

**BEFORE THE  
NEW YORK PUBLIC SERVICE COMMISSION**

**Case No. 07-M-0906**

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

**INITIAL BRIEF OF NUCOR STEEL AUBURN, INC.**

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Dated: April, 11, 2008

**TABLE OF CONTENTS**

I. BACKGROUND .....1

II. SUMMARY OF NUCOR’S POSITION .....3

II. ARGUMENT.....6

    A. IBERDROLA Support for Upstate Economic Development  
    Should be Reflected in Specific Commitments .....6

    B. Revenue Decoupling Mechanisms for NYSEG and RG&E  
    Should be Considered in a Subsequent Proceeding.....10

Conclusion .....14

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**I. BACKGROUND**

By petition dated August 1, 2007, IBERDROLA, S.A. requested Commission approval pursuant to Section 70 of the Public Service Law to acquire 100% of the Energy East Corporation, the parent holding company of New York State Electric & Gas Corporation (“NYSEG”) and Rochester Gas and Electric Corporation (“RG&E”). IBERDROLA is a multi-national utility and energy company that is organized in Spain, but operates electric and/or gas utility operations in Brazil, the United Kingdom, Guatemala and Bolivia (Petition at p. 4). IBERDROLA is among the world’s largest developers of wind power, although its affiliated companies also operate fossil-fired and nuclear facilities. IBERDROLA is pursuing numerous wind projects in New York State, including several in the NYSEG or RG&E service territories.

The Petitioners assert that New York customers would benefit from the merger in various intangible ways that reflect IBERDROLA’s claimed:

- Global experience;
- Focus on energy efficiency and environment;
- Financial Stability;
- Commitment to customer service and reliability; and

- Commitment to local communities

(Petition at pp. 2-3).

The Department Staff and numerous intervenor parties, including Nucor, submitted responsive testimony to the Petition and the Petitioners' supporting testimony. Nucor's testimony, submitted by Frank Radigan of the Hudson River Energy Group, emphasized the need for any Commission order approving the acquisition to ensure that the entity that controls the Energy East utilities commits to supporting economic development in the NYSEG and RG&E service territories.

On March 14, the Petitioners circulated a "Joint Petitioners' Partial Acceptance Document" which conceded certain Staff and Intervenor requests for merger approval conditions in the areas of Vertical Market Power, Positive Benefit Adjustments ("PBAs"), an IBERDROLA commitment concerning future investments in renewable energy in New York State, electric cooperatives' and the Village of Sherburne concerns regarding reliability and communications from NYSEG, and the City of Rochester (relating to access to certain facilities). With respect to the PBAs, IBERDROLA accepted approximately \$201.6 million in accounting adjustments and write-downs between NYSEG and RG&E that were identified in Staff's testimony and exhibits, and agreed to implement the rate effect of those PBAs immediately following closing on the transaction in whatever manner the Commission determined to be appropriate. (Exh. 50).

In addition to issues raised by the merger petition, the Commission had previously instituted Case No. 07-M-0996 to consider the development and implementation of a revenue decoupling mechanism ("RDM") for NYSEG. By Notice Consolidating Proceedings, dated October 22, 2007, the Commission determined that:

It now appears that the matters intended to be addressed in Case 07-M-0996 can be more effectively considered in the proceedings underway in Case 07-M-0906, which concerns (among other things) the effects upon NYSEG's operations should the Commission approve the proposed corporate acquisition.

Staff submitted proposed electric and gas revenue decoupling mechanisms that it recommended be implemented by the Energy East utilities. SM 1629-31. A utility rate panel responded to the Staff proposal in rebuttal testimony by offering to submit an RDM proposal in the second quarter of 2008. SM 262.

Following the conclusion of an unsuccessful settlement phase, evidentiary hearings on all issues related to the Petition and RDM implementation were held on March 17-20, 2008.

## **II. SUMMARY OF NUCOR'S POSITION**

Nucor recognizes that, with the effective repeal in 2005 of the Public Utility Holding Company Act of 1935, consolidation in the U.S. utility sector is likely, and that multi-national entities such as IBERDROLA may be participants in that process. This changed landscape mandates thorough Commission consideration in Section 70 proceedings of all matters required to safeguard New York consumer interests. Further, a Commission determination under Section 70 of the Public Service Law that an acquisition of New York utilities is in the public interest never occurs in a vacuum, and must take into account pertinent State and Commission policies. In this case, the acquisition of the Energy East utilities by a global energy company, which itself is the subject of acquisition rumors, poses potentially serious risks and benefits. Staff correctly judged that substantial and tangible consumer benefits are necessary for the Commission to consent to the acquisition. IBERDROLA, in offering the Partial Acceptance document, has conceded the need for a demonstration of positive consumer benefits, even if the exact level of such commitments and protections has not been settled.

In the broader context, the Commission can hardly disregard the consensus that the country is heading into a recession that may be serious, the particular vulnerability of a moribund Upstate economy that continues to lose quality manufacturing jobs, or the impediment that high energy costs pose to the State's efforts to re-vitalize the Upstate New York economy. IBERDROLA's petition, as modified by the Partial Acceptance document, repeatedly acknowledged the importance of economic development Upstate<sup>1</sup> as a State policy imperative that the utilities have a role in addressing in at least the following manners:

1. Retention of utility jobs (NYSEG, RG&E and Energy East) in New York State;<sup>2</sup>
2. Positive Benefit Adjustments affecting NYSEG and RG&E delivery or bundled electric and natural gas rates;<sup>3</sup> and
3. Utility tariff based economic development initiatives establishing rate programs designed to help retain and attract quality jobs to the utilities' service territories.<sup>4</sup>

IBERDROLA has maintained throughout this proceeding that its acquisition of the Energy East companies will result in changed ownership, but not changed local utility company management. The influence of IBERDROLA corporate decision-making in Spain on the actions and operations of the New York utilities is, however, a central concern in this docket.

In Nucor's view, each of the above economic development elements is important and must be addressed through specific and enforceable commitments. The Petitioners'

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<sup>1</sup> See e.g., Petition at pp.3, 15 ( Exh. 41); SM 493; see also SM 524.

<sup>2</sup> SM 501, 506.

<sup>3</sup> See Staff Policy Panel testimony, and IBERDROLA's Partial Acceptance document (Exh. 50).

<sup>4</sup> SM 659-60.

commitment not to reduce utility jobs as a result of the merger is a “snapshot” promise that has limited vitality (or enforceability) beyond the day of closing. The disparity between Staff’s testimony concerning the PBAs required to protect consumers and the concessions IBERDROLA offered in the Partial Acceptance document is substantial but at least well defined. The last element, utility support for economic development job retention and attraction initiatives, is addressed only in Nucor’s testimony and the Empire State Development Corporation’s general statement conditionally supporting the acquisition.

This brief addresses Nucor’s concern that the Commission should expect major policy and spending decisions affecting New York utility operations to be made in the future by IBERDROLA management in Spain that will be well removed from the economic struggles in the NYSEG and RG&E service territories. Just as specific commitments are required for continued infrastructure investments that are needed to sustain or improve system reliability and performance, the Commission should require reasoned commitments to support job retention and attraction efforts that extend beyond utility employee headcounts.

Secondarily, Nucor addresses the consolidation of revenue decoupling in this docket. While the theoretical premise for revenue decoupling mechanisms is not in issue here, there are substantial implementation questions that must be addressed that are more appropriately considered in a base delivery rate case. The simplistic total revenue model that Staff proposes for NYSEG and RG&E electric delivery rates is flawed and likely would produce aberrant outcomes. It also is unnecessary to apply an RDM to NYSEG transmission voltage customers whose delivery rates consist almost entirely of fixed and demand charges. Indeed, NYSEG’s delivery rate design for many large users have consistently moved toward the rate structures that Staff advocated should be considered in lieu of revenue decoupling in Case No. 03-E-0640. As part of this merger docket, Nucor opposes the RDM proposed by Staff and

recommends that revenue decoupling be further explored following the Energy East planned filings later this year.

Finally, Staff and other parties have devoted considerable efforts to addressing vertical market power, PBAs and financial and credit protections for New York utility consumers. Nucor takes no position on the vertical market power matters other than to acknowledge the Petitioner's concessions in the Partial Acceptance document. In all other respects, Nucor acknowledges the Petitioners' concessions and generally supports the Staff position.

### **III. ARGUMENT**

#### **A. IBERDROLA Support for Upstate Economic Development Should be Reflected in Specific Commitments**

Support for job retention and creation in manufacturing historically has been, and remains, critical to upstate economic development efforts. The Manufacturers Association of Central New York (MACNY) reports that manufacturing employs over 550,000 New Yorkers and contributes \$61 billion annually to New York State's GDP. Compared to other sectors of the economy, manufacturers pay higher wages, generate better benefits, and stimulate more high technology growth through research and development and productivity improvements. SM 711.

Manufacturing jobs in New York pay salaries on average of over \$48,000 a year. Service sector employees earn about 60 percent of that, and retail workers earn about 40 percent of the wages paid to manufacturers. Manufacturing accounts for over 70 percent of private sector research and development in the United States. Every manufacturing job creates more than 2.5 related jobs in other sectors, and every dollar spent generates an additional \$1.37 in economic activity. SM 711-12.

It is no secret that Upstate New York, and particularly the areas served by NYSEG and RG&E, have been losing the battle to retain and attract quality jobs. The US Bureau of Labor Statistics reports that between March 1990 and March 2007 manufacturing jobs in New York declined by approximately 55%. On January 5, 2008 the Albany Times Union reported that manufacturing jobs dropped almost 29% between 1996 and 2006, a bigger decline than all states except North Carolina and Rhode Island. In the same article, the Times Union also reported that the cost of doing business in New York (wages, taxes, electricity and real estate) are second only to the cost of doing business in Hawaii and are 30.7% above the national average. SM 712-13.

The cost of electricity is a very large part of this cost disparity. The Albany Times Union reported that the average price of electricity for 2007 in New York State was 14.54 cents per kWh, the fourth highest and 66 percent above the national average of 8.77 cents. A November 2007 report prepared by Power in the Public Interest (“PPI”) reported that gap in retail electricity prices between deregulated and regulated states was 2.0 cents per kWh in 2000 and more than 4.0 cents per kwh in 2007. Exhibit 62. PPI also reported that in 2000, the average electric rate for all customers in New York was 10.6 cents/kwh; the comparable figure for the collective regulated states was 6 cents/kwh—or a difference of 4.6 cents. As of June 2007, the difference had widened to 6.8 cents (14.5 cents/kwh for New York and 7.7 cents/kwh for the regulated states). *Id.* For the 12 months ending June 2007, New Yorkers paid \$22 Billion for their electricity. The same amount of electricity at the regulated states’ average rate would have cost \$11.6 Billion—a difference (or comparative purchasing-power disadvantage to New Yorkers) of \$10.4 Billion for a 12-month period. SM 713-14. In short, New York average electric rates have continued to lose ground, and the State is even less economically competitive in this area than a decade ago.

Historically, the State administered a series of economic development programs that streamed low cost hydro power and excess nuclear capacity through the New York Power Authority (NYPA), and the Commission has approved and provided oversight to a variety of utility administered economic development initiatives. NYSEG and RG&E have offered bundled, and more recently, unbundled, job retention and attraction (“flex rate”) service agreements. NYSEG also has a specific budget for various consolidated economic development programs that was established in its last delivery rate case, and has implemented various economic development rate plans.<sup>5</sup>

The historic NYPA, bundled flex rate and Economic Development Zone Incentive (“EDZI”) discounted rate programs have been highly successful, as indicated by the number of manufacturing loads that continue to take service under one or more of these programs. The same cannot be said of the current programs, based on program structure or limited availability, as is evidenced by the continued erosion of manufacturing jobs noted above. SM 714.

Taking the steps necessary to re-vitalize the economy of Upstate New York is a top State and Commission priority<sup>6</sup>, and IBERDROLA asserts that the acquisition will reinforce the State’s ongoing efforts in this area. SM 506, 524. IBERDROLA has offered a limited commitment not to reduce utility jobs as a result of the merger, but the issue obviously is much broader than that. Utility rate economic development initiatives historically have been a key feature of successful job retention and attraction efforts, and the Energy East companies remain committed to supporting job retention and attraction efforts. SM 660. What is required in this docket is a specific and enforceable commitment by IBERDROLA.

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<sup>5</sup> See SM 658-60.

<sup>6</sup> SM 711 and 1599-1600.

Staff's testimony discussed somewhat conflicting statements of the Petitioners concerning the influence that IBERDROLA management in Spain may exert on the policies and practices of NYSEG and RG&E.<sup>7</sup> With respect to matters such as capital investment in the utilities' transmission and distribution networks, and implementing programs and rate structures to support job retention and creation, there is a risk that IBERDROLA will not share the Commission's concerns. *See* SM 1599-1600. Since IBERDROLA has acknowledged the importance of Upstate re-vitalization efforts and a willingness to be part of the solution, the Commission should establish specific economic development commitments as part of any merger approval order.

On this point, it is noteworthy that ESD's statement in support of the acquisition, with conditions, recommended that:

The NYSEG/RG&E Economic Development Plans be reviewed by the PSC to determine how the merger addresses economic development objectives in the upstate region to assess the additional benefits that IBERDROLA might provide over the planned benefits of Energy East. The planned financial and technical resources dedicated to technical assistance, infrastructure improvements, low cost energy supplies, and demand side management of Energy East must be enhanced to continue the critical investments in economic development.<sup>8</sup>

Nucor's testimony also recommended that the Commission require an enhanced commitment to economic development as a condition of approving the IBERDROLA acquisition. With Commission approval, this could, for example, include 1) exempting flex rate and qualified at-risk manufacturing loads from various surcharges (SBC, RPS, EPS, etc.)<sup>9</sup> or 2) streaming low cost sources of supply or hedged positions to qualifying loads. As Mr.

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<sup>7</sup> *See* SM 1155-70.

<sup>8</sup> ESD Statement, dated January 11, 2008.

<sup>9</sup> *See* Case No. 06-0265, Delphi Corporation, *Order Establishing an Economic Development Rate*, issued March 16, 2006 (waiving application of SBC, RPS and NBMW surcharges).

Radigan discussed, NYISO wholesale power prices are not an accurate indicator of the actual cost of utility power because a utility meets its supply requirements through a mix of its own generation, power purchase contracts with generators, and hedges (both physical and financial) with market participants. For example, Energy East's 2007 10-k filing indicates that as of February 15, 2007, the portion of expected load for fixed rate option customers not supplied by owned generation or long-term contracts is 100% hedged for NYSEG for on-peak and off-peak periods in 2007. SM 716. As such, low cost power supplies could be streamed directly to manufacturing customers as a means of retaining and attracting manufacturing businesses to the State. Also, notwithstanding the proposed spin-off of NYSEG and RG&E fossil-fired generation as described in IBERDROLA's Partial Acceptance document (Exh. 50), NYSEG has hydroelectric units and the cost of power from contracts with Independent Power Producers that is forecast to be under market prices. SM 716. The Commission has previously approved streaming low cost power sources to retain and attract manufacturing jobs New York.<sup>10</sup> Nucor recommends that the Commission direct NYSEG and RG&E to consult with interested stakeholders, and, based on those discussions, propose enhancements to their existing Economic Development Plans.

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<sup>10</sup> E.g., Case No. 02-E-1335, *Tariff Filing by City of Jamestown to Establish Economic Development Riders*, Order issued January 11, 2003.

**B. Revenue Decoupling Mechanisms for NYSEG and RG&E Should be Considered in a Subsequent Proceeding**

Unlike many states that have only considered revenue decoupling conceptually as a way to mitigate a utility's financial disincentive to promote consumer end use energy efficiency, peak demand reduction and distributed generation, New York has historic experience with such mechanisms. In Case No. 03-E-0640, the Commission re-visited RDMs as a vehicle for mitigating rate disincentives in these areas. In this regard, a July 2004 Staff Report ("RDM Report") prepared in that docket explored both RDM theory and the real implementation issues that an RDM creates or may create. Exh. 117.

In brief, an RDM breaks the link between utility sales and profitability by guaranteeing a target level of revenues notwithstanding the actual variation in electric sales that will occur. Revenue shortfalls or over-collections relative to the targets are true-up through a surcharge/credit in subsequent consumer bills.

Like broadcast pesticides used on rights-of-way, an RDM in the first instance is a blunderbuss approach that is indifferent to the cause of such variations. Because weather and economic growth (new customers, business expansion or closures) are the principal causes of electric and gas sales variability in the short term, a basic RDM tends to produce aberrant outcomes that are not sustainable. As Staff found in the RDM Report:

Staff's previous experience with comprehensive RDMs is that they tend to generate large revenue accruals, nearly all caused by weather. Such accruals can either re-introduce rate instability or create large revenue deferrals. When the true-up is applied with a one year or more delay, as is typical, customer confusion and large bill swings can result. In effect, the risks of weather fluctuations are shifted from the utility to the customers.

Exh. 117 at 8. Similarly, an RDM weakens a utility's otherwise constructive incentive to promote economic development (job retention and attraction) in its service territory. From a

utility's perspective, revenue growth associated with customer growth and economic expansion offsets the added cost of serving that growing load. SM 312-14. Consequently, a basic RDM likely leads to earnings erosion and correspondingly frequent rate cases.

Finally, an RDM at best aims to neutralize a utility's disincentive to promote energy efficient behavior by its customers; the mechanism provides no incentive directly to end users, but can actually be a cause of customer confusion.<sup>11</sup> For example, during a period of unusual weather (e.g., a summer heat wave) most loads (and particularly air conditioning loads that tend to drive system peak demands) do not see a relevant price signal as to the cost or availability of power, so energy demand is highest when system costs are high. Under an RDM, above-target revenues associated with the hot weather are returned to consumers many months later, thus muddling price signals in rates that are already poor.<sup>12</sup> Similarly, if an economic slowdown or recession, a circumstance now forecast for the U.S. economy, leads to shift reductions, temporary or permanent business shutdowns, or other business contractions associated with that economic downturn, surviving customers in those service classes will experience RDM-based bill increases to cover the utility revenue target shortfall. SM 309; 1635.

In addressing a revenue decoupling mechanism ("RDM") for the NYSEG and RG&E electric and gas companies, the Petitioners' RDM panel correctly recognized that any RDMs implemented should avoid producing earnings erosion that could lead to annual delivery rate filings. SM 304. The panel also properly noted that the RDMs should not "misalign utility interests" with the interests of the service territory (in fostering economic growth). SM 304-05; 311. The panel asserts that the "trade-offs" associated with different RDM need to be

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<sup>11</sup> Exh. 117 at 8; also SM 1634.

<sup>12</sup> See SM 308.

considered further, and proposes to make a detailed RDM filing in the second quarter of 2008. SM 307.

Staff proposes a total delivery revenue mechanism for the NYSEG and RG&E electric operations that would be implemented for each customer service class, with the exceptions of street-lighting, buyback, individually negotiated contracts and standby service. SM 1629. This requires an up-to-date, “rate case quality” forecast of monthly delivery revenues for each eligible class or sub-class. SM 1629-30. Staff proposes to apply the RDM only to delivery revenues. SM 1630.

The Commission’s April 2007 *Order Requiring Proposals for Revenue Decoupling Mechanisms* in Cases 03-E-0640 and 07-G-0746 recognized the complexities associated with RDMs that are described above, as well as the rate design progress made to lessen the recovery of fixed delivery costs in volumetric rates. Whether to apply an RDM to all delivery customer classes was a factor to consider in developing an RDM, particularly for large industrial customers served under rate structures that better reflect service costs. (Order at p. 8 and 10).

In Nucor’s view, Staff’s proposed RDMs for NYSEG and RG&E should be considered a starting point for the development of such mechanisms, but the Staff proposal itself is flawed, and should not be adopted as part of the Commission’s order in this docket.

### **Conclusion**

Nucor urges the Commission to adopt each of its positions in this docket for the reasons stated herein.

Respectfully submitted,

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