital structure instead of consolidated capital structure because the utility issued its own debt and the holding company's debt ratio was out of line with industry average). Staff's position is also contrary to the stand-alone capital structure approved in the National Grid/KeySpan proceeding. *NG/KS Order*, *supra* note 12.

here (and in *St. Lawrence Gas*) the parent company will not be raising debt for the regulated operating companies and the operating companies will remain independently regulated by the Commission (Tr. 1087). Moreover, if a stand-alone capital structure is for some reason deemed inappropriate for ratemaking purposes, there are more reliable methods to set regulated capital structures rather than the "reverse engineering" that Staff attempts, namely, use of a proxy group of operating utility companies that are in the same business and subject to the same type of business risk (Tr. 1089).[76]

Staff's erroneous logic does not stop with its assumption that a consolidated structure "must" be used, as Staff goes even further to argue that its assumed consolidated capital structure must be subjected to two arbitrary and unprecedented "subsidiary adjustments": (1) removing Goodwill from Iberdrola's capital structure using a 75% equity ratio and 25% debt ratio, and (2) removing $55.4 billion of Iberdrola non-jurisdictional operations at a rate of 50% equity and 50% debt (Tr. 1331; 1334). Staff then argues that its assumed capital structure poses a risk to ratepayers that can be avoided if the Commission does not approve the Proposed Transaction (Tr. 1336-37).

There is no precedent or logic for either of the two subsidiary "adjustments" made by Staff. To "remove" Goodwill that has been properly placed on Iberdrola's books, Staff witness Mr. Barry conceded that "I came up with it myself" (Tr. 1569) and that he is unaware of any precedent for the proposal in any jurisdiction (Tr. 1568-69 (removing Goodwill had not "to

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[76] While a consolidated capital structure was used in the ratemaking context in Case 05-E-1222 - *NYSEG, Order Adopting Recommended Decision With Modifications* (Aug. 23, 2006), that case is distinguishable. In *NYSEG*, the Commission did not believe that anything in the record showed that Energy East had implemented any corporate restrictions or standards to separate NYSEG's capital structure from its own (Tr. 1089-90). Here, in contrast, there is ample evidence in the record both that the rating agencies recognize NYSEG's and RG&E's credit worthiness separate and apart from Energy East, and that Iberdrola and Energy East have in sworn testimony committed themselves to financial protections to ensure that NYSEG's and RG&E's capital structures remain separate from those of Iberdrola and Energy East (*see, e.g.*, Tr. 554; 556-57).

[his] knowledge" ever been done in the State of New York); *id.* (same, with respect to FERC)). Staff also fails to point to any accounting justification for its proposed Goodwill adjustment, and in fact there is no justification as Goodwill is a well-established accounting asset. Dr. Makholm confirms that the proposed adjustment to back out Goodwill at a 75/25 equity/debt ratio is supported only by "Staff's own assumptions" (Tr. 1088).

Staff then calculates a negative common equity ratio of 112% under one approach and 21% under another (Tr. 1569-70).[77] The result of a negative common equity ratio is highly illogical, yet Staff simply ignores the obvious conclusion that its negative equity results disprove the validity of its hypothetical "adjustment" methodology. Instead, Staff proceeds to conclude that after applying its unsupportable Goodwill adjustment "Iberdrola's pro forma capitalization would be overleveraged" and that there "is not enough equity to adequately support an A3 rating for Iberdrola's current operating assets, its Goodwill and the operating assets of Energy East" (Tr. 1335). Staff assigns a 38% equity ratio to Iberdrola and then goes on to claim that Iberdrola's hypothetical "over leverage" will result in $148 million of "over earnings" for Iberdrola (Tr. 1341; 1571; 1573).

Staff's second "adjustment" is to remove $55.4 billion from Iberdrola's *pro forma* capital structure associated with Iberdrola's non-jurisdictional operations at a rate of 50% equity / 50% debt (Tr. 1331). This administrative "adjustment" to the books at the Iberdrola holding company level is, in Staff's view, needed to ensure that a holding company's "non-jurisdictional operations" are supported with a capital structure "appropriate for the risks of its operations." (Tr. 1329). This adjustment is also arbitrary, and as Dr. Makholm testifies, backing out $55.4

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[77] The wide variation in Staff's own calculation of the negative equity (112% versus 21%) further calls into question the validity of Staff's methodology.

billion from Iberdrola's capital structure based on S&P U.S. ratings criteria makes no sense as Iberdrola is not a U.S. utility (Tr. 1087-88).

The logic of Staff's claim of excessive "over earnings" by Iberdrola is readily highlighted by applying Staff's flawed methodology to the National Grid/KeySpan transaction. If Staff's Goodwill adjustment were applied to National Grid, the negative equity ratio would be "significantly higher" than the illogical 121% Staff calculated for Iberdrola (Tr. 1576), further proving the invalidity of Staff's methodology. Staff's Policy Panel conceded on cross-examination that utilizing the same methodology that produced the alleged $148 million in "over earnings" for Iberdrola would result in $253.1 million of annual "over earnings" for National Grid (Tr. 1580). These "over earnings," if multiplied by the five-year period at issue in that proceeding, would result in $1.265 billion in "over earnings" for National Grid, far outweighing the $400 million in customer synergy savings recognized by the Commission in that merger. When faced with the fact that its methodology would lead to almost $1.265 billion of "over earnings" for National Grid, Staff's only response was to claim that National Grid was ring-fenced thus allowing the Commission to use a higher ROE of 9.8% (above the 9.0% recommended by Staff in this proceeding) and an equity ratio of 45% (far above the 38% recommended by Staff in this proceeding) (Tr. 1579; 1581-82). Not surprisingly, Staff was unable to clarify why ring fencing was worth $1.265 billion (Tr. 1582). The lack of "any objective or accepted basis" for making the adjustment renders Staff's consolidated capital structure analysis meaningless.

The Commission should reject Staff's inaccurate claims that a consolidated capital structure with arbitrary, illogical and unprecedented adjustments, is somehow appropriate.

c. Staff's Earnings Sharing Mechanism Only Magnifies The Financial Harm To The Companies

Staff also proposes to impose an ESM in order to address the alleged problem of Staff's own manufactured high returns. This proposal is beyond the scope of this proceeding; nevertheless, the Joint Petitioners note that there are significant flaws in Staff's proposal.

Because Staff's PBAs and one-time rate adjustments of $855 million are comprised primarily of write-offs and reserve increases, the impact on NYSEG and RG&E would be to reduce rate base, eliminate associated amortizations and create the illusion of higher returns. Based on the expected imposition of Staff's own PBAs, Staff then concludes that NYSEG and RG&E would be "over earning" and proposes a series of additional rate plan modifications, including an ESM, to reduce the manufactured high returns (Tr. 321-22).[78] The ESM proposed by Staff would not exclude the impact of Staff's proposed PBAs, with the result that the ESM will be triggered. Regardless of whether Staff's total rate adjustments are used to immediately reduce rates, or are deferred as a result of a new ESM, the total financial impact on NYSEG and RG&E represents over 25% of their five-year delivery revenues (Tr. 327; Exh. 28).

Staff's ESM proposal will impose a ceiling on NYSEG's and RG&E's returns on equity (Tr. 329-30; Exh. 32). For NYSEG, Staff has proposed an ESM under which delivery earnings between 9% and 10% ROE would be shared 50/50 between customers and shareholders. NYSEG earnings between 10% and 11% would be shared 75/25, customer/shareholder, with all earnings above 11% flowing to customers. The effect of this

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[78] Staff has essentially proposed two financial scenarios. Under Scenario 1, Staff would impose all PBAs and rate plan modifications with an ESM, but would not require immediate rate reductions. Under Scenario 2, Staff would require immediate implementation of all PBAs, rate plan modifications with an ESM, and rate reductions. The financial impact on the utilities under either scenario is roughly equivalent. Under Scenario 1, the financial impact over five years is $1.71 billion ($753 million for NYSEG and $957 million for RG&E). Under Scenario 2, the financial impact over five years is approximately $1.64 billion ($742 million for NYSEG and $896 million for RG&E) (Tr. 323-24).

ESM for NYSEG, after reflecting the interest expense on the customer share of the earnings, would be to limit the potential shareholder ROEs in year five at NYSEG Gas to 7.3% and at NYSEG Electric to 8.0%. On the stand, Mr. Haslinger modified his prefiled testimony so that the proposed ESM for RG&E would match that of NYSEG (Tr. 1642; 1709-10). Prior to Mr. Haslinger's modification, the highest possible ROEs at RG&E, after reflecting interest expense on the customer share of earnings, would be 7.9% at RG&E Gas and 2.1% at RG&E Electric (Tr. 329; Exh. 32).

Thus, Staff's proposed rate adjustments would limit the returns of NYSEG and RG&E to levels well below their authorized returns. Moreover, the ESM proposals are unreasonable because they would unilaterally require a much higher level of earnings sharing by NYSEG and RG&E than provided for under their existing rate plans and orders. Currently, NYSEG Electric has no ESM and NYSEG Gas shares earnings on a 50/50 basis only upon reaching a threshold of 12.5%. Similarly, for RG&E Electric, there is a 50/50 earnings sharing only above a 12.25% ROE and for RG&E Gas there is a 50/50 sharing only above a 12.0% ROE threshold (Tr. 330).

d. Staff's Proposed Changes To The RG&E Commodity Program Are Unfounded

Staff proposes rate plan modifications related to the RG&E Commodity Program. This proposal is beyond the scope of this proceeding; nevertheless, the Joint Petitioners note that there are significant flaws in Staff's proposal.

Staff witness Haslinger inappropriately proposes that the RG&E Commodity Program be modified to reflect changes recently approved for the NYSEG Commodity Program (Tr. 1673). These changes include the reduction of the Fixed Price Option ("FPO") conversion factor and a reconstructed earnings sharing mechanism that provides no downside risk to customers and allows customers to share upside potential (Tr. 379). Staff's proposed modifications to the RG&E Commodity Program are inappropriate and unsupported. The existing Commodity Program is one of the provisions that RG&E proposes to continue under the RG&E Electric Rate Plan and Continuation filing.[79] Similar to other Staff rate plan modifications, this matter should be addressed, if at all, in a subsequent proceeding.

e. Annual Compliance Filings Of NYSEG And RG&E

Staff raises concerns regarding NYSEG Gas and RG&E Electric and Gas annual compliance filings ("ACFs") under their existing rate plans. This proposal is beyond the scope of this proceeding; nevertheless, the Joint Petitioners note that there are significant flaws in Staff's proposal.

Each year NYSEG Gas and RG&E Electric and Gas are required to file ACFs under their existing rate plans. NYSEG and RG&E have made these filings since 2002, but they have never received an audit report from Staff in regard to the ACFs. In fact, Staff's audit report for NYSEG Electric will not be issued until the close of 2009, nearly seven years after the first filing and up to three years since the rate plan ended (*see* Tr. 1694). Similarly, the first audit reports for NYSEG's gas division or RG&E's gas or electric divisions will not be filed until 2009, years after the first ACF filings. Now, Staff raises multiple issues related to the ACF compliance filings for the electric and gas divisions of NYSEG and RG&E. That Staff has remained silent on these issues for so long is telling—Staff's failure to raise these issues on a timely basis strongly suggests that Staff's concerns in this case are overstated, and that Staff should not be rewarded for its unwarranted delay in raising these issues by entertaining them in a proceeding wholly unrelated to past rate plans.

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[79] Case 03-E-0765 and Case 02-E-0198 - *Proceeding on Motion of the Commission as to the Rates, Charges, Rules and Regulations of Rochester Gas and Electric Corporation for Electric Service, Electric Rate Joint Proposal* (Mar. 9, 2004).

Treating the ACFs as multi-year filings with audit reports provided years after the end of the rate plan magnifies the impact of any disputes, because the potential reversal of charges and accumulated interest long after the initial reporting can transform a relatively minor issue into a major financial dispute. On cross examination, Mr. Haslinger has admitted that it is possible for Staff to provide timely feedback to NYSEG and RG&E on issues Staff identifies in the ACF filings (Tr. 1703). Staff's years-long delay is simply without excuse—if and when these issues are ever addressed, it should be through separate proceedings so that any issues can be resolved in a timely and orderly fashion.

C. Staff's Proposals Will Have An Immediate And Significant Adverse Financial Impact On NYSEG And RG&E

The Staff Policy Panel's assertion that Staff's proposed rate adjustments "will not impact the utilities' current cash flow" or result in "a long-term impairment of the utilities' finances" (Tr. 1368) is flawed and erroneous.

Staff labels the PBAs as "paper assets" in an effort to mislead the Commission into thinking that these regulatory assets do not have a cash impact. However, Staff is simply wrong. First, at NYSEG, the IPP costs of $49 million are a true cash outlay (Tr. 1740; 1760). If the Commission does not allow NYSEG to charge customers for above-market IPP costs, it would not result in the elimination of payments that NYSEG must continue to make to IPPs. Second, all of the regulatory assets are financed by equity and debt. The debt portion equals between 55% and 58.4% of the regulatory assets. The mere act of writing off a regulatory asset (and reducing revenues associated with it) does not release NYSEG or RG&E from its obligation to repay its investors, including interest and dividends. Indeed, at hearing, Staff had to admit that its proposed rate adjustments and conditions would negatively impact NYSEG's and RG&E's cash flows (Tr. 1708-09; 1760). As described in Section VI.B.1.c above, Staff's proposed ESMs will also impose an effective earnings cap on NYSEG and RG&E below their authorized levels of return on equity.

VII. RELIABILITY, SAFETY, AND SERVICE QUALITY ISSUES

The Staff Electric Reliability and Safety Panel, Staff Gas Safety Panel, Staff Consumer Services Panel, and Staff Policy Panel make a number of recommendations that would impose conditions upon approval of the Proposed Transaction. These recommendations are unrelated to the Proposed Transaction, are arbitrary in light of NYSEG's and RG&E's proven history of and commitment to reliable service, and are unsupported by the record in this proceeding. To the extent that the Commission finds any of these recommendations worthy of consideration (which for the reasons set forth below they are not), it should address such matters in a separate proceeding or proceedings, to be commenced after the close of the Proposed Transaction. Nonetheless, because these issues have been raised by Staff, the Joint Petitioners briefly state their primary objections to these recommendations.

A. Staff's Electric Reliability Recommendations Are Unsupported And Arbitrary

The Staff Electric Reliability and Safety Panel recommends: (a) dramatic increases to the revenue adjustments associated with NYSEG's and RG&E's SAIDI and CAIDI targets; (b) a "five-year forecast of planned system upgrades, including the expected costs for each project or program" along with a reconciliation to the past year's forecast, thirty days from NYSEG's and RG&E's current planning cycle and annually thereafter; and (c) an assessment of the physical condition of all elements in the NYSEG and RG&E electric systems, along with repair plans, remedial actions and monitoring programs for any facilities found to be deficient, within ninety (90) days from a decision in this proceeding (Tr. 144; 1856-1862). The recommendations are unrelated to the Proposed Transaction, arbitrary in light of NYSEG's and RG&E's proven history of and commitment to reliable service, and unsupported by the record.

Staff's and the Joint Petitioners' testimony both show that NYSEG and RG&E have consistently met their SAIFI and CAIDI targets for a ten-year period (Tr. 146; 1857-59). Staff testified that, over a ten-year period, NYSEG's SAIFI performance ranged from a high of 1.14 in 2002 to a low of 0.90 in 1999, with an average of 1.05 for this period (Tr. 1857). NYSEG's performance was well within its SAIFI targets of 1.20/1.26 (Tr. 1857). For CAIDI, the levels ranged from a high of 2.01 in 2006 to a low of 1.76 in 2001, with an average of 1.90 for this period (Tr. 1857). NYSEG's performance was well within its CAIDI targets of 2.08/2.18 (Tr. 1857). Similarly, RG&E's SAIFI performance for the ten-year period ranged from a high of 0.87 in 2001 to a low of 0.59, with an average of 0.74, and RG&E's CAIDI performance ranged from a high of 1.87 in 2005 to a low of 1.56 in 2001, with an average of 1.69 (Tr. 1858). Again, RG&E's performance was well within its targets for SAIFI and CAIDI, .90 and 1.90, respectively (Tr. 1857). Staff admitted that NYSEG's and RG&E's historic performances "have been acceptable relative to the established targets" (Tr. 1859). As the Joint Petitioners' Electric Reliability Panel explained, NYSEG's and RG&E's performance "is particularly meaningful data given that major and minor storms have challenged all New York electric utilities over the past several [sic] years" (Tr. 146). NYSEG and RG&E continually strive to exceed the targets by improving reliability and emergency response, through innovations in communications, outreach and special services (Tr. 146). NYSEG's and RG&E's efforts have been noted by customers and elected officials and honored with an EEI Award for Emergency Response for their response to some of the most notable emergencies in the State, including the 2006 flood and October snowstorms (Tr. 146-47).

Despite NYSEG's and RG&E's history of excellent service, Staff proposed a doubling of the revenue adjustments and an additional doubling if either NYSEG or RG&E fails to meet the thresholds in any subsequent year (Tr. 1859). Staff's only rationale for its recommendations is that the Commission imposed that same doubling of the revenue adjustments in the National Grid/KeySpan merger proceeding. Staff overstates the risks of the Proposed Transaction as discussed in Dr. Makholm's testimony (*see* Tr. 1043-1106), ignores Iberdrola's commitment to rely on local management (*see* Tr. 514; Exh. 41, pp. 3 and 5; Exh. 42, pp. 3 and 25), and inappropriately compares the Proposed Transaction to the National Grid/KeySpan merger as further discussed in Mr. Meehan's testimony (*see* Tr. 933; 959-964).

Staff also ignores the fact that the reliability performance of Niagara Mohawk d/b/a National Grid ("National Grid") was dramatically different from that of NYSEG and RG&E. National Grid failed to meet its SAIFI targets in 2004, 2005 and 2006 (Tr. 148). Staff admitted in a response to interrogatory I/E (DPS-142) that National Grid "failed to meet its established SAIFI and CAIDI targets a total of four times prior to the doubling of the performance mechanism" by the Commission (Exh. 11). As the Joint Petitioners' Electric Reliability Panel testified, in stark contrast to National Grid, NYSEG and RG&E have a proven history of meeting their performance targets (Tr. 149). Such performance does not present any cause for concern and, certainly, does not warrant comparison to National Grid, a utility that required substantial improvement in its reliability performance as acknowledged by Staff and the Commission.

Likewise, Staff's recommendations that NYSEG and RG&E provide a five-year forecast of planned system upgrades and an assessment of the physical condition of all elements in their systems are unnecessary and unwarranted. The Staff Electric Reliability and Safety

Panel simply cites to the Commission's decision in the National Grid/KeySpan merger as support for the infrastructure plans and the risk “that resources might be diverted post merger” (Tr. 1860), a flawed comparison as discussed above and in Mr. Meehan’s testimony (Tr. 149; 933; 960-961). In addition, the record shows that NYSEG’s and RG&E’s inspection, maintenance and capital replacement programs and practices represent systematic, ongoing assessment and follow-up actions that have resulted in reliable service. Moreover, there is no evidence in the record to the contrary to warrant adoption of Staff’s recommendations (Tr. 150). Accordingly, the Commission should reject Staff’s recommended assessment of the NYSEG and RG&E systems.

B. There Is No Basis For The Imposition Of Staff’s Gas Safety And Reliability Metrics

The Staff Gas Safety Panel proposes “enhancements” to the current safety and performance measures applicable to NYSEG and RG&E (Tr. 1799; 1801-03; 1839). There is no evidence that the current performance metrics are inadequate to provide incentives to NYSEG and RG&E to avoid deterioration in the area of safety and reliability following the acquisition of Energy East by Iberdrola. In fact, the evidence demonstrates that NYSEG and RG&E consistently meet or exceed their current safety and reliability targets and consistently outperform most of the other local distribution companies (“LDCs”) in the State (Exh. 18). Staff’s proposed enhancements in the areas of leak management, mains replacement and damage prevention would be inconsistent with existing rate plans and orders for NYSEG and RG&E and would subject them to financial penalties that are double or triple, and, in certain instances, five times higher than, the total amount currently at risk for failure by NYSEG and RG&E to achieve their targets (Tr. 223-24). The level and nature of the enhancements proposed by Staff are excessive and extreme. Accordingly, Staff's recommended metrics and revenue adjustments should be rejected as arbitrary, excessive, punitive, and beyond the scope of this Section 70 proceeding.

1. The Current Metrics Are Adequate To Ensure Superior Performance

NYSEG Gas is currently subject to targets and associated revenue adjustments related to infrastructure enhancements, leak management, damage prevention and emergency response time, established in Case 01-G-1668. As recently as 2005, the Commission adopted revised gas safety metrics for NYSEG that were agreed to by Staff, including the requirement that NYSEG increase the minimum mileage of bare steel mains replaced annually from 8 miles to 15 miles.[80] The Commission noted that the purpose of the 2005 Joint Proposal was to "refocus the rate plans incentives onto other gas safety activities."[81] RG&E is subject to similar targets and revenue adjustments adopted by the Commission in 2004.[82] The targets for both NYSEG and RG&E continue in effect through 2008, and from year to year thereafter unless modified by the Commission. It is inappropriate for Staff to use this Section 70 proceeding as an opportunity to reopen the gas safety and reliability targets it agreed to for NYSEG and RG&E in prior proceedings, particularly when there is no record evidence that would justify the changes in targets.

The Joint Petitioners propose no changes to NYSEG's and RG&E's operations as a result of the Proposed Transaction and therefore the issue of gas safety and reliability is irrelevant in the context of this merger proceeding (Tr. 204). The only impacts on NYSEG's and

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80 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*").

81 *2005 NYSEG Order and JP*, at 2.

82 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*").

RG&E's safety and reliability resulting from the Proposed Transaction would be positive, such as the potential sharing of best practices.

Staff admits that at least some of the enhancements it proposes are irrelevant to the Proposed Transaction. For example, the Gas Safety Panel states, "[T]he need to replace leak-prone pipe on a more expedited basis is not dependent on a merger or related to what business entity owns the LDCs" (Tr. 1811). Staff's admission on this point applies equally to all of the Gas Safety Panel's proposed enhancements. In light of NYSEG's and RG&E's excellent safety records there is no need to change their performance metrics or associated revenue adjustments because of the Proposed Transaction. Staff's assumption that the acquisition will cause NYSEG's and RG&E's safety and reliability standards to deteriorate is arbitrary and without foundation (Tr. 1799). In fact, because no change in operations is anticipated as a result of the Proposed Transaction and because there is the potential for sharing of best practices, the evidence indicates that NYSEG's and RG&E's performance will continue to be excellent and to improve (Tr. 204-05).

2. NYSEG And RG&E Currently Outperform The Other New York LDCs

The measures Staff proposes are unnecessary, excessive and, in many instances, redundant because NYSEG and RG&E have demonstrated a commitment to gas safety and reliability and do not need additional "incentives" in the form of harsher standards and higher revenue adjustments to continue this commitment. The evidence is uncontroverted that NYSEG and RG&E have consistently met or exceeded their current safety-related targets, and have consistently matched or outperformed the top performing LDCs in the State in every area pertaining to safety and reliability (Tr. 206-07). Staff's own 2006 Gas Safety and Reliability Report (Exh. 18) demonstrates that NYSEG's and RG&E's performance has improved significantly over the last five years, and in 2006, NYSEG and RG&E ranked among the top performers in the State in virtually every area (*see id*). Neither NYSEG nor RG&E is cited in the 2006 Safety Report for poor performance in any category, and neither company is singled out as requiring improvement in any safety measure. In fact, there are several instances in the report where Staff acknowledges the superior performance of NYSEG or RG&E (*e.g.*, NYSEG is among the better performers in the State in the area of leak repairs; NYSEG improved 42% in the total damages per ticket measure (Exh. 18 at 8); and NYSEG and RG&E are "among the best in the State" in the damage mismarks category (Exh.18 at 11)). In 2006, the Commission did not order NYSEG and RG&E to "self-assess their performance" and "respond with action plans on how to improve performance in the future" (Exh. 18 at 27). Nevertheless, Staff is now singling out two of the State's top-performers for punitive treatment by raising the bar to an unreasonably high level that could not realistically be required to meet a "public interest" standard (*see id.*).

3. Increase In Amounts At Risk

In addition to imposing more stringent performance targets, the safety and reliability enhancements Staff proposes would also subject NYSEG and RG&E to significantly increased revenue adjustments for failure to achieve the recommended targets (Tr. 222-25). For example, the amount at risk under the infrastructure enhancements measure (mains and services) Staff proposes would more than triple for NYSEG and would more than double for RG&E (Tr. 223). Under the leak management measure Staff proposes, the proposed total amount at risk for NYSEG is five times more than the current total amount at risk ($100,000 compared to $516,000), and more than three times the amount of RG&E's current risk ($100,000 compared to $360,000) (*Id.*). For mismarks, NYSEG's revenue adjustment would increase from $50,000 to $430,000 under Staff's proposal and a new mismark revenue adjustment would be implemented for RG&E in the amount of $300,000 (*Id.*).

Apart from Staff's astonishing claim that Iberdrola can afford to pay higher penalties (Tr. 1810-11), Staff tries to justify harsher metrics and penalties for NYSEG and RG&E because "the proposed acquisition … carries similar financial risks similar to the National Grid/KeySpan merger"[83] (Tr. 1809). As Mr. Meehan explains (Tr. 933; 959-64), the comparison between the two transactions is inappropriate because the Proposed Transaction does not present the same risks as the National Grid/KeySpan merger. There is no justification, therefore, for imposing on NYSEG and RG&E the doubling, tripling, quadrupling penalty mechanism adopted in the National Grid/KeySpan merger for failure to meet gas safety and reliability targets because the evidence is clear that NYSEG and RG&E outperform both National Grid and KeySpan in virtually every safety–related measure (Tr. 224; Exh. 18). Staff specifically acknowledged that in the area of mismarks, "NGRID remains an outlier . . . with the lowest measure of performance among the LDCs" (Exh. 18 at ii, 10). In the damages from no-calls measure, 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, the Staff noted that KeySpan "continues to have high repairable leak backlogs" (*Id.* at 26). A review of the various tables throughout the report, for every category measured, demonstrates that NYSEG's and RG&E's performance does not present any cause for concern, and certainly does not warrant the same level of revenue adjustments adopted in the National Grid/KeySpan merger -- LDCs that Staff admitted require significant improvements in their safety-related performance.

4. Staff's Proposal For Increased Reporting Should Be Rejected

The Commission should reject Staff's recommendation that NYSEG and RG&E submit a report to the Director of the Office of Electric, Gas and Water on their gas safety and

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[83] *NG/KS Order, supra* note 12.

reliability performance under the proposed targets within 30 days following the end of each calendar year (Tr. 1839). Such a report would be duplicative of the Gas Safety Performance Measures Report prepared and published annually by Staff, which is based upon data provided to Staff by the LDCs (Tr. 226). Layering additional reporting requirements on NYSEG and RG&E would be unnecessary, costly, ineffective and counterproductive. Moreover, 30 days from the end of the calendar year is an unreasonable and unworkable timeframe within which to prepare and produce such a report (*Id.*). Furthermore, NYSEG Gas and RG&E Gas already have annual gas safety reporting requirements in their applicable rate plans.

C. Staff's Service Quality Recommendations Are Unsupported And Arbitrary

The Staff Consumer Services Panel recommends modifications to NYSEG's and RG&E's Customer Service Performance Incentive ("CSPI") metrics and an increase in the associated amounts at risk, modifications to NYSEG's and RG&E's low income programs, and the development and filing of an outreach and education plan with the Commission (Tr. 118; 1871). Joint Petitioners' Consumer Services Panel's testimony shows that Staff's recommendations are unnecessary and excessive given NYSEG's and RG&E's excellent customer service record. In addition, there is no evidence in the record to support Staff's recommendations.

RG&E has consistently "exceeded all of its current CSPI measures, other than the performance standard that measures calls answered within thirty seconds ('Service Level')" (Tr. 122). NYSEG has consistently exceeded its targets on all performance measures except for Service Level and Customer Satisfaction (*Id.*). RG&E's and NYSEG's excellent customer service is demonstrated in Exhibit 9 and in the testimony of the Joint Petitioners' Service Quality Panel (Tr. 122-23). Staff raised no issue regarding NYSEG's and RG&E's service quality and, in fact, testified that NYSEG's and RG&E's performance was satisfactory with the noted exceptions mentioned above (Tr. 126-27). NYSEG and RG&E demonstrated, however, that both exceptions were the result of the implementation of new technology, that they took action to improve performance, that they met with Staff before, during and after the implementation of the systems, and that Staff indicated that it was pleased with their progress (Tr. 124).

Staff specifically argues that the following measures should be added for NYSEG: Escalated Complaint Response Time; Appointments Kept; Calls Answered; Billing Accuracy; and Estimated Meter Reads (Exh. 136). NYSEG, however, already regularly reports to Staff on these measures as part of its monthly CSPI report (Tr. 126). NYSEG's performance on customer satisfaction indicators such as Appointments Kept, Billing Accuracy, and Estimated Meter Reads is reflected in its Overall Satisfaction, Contact Satisfaction and PSC Complaint Rates (Tr. 122). Given this fact and NYSEG's record of excellent service quality, there is no reason to impose more requirements on NYSEG.

For RG&E, Staff recommends the following additional measures: Escalated Complaint Response Time and additional PSC Complaints metrics. Staff offers no justification for its proposal and, again, Staff's proposal is unwarranted in light of RG&E's service quality performance.

The "Escalated Complaint Response Time" for NYSEG and RG&E that Staff recommends is likewise unjustified and unsupported by the record. Staff provides no evidence that there is an issue regarding either NYSEG or RG&E that warrants adoption of the metric. The metric Staff advances will not lead to enhanced customer benefits (Tr. 129). Exhibit 9 highlights NYSEG's and RG&E's PSC Complaint Rate performance. The results for NYSEG and RG&E have consistently been below the required PSC Complaint Rate (*Id.*). NYSEG has had the lowest PSC Complaint Rate in the State for years (*Id.*). The Joint Petitioners' Consumer

Services Panel explained that the proposed Escalated Complaint Response Time – a measure of how quickly "paperwork" is sent to the Commission (independent of customer communication) – is of no benefit to customers given NYSEG's and RG&E's excellent performance on this measure and the small number of customers who would be impacted (*Id.*). In addition, Staff admits in a response to I/E (DPS-112) that no other utility has been required to implement the Escalated Complaint Response Time (Exh. 8, at 47). Staff's use of this proceeding to impose a CSPI on NYSEG and RG&E that no other utility has been required to implement and that will provide no additional benefits to customers is inappropriate and unnecessarily punitive.

The Staff Consumer Services Panel proposes an increase in the revenue adjustments for the service quality metrics (Tr. 1880-81). As the Joint Petitioners' Service Quality Panel explains, the proposed total amount at risk for NYSEG Electric more than doubles and the proposed amount at risk for NYSEG Gas is almost five times more than the current total amount at risk (Tr. 130). Staff's proposed total amounts for RG&E Electric and RG&E Gas are double the current total amount at risk (*Id.*). There is no reason to increase the maximum amounts at risk for failure to achieve targets.

Staff appears to base its recommendation primarily on the fact that the Commission imposed service quality conditions on the National Grid/KeySpan merger and on the mistaken belief that the Proposed Transaction carries risks similar to those of the National Grid/KeySpan merger. Staff's reasoning is flawed for a number of reasons.

First, as Mr. Meehan explains, the Proposed Transaction does not present the same risks as the National Grid/KeySpan merger (Tr. 933; 959-64). Second, as discussed above, NYSEG and RG&E have a history of excellent customer service. NYSEG and RG&E also have a strong commitment in this area and adequate incentives to provide high-quality customer service (Tr. 132). In direct contrast, during the National Grid/KeySpan merger proceeding, Staff raised concerns regarding Niagara Mohawk's service quality based on the fact that its service quality had declined after it was purchased by National Grid.[84] NYSEG's and RG&E's service quality neither presents any cause for concern nor warrants comparison to National Grid, a utility that Staff admits required improvements in its service quality performance.

Third, Staff arbitrarily assumes that the Proposed Transaction will somehow cause NYSEG and RG&E to deliver an inadequate level of service to customers. There is no basis in fact for this assumption. As the Joint Petitioners' Service Quality Panel explains, neither NYSEG nor RG&E expects any operational changes to customer services as a result of the merger (Tr. 133) and, if there were any such impacts of the merger, the impacts would be positive, such as the sharing of best practices. There is no reason to believe that NYSEG's and RG&E's service will decline (*Id.*). Thus, the record contains no evidence to support a finding that revenue adjustments should be increased as a condition to merger approval.

Staff also recommends that RG&E increase the number of Residential Energy Customer Assistance Program ("RECAP") participants and double program funding and that RG&E create a new low income program similar to NYSEG's Power Partner Program, but funded by shareholders. There is, however, no support in the record for Staff's recommendations.

As discussed in more detail herein, the Proposed Transaction provides numerous benefits for New York and, in particular, for NYSEG and RG&E ratepayers. There is no need for Staff to invent additional benefits. The needs of RG&E customers are being addressed through the existing programs (Tr. 136) and Staff does not allege otherwise. If RG&E retains

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84 *NG/KS Order*, *supra* note 12, at 96.

RECAP and establishes a Power Partner type program, as proposed by Staff, it would create unnecessary redundancies (*Id.*). For these reasons, Staff's recommendations regarding low income programs should be rejected by the Commission.

Likewise, Staff provides no support for its proposal that NYSEG and RG&E develop outreach and education plans with an identified budget. While the Joint Petitioners' Service Quality Panel agreed that, "from an internal planning perspective and to facilitate communications with Staff, it is useful for the Companies to continue the outreach and education plan filing process," the Panel opined that the content of the NYSEG and RG&E current overall outreach and education plan filings is sufficient (Tr. 137-38). Staff apparently agrees. When asked in an interrogatory (I/E (DPS-116)) for an example of its proposed plan, it referred NYSEG and RG&E to their prior filings (Tr. 138; Exh. 8, at 48). Accordingly, the record contains no basis to adopt Staff's proposals.

D. Staff's Retail Access Recommendations Are Unwarranted And Should Not Be Considered In This Proceeding

The Staff Policy Panel proposes changes to NYSEG's and RG&E's application of the billing issuance and payment processing charge ("BIPP") and recommends that NYSEG and RG&E undertake an ESCO Referral Program collaborative (Tr. 168; 1437-47). The retail access issues raised by Staff are unrelated to the instant proceeding and the Proposed Transaction will have no impact on NYSEG's and RG&E's retail access programs. It is inappropriate for Staff to attempt to use this proceeding to institute new programs and practices that have no relevance to the transaction between Iberdrola and Energy East (Tr. 169). The Commission should therefore reject Staff's retail access recommendations.

Staff's testimony asserts that NYSEG and RG&E have not complied with Commission unbundling and BIPP orders and that the Joint Petitioners must address these issues.

Staff's allegation that "[c]ertain issues regarding the way that these utilities apply their billing charges do not conform to Commission policy and Orders…" (Tr. 1437), is simply untrue. As the Joint Petitioners' Rate Design and Retail Access Panel explains, 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). NYSEG also complied with orders in its last electric rate case (Case 05-E-1222) that addressed and resolved BIPP matters (Tr. 171). NYSEG's treatment of the BIPP for gas customers is also consistent with relevant Commission orders (Tr. 171-72), as is RG&E's application of the BIPP.

Staff's BIPP proposal raises additional concerns for the Joint Petitioners. The Rate Design and Retail Access Panel demonstrated for numerous reasons that the proper forum for any modification to the established BIPP charges and costs is a rate case for NYSEG and RG&E (Tr. 173-75). This proceeding is not, and was never intended to be, a rate case. The Commission should not take action on Staff's BIPP recommendations other than to reject them as inappropriate in this proceeding.

Staff's ESCO Referral Program recommendation that NYSEG and RG&E should undertake an ESCO Referral Program collaborative, as a condition of merger approval, is unsupported by the record and is unnecessary. Staff's only rationale for its recommendation is that the Commission has ordered other utilities in rate proceedings to undertake an ESCO Referral Program collaborative (Tr. 1445). There is no analysis of NYSEG's and RG&E's existing retail access programs and practices, 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. Moreover, as the Rate Design and Retail Access Panel testified, in the NYSEG Supply Service case, all of the parties that executed the Joint Proposal, including Staff, CPB, ESCOs and NYSEG Electric, agreed that NYSEG Electric should implement an "ESCO Introduction Program" rather than an ESCO Referral Program, and the Commission approved that Joint Proposal.[85] This proceeding should not be used as a reason to replace the ESCO Introduction Program with an ESCO Referral Program. As the Rate Design and Retail Access Panel explains, the more appropriate forum for consideration of ESCO Referral Programs is the Commission's on-going generic retail access proceeding (Tr. 180-81). Accordingly, the Commission should reject Staff's recommendation.

VIII. REVENUE DECOUPLING ISSUES

The Commission has consolidated this case with Case 07-M-0996,[86] regarding consideration of a Revenue Decoupling Mechanism for NYSEG and RG&E. NYSEG and RG&E proposed to make an RDM filing by the second quarter of 2008 (Tr. 257-58). However, given the timing of this proceeding and the fact that this issue remains pending before the Commission, NYSEG and RG&E request that they be allowed to file the RDM proposals later this year after Commission approval of the Proposed Transaction. Although Staff supports NYSEG's and RG&E's proposal, MI opposes it on the grounds that the Commission's generic order stated that RDM proposals must be filed in the context of a base rate proceeding (Tr. 284-86). Unlike Staff, which seeks different RDM mechanisms for the electric and gas businesses, the RDM Panel proposes that the same reconciliation mechanism be used for both electric and

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85 Case 07-E-0479 - *Tariff Filing of New York State Electric & Gas Corporation to Offer Customers a Single Fixed Supply Service*, *Order Establishing Commodity Program*, at 16 and Joint Proposal, § II.C.7-12 (Aug. 29, 2007). The ESCO Introduction Program was intended to supplant rather than supplement an ESCO Referral Program (Joint Proposal, § II.C.10-11).

86 Case 07-M-0996 - *Proceeding on Motion of the Commission to Consider a Revenue Decoupling Mechanism for New York State Electric and Gas Corporation, Notice Consolidating Proceedings* (Oct. 22, 2007).

gas services unless a compelling rationale exists for separate procedures (Tr. 259). NYSEG and RG&E also endorse an RDM that includes an annual indexing of RDM targets in order to help avoid the need for frequent rate filings to recover general increases in delivery costs (*e.g.*, due to inflation) (*Id*.). Finally, the RDM Panel recommends that NYSEG's and RG&E's respective fixed price commodity programs should not be subject to an RDM (*Id*.). No parties in this proceeding have disputed that the RDM issues should be addressed in the context of NYSEG's and RG&E's proposed plan to submit RDM filings.

IX. CONCLUSION

For the foregoing reasons, the Joint Petitioners respectfully request that the Commission approve the Proposed Transaction without any conditions in excess of those the Joint Petitioners commit to herein. The record has demonstrated that the Proposed Transaction will bring extensive benefits to NYSEG's and RG&E's ratepayers and to the State of New York. These benefits meet and exceed the "public interest" standard of Section 70.

Respectfully submitted,

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