STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

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

INITIAL BRIEF

OF THE

NEW YORK STATE CONSUMER PROTECTION BOARD

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Dated: April 11, 2008
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I. Executive Summary

By petition dated August 1, 2007, Iberdrola, S.A. ("Iberdrola"), Energy East Corporation, RGS Energy Group, Inc. ("RGS"), Green Acquisition Capital, Inc., New York State Electric & Gas Corporation ("NYSEG") and Rochester Gas and Electric Corporation ("RG&E") (collectively, "Joint Petitioners") requested pursuant to Section 70 of the Public Service Law that the Public Service Commission ("PSC" or "Commission") approve the acquisition by Iberdrola of 100% of the outstanding stock of Energy East ("the Proposed Transaction"). The petition was supported by direct testimony which was supplemented by an additional submission on November 28, 2007.

The Department of Public Service Staff ("DPS Staff") and several intervening parties filed testimony on January 11, 2008, and the Joint Petitioners filed rebuttal testimony on January 31, 2008. Subsequently, on March 14, 2008, Joint Petitioners took the unusual step of submitting what they termed a "Partial

Acceptance Document," which they stated was intended to "narrow the issues raised" in the proceeding by "unilaterally accept[ing] certain benefits and/or conditions proposed" by various parties.[1] This Partial Acceptance Document was admitted into the record during evidentiary hearings conducted from March 17 through March 20, 2008, together with the pre-filed testimony of all witnesses and over 130 other exhibits. All parties were afforded an opportunity to cross-examine the sponsoring witnesses, and a transcript of nearly 2000 pages was produced.

While the New York State Consumer Protection Board ("CPB") did not file direct testimony in this case, we participated actively in discovery and in the evidentiary hearings, and we now submit this Initial Brief on contested issues in accordance with the schedule established by the presiding Administrative Law Judge ("ALJ"). In this brief, we focus on three questions:

(1) Does the Proposed Transaction generate a net positive public benefit?

(2) Should issues of vertical market power related to ownership by the combined entity of both generation and transmission be considered an impediment to approval of the transaction?

(3) What conditions should the Commission impose for the financial protection of ratepayers if it approves the Proposed Transaction?

In summary, our recommendations to the Commission on these three issues are as follows:

[1] Exhibit 50, "Joint Petitioners Partial Acceptance Document p. 1 ("Partial Acceptance Document").

1. Approval of the Proposed Transaction should be conditioned upon customers receiving the rate reductions associated with the $646 million in Positive Benefit Adjustments ("PBAs") and the $208 million in rate adjustments proposed by the DPS Staff. As we discuss below, many of the less tangible benefits that Joint Petitioners assert for the transaction are highly uncertain and difficult to quantify. Consequently, the $201.8 million in PBAs they offer in their Partial Acceptance Document is simply not an adequate amount to compensate consumers for the very substantial risks associated with the Proposed Transaction.

2. All vertical market power issues related to existing generating facilities, whether currently owned by Iberdrola, or to be acquired through the Proposed Transaction, should be found to have been adequately addressed by the divestitures agreed to by Joint Petitioners in their Partial Acceptance Document; and no restrictions should be placed on the future development of wind generation by Iberdrola that are different from, or in addition to, those applicable to any other transmission owner in the State.

3. Approval of the Proposed Transaction should be further conditioned upon the adoption of financial protection measures similar to those adopted by the Commission in the recent National Grid/KeySpan merger, particularly the creation of a limited purpose entity possessing the voting power necessary to prevent the inclusion of NYSEG and RG&E in a bankruptcy proceeding involving the parent holding company.

Because, overall, we conclude that the risks created for consumers by the Proposed Transaction outweigh the quantifiable benefits it is expected to generate, we cannot recommend that it be approved in its present form.

II. Preliminary Matter: The Significance of Joint Petitioners' Partial Acceptance Document

The Partial Acceptance Document contains a series of concessions made by Joint Petitioners on specific issues or points raised by other parties. The sponsors do not contend that the document constitutes an offer of settlement or that the concessions it incorporates are mutually interdependent. As counsel for Iberdrola stated on the record, the intent of the document was to reduce the issues requiring litigation by indicating positions espoused by other parties that the companies were willing to accept as conditions to be included in an order approving the Proposed Transaction. (Tr. 579)

The concessions made in the Partial Acceptance Document are binding on the Joint Petitioners according to their terms, but they do not restrict in any manner the rights of any other parties to the proceeding. A party who disagrees with a point being conceded is free to continue to contest it. The significance of the document is manifest only when an issue becomes uncontested because of a concession it incorporates. In that case, the Commission could adopt the conceded resolution if it finds it to be in the public interest without requiring any additional proof. In effect, the acceptances made by Joint Petitioners in this document should be viewed no differently than those commonly included by respondents in rebuttal testimony.

III. Joint Petitioners' Partial Acceptance Document Is Sufficient To Resolve All Vertical Market Power Issues Related To Existing Generating Facilities. Iberdrola Should Be Treated No Differently Than Any Other Entity In This State With Regard To Future Generation Development.

The Commission has described vertical market power as the ability of an entity possessing market power in one stage of a production process to leverage that power to gain an advantage in another stage.[2] In the area of utility regulation, the potential for the exercise of such power most commonly arises when a single entity controls both a cost-of-service regulated transmission and distribution system, and a generation facility that sells its output at market prices. When this situation exists, "in certain circumstances," the common owner may "be able to adversely influence prices in that generator's market to the advantage of the combined operation."[3] The Commission's policy is to avoid such circumstances by requiring elimination of the common ownership of assets unless it finds that there are offsetting benefits for ratepayers, and that the potential for the exercise of vertical market power can be mitigated.[4]

Vertical Market Power issues have been raised in this case in regard to both existing generating facilities and the future development of wind generation

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[2] Cases 96-E-0900 - In the Matter of Orange & Rockland Utilities,Inc.'s Plans for Electric Rate Restructuring Pursuant to Opinion 96-12, et al., "Statement of Policy Concerning Vertical Market Power," Appendix I, p. 1, July 17, 1998, ("VMP Policy Statement").

[3] Id.

[4] VMP Policy Statement, Attachment I, p. 2. To rebut the presumption favoring divestiture of generation held by an affiliate, the owner of a transmission and distribution system must demonstrate that no opportunity exists for the exercise of vertical market power, that reasonable means exist to mitigate the exercise of vertical market power, or that substantial benefits to ratepayers combined with mitigation measures warrant overcoming the presumption.

by an affiliate of Iberdrola. We address each of the categories of generation in the following sections.

A. Fossil Fuel Generation

Fossil fuel generation that would be acquired by Iberdrola through the proposed transaction includes the Russell Station, the Allegany Station, and the 14 megawatt plants known as Peaker Station No. 3 and Peaker Station No. 9, all of which were retained by RG&E at the time of its electric restructuring, and the 67 megawatt Carthage Peaking Unit owned by Energy East subsidiary Cayuga Energy. All vertical market power issues related to these facilities were removed by the Partial Acceptance Document. Joint Petitioners have agreed to sell the units and there does not appear to be any opposition to that proposal.[5] The Commission should so order if it authorizes the Proposed Transaction.

Although the divestiture itself may be uncontested, all other incidents of the sale, including its timing, the protocols for the auction and the disposition of the net proceeds, remain undefined and must be resolved. On cross-examination, Joint Petitioners' Joint Policy Panel stated that it would be feasible for the companies to develop auction protocols in as little as a month, and that a goal of completed sales within nine months would not be unreasonable. (Tr. 693) The Panel also stated, however, that the schedule should allow sufficient time for "adequate review by the parties on the protocols" and for consideration of "market conditions." (Id.)

[5] Partial Acceptance Document, p. 1, Section I. Although the Partial Acceptance Document does not specifically state that the sales will be to unaffiliated entities, that requirement clearly is implied. Joint Petitioners have expressly so recognized in their discussion of the possible divestiture of the Russell facility (Tr. 563, ll. 1-9).

With respect to the plants that were financed by ratepayers and have been subject to cost-of service regulation (Russell, Allegany, and Peaking Units 3 and 9), the CPB both supports the scheduling parameters found acceptable by the Panel and agrees with the caveats it expressed.[6] Although the primary purpose of the sales may be to separate generation and transmission functions, an equally important objective is to obtain the best possible return on the assets for both ratepayers and shareholders. The design of the auction protocols is critical to this result, and all parties should have an opportunity to review and comment on the companies' proposals before they are finalized by the Commission. Likewise, an arbitrary sales deadline should not be permitted to force a "fire sale" in the face of adverse market conditions if the companies can demonstrate that a reasonable extension of time might produce a better outcome. No party in this proceeding has presented any evidence to suggest that the completion of the disposition of these assets is a matter of urgency.

The Partial Acceptance Document proposes that the sharing of net proceeds from the sales between shareholders and ratepayers be determined by the Commission.[7] Joint Petitioners make no specific recommendation as to the sharing formula.

The CPB recommends that the Commission provide in any order approving the Proposed Transaction that RG&E be permitted to retain no more than 10% of the net, after-tax proceeds in excess of book values from the sale of

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6 Because we agree that all proceeds from the sale of the Carthage Peaker should be retained by the companies, the CPB takes no position on the protocols or schedule for its sale.

7 Partial Acceptance Document, p. 1, n. 3.

Russell, Allegany, and Peaker Stations 3 and 9 as an incentive to maximize the sale value. The remaining 90% of the proceeds would inure to the benefit of ratepayers. This is the sharing formula that was agreed upon by the parties in a joint proposal for the sale of RG&E's Ginna nuclear facility that was subsequently approved by the Commission.[8] There is no reason why a greater incentive should be authorized for these substantially less complex sales.

In the Ginna case, ratepayers' share of the net sales proceeds was divided between cash refunds and an interest bearing asset sales gain account retained by the Company for the benefit of ratepayers and subject to disposition by the PSC.[9] In this case, we recommend that the Commission provide in its order for a period of collaboration following the completion of the sales during which interested parties would attempt to work out a consensus as to the appropriate disposition of the proceeds. The process should allow for statements from the parties in support or opposition of any proposal submitted to the Commission as a result of the collaboration.

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[8] Case 03-E-0765, Proceeding on Motion of the Commission as to the Rates, Charges, Rules and Regulations of Rochester Gas and Electric Corporation for Electric Service; 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; Case 03-G-076, Proceeding on Motion of the Commission as to the Rates, Charges, Rules and Regulations of Rochester Gas and Electric Corporation for Gas Service. "Order Adopting Provisions of Joint Proposals with Conditions," Issued May 20, 2004, p. 10, n. 31.

[9] Id. at p. 10.

B. Hydroelectric Generation

NYSEG and RG&E combined own and operate approximately 125 megawatts of run-of-river hydroelectric units.[10] The continued ownership and operation of these low-cost, renewable energy facilities by the utilities provides direct benefits to ratepayers while creating no problems for the continued development of a competitive generation market that any party has been able to identify or quantify. There is no justification for a Commission order directing the divestiture of these plants.

First, and most obviously, this issue is completely unrelated to the Proposed Transaction. The hydroelectric plants are already in the hands of entities that own and operate transmission and distribution systems. The transaction, in and of itself, is not a basis for overturning previous Commission decisions concerning these facilities. If divestiture is now to be ordered, that order must be justified on some other substantive basis.

While DPS Staff and the Independent Power Producers of New York ("IPPNY") do call for the sale of all rate-based generating facilities still owned by RG&E and NYSEG, (Tr. 1420 and Tr. 923) the bulk of their testimony is focused on the Russell Station which, as noted above, Joint Petitioners have agreed to sell. Neither party makes any effort to explain why divestiture of the hydroelectric plants, specifically, would now be in the public interest.

Both IPPNY and DPS Staff point to the recent decision in the National Grid/KeySpan merger proceeding as evidence that the Commission continues to

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[10] Derived from DPS Staff testimony at Tr. 1263-1264: 546 MW total minus 253 MW for Russell, 63 MW for Carthage, and 105 MW for other combustion turbines, equals 125 MW.

favor separation of the ownership of generation and transmission facilities as the most effective means for removing incentives to exercise vertical market power. (Tr. 908 and 1253) That case, of course, involved the largest single generating station in the most notoriously capacity constrained market in the State (if not the country). This case involves 125 MW of run-of-river hydro that is all located on the low-cost side of the State's principal transmission constraints.

Aside from the factual differences, there is an important legal distinction between the National Grid/KeySpan case and this one. In the former proceeding, the Commission had previously determined that the facility in question should be sold to a non-utility generator. Approval of the merger transaction would have reversed the result of that decision, at least temporarily. It was, therefore, the opponents of divestiture who had the burden of demonstrating that a change in circumstances required revision of the Commission's earlier decision.

Here, the Commission has decided that neither RG&E nor NYSEG need dispose of its hydroelectric facilities.[11] Approval of the Proposed Transaction will have no effect on the status quo. Consequently, it is the proponents of a change to the Commission's previous orders who have the burden of proving that divestiture is now required. They have not met that burden.

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[11] Cases 96-E-0891, In the Matter of New York State Electric & Gas Corporation's Plans for Electric Rate/Restructuring Pursuant to Opinion No. 96-12; "Opinion and Order Adopting Terms of Settlement Subject to Modifications and Conditions," issued March 5, 1998; Case 96-E-0898, In the Matter of Rochester Gas and Electric Corporation's Plans for Electric Rate/Restructuring Pursuant to Opinion No. 96-12, "Opinion and Order Adopting Terms of Settlement Subject to Conditions and Changes," Issued January 14, 1998.

DPS Staff gives two reasons why the hydroelectric facilities should be sold: (a) there is a market for such plants, and (b) the sale will put an end to disputes over vertical market power issues with these utilities. (Tr. 1420-1421) The first point is clearly not a new circumstance. DPS Staff itself notes that both Niagara Mohawk and Orange & Rockland sold their hydro facilities when they divested the rest of their generation. (Tr. 1420) There has never been any question that the plants could be sold if doing so made any sense.

As far as the second point is concerned, vertical market power disputes do not appear to have been a problem until now. Both NYSEG and RG&E have filed major rate cases at least twice since their electric restructuring orders were issued in 1998. In none of those cases does the final Commission order evidence any issue concerning continued ownership of hydroelectric facilities. In fact, in NYSEG's last electric rate case, among the contested issues that had to be decided by the Commission were the appropriate allowances in revenue requirement for operation, maintenance and capital improvements related to hydroelectric plant.[12] Had any party been interested in proposing that those plants be sold (and the associated revenue requirement eliminated) that would have been an excellent time to do so.

The absence of any such proposal can be attributed to the fact that, as Nucor Steel Auburn, Inc. ("Nucor") pointed out in its testimony, these hydroelectric facilities are a source of savings for consumers. (Tr. 716)

[12] Case 05-E-1222, Proceeding on Motion of the Commission as to the Rates, Charges, Rules and Regulations of New York State Electric & Gas Corporation for Electric Service, "Order Adopting Recommended Decision with Modifications," issued August 23, 2006, p. 62-66.

Currently, the market value of the power generated by the plants flows through and reduces the transition (non-bypassable wires) charge, producing a net benefit for all customers.[13] Nucor has suggested that this relatively low cost power might instead be used to support economic development programs. (Tr. 716) Whether this would further the public interest more than the current arrangement is open to debate, but it is indisputable that neither option would be available if the plants were sold. Divestiture of these facilities should not be required.

C. Wind Generation

DPS Staff recommends that approval of the Proposed Transaction be conditioned on a divestiture by Iberdrola of "all wind generation interests in New York." (Tr. 1420) IPPNY takes a less extreme position, asking only that Iberdrola be barred from constructing new generating facilities located within the service territories of RG&E or NYSEG. (Tr. 923) Neither proposal is fair to Iberdrola, and neither makes sense for the State's commitment to the promotion of renewable energy resources. The proposed conditions should be rejected.

As a matter of equity, there is no justification for treating Iberdrola differently than any current transmission owner. NYSEG and RG&E can, today, through unregulated subsidiaries, seek to construct wind generation projects inside or outside their service territories, as can National Grid, Consolidated Edison and Central Hudson. If the facilities are smaller than 80 MW, they can pursue development without application to, or approval from the PSC, and without raising any legally cognizable vertical market power concerns. The

[13] NYSEG Tariff, PSC No. 120, Rule 25.I.B; RG&E Tariff, PSC No. 19, Rule 12.B.1.

Legislature, in enacting the "alternate energy facility" exception to the definition of "electric corporation" in PSL §2(13) has effectively made the statement that the small size and environmental benefits of these facilities trump any claimed need for regulatory oversight. Barring Iberdrola's subsidiaries, in advance, from pursuing the development of small wind generation facilities in the NYSEG and RG&E service territories would not only be inequitable, it would circumvent the clear legislative intent of PSL § 2(13). There is no reason, other than perhaps doctrinal purity, for attempting to incorporate these small plants within the ambit of the Commission's vertical market power policy.

For projects larger than 80 MW, Iberdrola, or any other transmission-owner affiliated developer, would be required to obtain a certificate of public convenience and necessity pursuant to PSL §68. As long as the Commission's VMP Policy Statement remains in effect, that developer would be obligated to "demonstrate that vertical market power could not be exercised ... or ... reasonable means exist to mitigate market power."[14] If it cannot do so, the Commission can deny the application. There is simply no reason why all Iberdrola projects, for all time, should be pre-judged in advance as a condition to approval of the Proposed Transaction.

With respect to existing wind generation facilities in which Iberdrola has an interest, divestiture is clearly unwarranted. None of the facilities is located within the NYSEG or RG&E service territories. None of the facilities is on the high-cost side of <u>any</u> transmission constraint, much less a constraint over which Iberdrola would have any control. (Tr. 819-821) Even IPPNY, representing the generation

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[14] VMP Policy Statement, Attachment I, p. 2.

interests that would be most directly affected by any exercise of vertical market power, does not advocate the divestiture of these facilities. On this matter, the DPS Staff's position is unreasonable.

New York is committed to reducing its dependence on fossil fuel generation by producing 25% of its electricity from renewable sources by 2013.[15] In his former capacity as Lieutenant Governor, now Governor Paterson sponsored a study which concluded, among other things, that the State should "develop a strategy to reap the benefits of New York's wind energy potential."[16]

Iberdrola is indisputably one of the premier developers of wind energy in the world. In ordinary circumstances, if such a company were contemplating establishing a presence in this State, New York would be much more likely to offer incentives than to erect obstacles. Indeed, the National Resources Defense Council, (Tr. 1030) the Department Environmental Conservation ("DEC") (Tr. 108) and the Rochester Enterprise Institute (Tr. 1774) have all testified to the value of having Iberdrola in this State. In fact, the DEC has called upon the Commission to produce "an outcome that would take full advantage of the potential offered by Iberdrola for the siting of clean and renewable energy in New York" and to "give due consideration to Iberdrola's experience ... in developing renewable energy." (Tr. 108)

This is not an ordinary circumstance, however, because Iberdrola's entry involves the acquisition of regulated utilities. The Commission, therefore, has an obligation to ensure that the Proposed Transaction will be in the public interest.

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15 Exhibit 112, p. iii.

16 Id. at p. vi.

In performing that obligation, it should consider the undesirability, as a matter of public policy, of erecting barriers for wind generation development by Iberdrola that would not exist for other State utilities. Iberdrola has stated on the record that it is fully prepared to accept all PSC policies that are generally applicable to transmission owners. (Tr. 676, 883) That is the only condition related to vertical market power that the Commission should impose upon approval of the Proposed Transaction.

IV. The Financial Conditions Proposed By The DPS Staff, In Particular The Limited Purpose Entity, Are Essential For The Protection Of Ratepayers.

The DPS Staff recommended a series of "financial protections" that should be incorporated as conditions in any order approving the Proposed Transaction. The recommendations are consistent with those adopted by the PSC in its order authorizing the recently completed acquisition of KeySpan Corporation by National Grid. They include acquisition adjustment conditions, credit quality conditions, dividend limitations, money pool rules, and certain structural protections. (Tr. 1402-1420) The need for these protections has been amply demonstrated and they should be adopted.[17]

As noted, DPS Staff's recommended conditions are consistent with those adopted in the National Grid/KeySpan merger, but they are specific neither to National Grid nor to Iberdrola. They are, as Staff notes, generic in nature. (Tr.

[17] We note that the "acquisition adjustment conditions" are largely aimed at assuring the goodwill resulting from any acquisition premium will not appear on the books of NYSEG, RG&E or Energy East and will not have any ratemaking impact. (Tr. 1402-1403) Joint Petitioners have agreed that no goodwill arising from the Proposed Transaction will be "pushed down" or recorded on the books of NYSEG and RG&E and contend that this will preclude any ratemaking issues. (Tr. 547)

1375) They represent the current state of the Commission's evolving understanding of the types of measures required to protect ratepayers in a period of multi-state and multi-national consolidation of utility holding companies freed from the constraints associated with the New Deal era Public Utility Holding Companies Act. The fact that the Commission required National Grid to adopt for Niagara Mohawk the same financial conditions it mandated for the KeySpan utilities clearly suggests that it is not the quality of the acquiring company, but rather the changing nature of the industry that has altered the Commission's perception of what constitutes adequate ratepayer protection.[18] What was not considered necessary for the protection of Niagara Mohawk ratepayers in 2001, appeared essential in 2007. Thus, Staff's recommendation of these conditions does not reflect a negative view of Iberdrola as a company, so much as a realistic assessment of the industry it is in.

The generic nature of the recommended conditions necessarily means that company-specific arguments presented by Joint Petitioners as to why they are not required are irrelevant. In the absence of any showing that a particular condition would actually be detrimental to ratepayers, all should be adopted.

The CPB is particularly concerned that the structural protection sometimes referred to as a "golden share" held by a limited purpose entity ("LPE") be put in place if the Proposed Transaction is approved. As DPS Staff points out, a weak parent company forced to seek protection in bankruptcy may have an economic

[18] See Case 01-M-0075, Joint Petition of Niagara Mohawk Holdings, Inc., Niagara Mohawk Power corporation, National Grid plc and National Grid USA for Approval of Merger and Stock Acquisition; Case 06-M-0078, Joint Petition of National Grid plc and KeySpan Corporation for Approval of Stock Acquisition and other Regulatory Authorization, "Order Adopting Financial Protections for Niagara Mohawk Power corporation," issued March 28, 2008.

incentive to bring its utility subsidiaries with it, even if they would be fully solvent on a stand-alone basis. (Tr. 1381) Although Joint Petitioners' witness, Dr. Makholm, describes Iberdrola today as "a large and successful and savvy international energy company," (Tr. 1122) he concedes that the same description could have been applied to Enron Corporation less than a decade ago. (Tr. 1127) Consequently, Dr. Makholm acknowledges that "nothing about the size of Iberdrola" should lead the Commission to "let go of the ways and means it uses to protect ratepayers." (Tr. 1128)

In 2001, Portland General Electric Company was owned by Enron when the parent company declared bankruptcy. (Tr. 1104) In support of his assertion that an LPE is not necessary in this case, Dr. Makholm argued that protective mechanisms in place in Oregon had been adequate, and perhaps necessary, to protect the ratepayers of Portland General from the effects of that bankruptcy. (Id.) When asked if similar protections were in place in New York, he responded affirmatively. (Id.)

In fact, however, as the DPS Staff's Policy Panel testified on cross-examination by the CPB, it was the existence of a golden share provision that was the entire reason why Portland was not dragged into the Enron bankruptcy. (Tr. 1605) The Panel further noted that it was unaware of any provision of New York law that would give rise to such a golden share requirement. (Id.) Therefore, the Commission must adopt the requirement as a condition of approval of the Proposed Transaction in order to ensure that ratepayers receive this essential protection.

V. The Proposed Transaction, As Currently Structured, Is Not In The Public Interest Because Its Risks Outweigh Its Asserted Benefits, But It Could Be Approved With Conditions That Assure The Receipt By Ratepayers Of Significant Additional Value.

Section 70 of the Public Service Law requires the consent of the Commission to the acquisition of the voting capital stock of any gas or electric corporation "organized or existing under the laws of" New York, and it proscribes the granting of such consent "unless it shall have been shown that the acquisition is in the public interest." This obligation requires the Commission to engage in a form of cost-benefit analysis.[19]

The cost side of the "ledger" in this analysis generally comprises risks imposed on consumers by the proposed transaction that would not have been present, or present to the same degree, in its absence. The risks of the Proposed Transaction in this case have been spelled out in considerable detail by DPS Staff, as set forth below.

On the benefit side, there may be positive aspects of the transaction that are also difficult to forecast and quantify, but the Commission has stated that a "significant" element in the equation – and we would argue that it is the most significant – is the measurable dollar benefit that ratepayers are assured of realizing.[20] The reason why positive monetary benefits are so important is simple. Once the Proposed Transaction is consummated, Iberdrola will be, quite properly, focused on maximizing the return on the acquisition for its

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[19] See Case 06-M-0878, Joint Petition of National Grid PLC and KeySpan Corporation for Approval of Stock Acquisition and other Regulatory Authorizations, "Order Authorizing Acquisition Subject To Conditions And Making Some Revenue Requirement Determinations For Keyspan Energy Delivery New York And Keyspan Energy Delivery Long Island," Issued September 17, 2007, p119, ("NG/KeySpan Merger Order").

[20] Id.

shareholders. It is only during the approval process that demonstrating benefits for ratepayers is a primary objective of the transaction's proponents. If the flow of tangible benefits into the pockets of ratepayers is not assured during this proceeding, it may never be. As DPS Staff states, "benefits which are not readily enforceable ... have no value because there is no substantive way to ensure that the post-acquisition companies will live up to them." (Tr. 1197)

The Energy East acquisition of RGS is a good example of this phenomenon. As DPS Staff points out, the merger petition in that case promised "significant, tangible benefits to consumers" including, among other things, a stronger financial base, no layoffs, stable rates, undiminished customer service and a strengthened commitment to the region. (Tr. 1195) After the merger, RG&E proposed a rate increase of over 6%, had its debt downgraded, announced layoffs and closed customer service offices. (Tr. 1196) In addition, Energy East moved the holding company headquarters to Maine. (Id.) Had it not been for the synergy savings that the Commission ordered to be shared with them, ratepayers might have realized little or no benefit from the merger.

A. What Constitutes A Benefit Of The Transaction

To be considered a benefit of the Proposed Transaction, the value of a promise, payment, cost reduction or other undertaking by the Joint Petitioners must be created by Iberdrola's acquisition of Energy East. It is not enough that it arise in conjunction with the transaction. The Commission clearly recognized this principle in its evaluation of the proposed settlement in the National Grid/KeySpan merger case when it explained that "changes that KeySpan could

and would be expected to implement even if there is no merger" and "gas cost savings [that] would be available whether or not there is an acquisition," should not be considered benefits of the merger.[21]

Similarly, measures offered to solve problems or avoid risks that would not have existed but for the Proposed Transaction are not benefits of the transaction. Creating a concern and then resolving it does not generate a gain for ratepayers.

Finally, the promise of improved capabilities in areas where there has been no showing that the performance of the incumbent utilities is inadequate, is not a benefit of the transaction. Giving ratepayers what they already have, adds nothing to their benefits from the transaction.

B. Availability Of Synergy Savings

A fundamental theme of Joint Petitioners is that the Proposed Transaction will not generate any synergy savings of the type that are commonly used both to justify an acquisition and to provide some tangible rate reduction benefits to customers. (e.g. Tr. 685) This, they contend, is because the acquisition of Energy East by Iberdrola should be viewed as a "first mover" transaction, meaning one in which the acquiring party is geographically extending its range of operations into a new area. (Tr. 929)

As a consequence of this position, Joint Petitioners have made no effort to provide the types of studies and analyses of cost savings that would normally be expected in a merger case. (Tr. 1207) This is true even though Iberdrola's own advisers suggest that potential savings may be available. (Tr. 1209) Given the

[21] NG/KeySpan Merger Order, p. 119.

approach they have taken, which forces other parties to attempt to ferret out synergy savings from data that is largely within Joint Petitioners' control, the claims of the transaction's proponents that such savings are absent should be heavily discounted, if not disregarded.

Despite the lack of analysis from Joint Petitioners on this issue, evidence of the potential for synergy savings does appear throughout the record. First, even accepting their definition, this is not entirely a "first mover" transaction. Through previous acquisitions, Iberdrola owns or has interests in an extensive network of facilities and projects in the United States, including a dozen that are in operation or under development in the State of New York. (Tr. 1170-1171, Exhibit 57) It strains credulity that there would be no savings whatsoever available through coordination, cooperation or consolidation among these multiple entities.

Furthermore, Iberdrola acknowledges that its acquisition of Scottish Power in the United Kingdom was a first mover transaction, and yet they also project the achievement of $374 million in true synergy savings as a result of the deal. (Tr. 644, 1190) Their contention that this was primarily due to the fact that Scottish Power had not adopted certain software systems is irrelevant. (Tr. 644) No one is arguing that the synergy savings that will be identified at Energy East, NYSEG or RG&E will be identical to those realized elsewhere. What is significant is that, to date, Iberdrola has not even conducted an analysis of the potential application of "best practices" to those companies. (Tr. 1209)

Another potential source of synergy savings is refinancing. Joint Petitioners contend that the superior credit rating of Iberdrola may trickle down to the acquired companies, providing an opportunity for them to obtain credit on better terms. (Tr. 504) The refinancing of existing debt at lower interest rates would provide true synergy saving, but no estimate of the potential has been presented.

Finally, another source of synergy savings will almost surely be tax benefits. As DPS Staff points out, Iberdrola's wind generation facilities in the United States are eligible for production tax credits ("PTCs") based on their output. (Tr. 1213) Currently, however, the company does not owe enough in federal income taxes to take full advantage of the credit. (Tr. 1214) Acquisition of Energy East may allow it to do so.

Joint Petitioners respond that the PTCs are not going to waste. The entities that develop Iberdrola's projects, they say, take on tax equity partners who invest in the facilities in return for the right to use the PTCs. (Tr. 529-530) They acknowledge, however, that these are commercial investors who are seeking a return on their investment. (Tr. 530) They cannot do this if they pay the full value of the PTCs for the right to use them. The price must be discounted for the transaction to be profitable. Therefore, Iberdrola can obtain greater value, perhaps much greater value, for its PTCs if it uses them itself.

DPS Staff also notes that Iberdrola may be eligible, by virtue of the Proposed Transaction, for other tax benefits under Spanish law, possibly ranging from $125 million to $476 million. (Tr. 1211) Whatever the final numbers from all

of these items, it is clear that substantial, as yet unquantified, synergy savings will arise from this transaction.

C. A Proxy For Synergy Savings

Because of the inadequate analysis of synergy savings provided by Joint Petitioners, DPS Staff was forced to develop a proxy measure for the total tangible monetary benefits that the Proposed Transaction could be expected to generate. (Tr. 1609) Among the major elements included in this quantification were the costs expected to be incurred by Iberdrola to consummate the transaction, including the premium paid for the stock of Energy East, payments to Energy East executives, and fees for third party advisors. (Tr. 1220-1221) In total, DPS Staff estimated tangible monetary benefits to be approximately $1.6 billion.

The rationale for Staff's use of costs as a proxy for benefits is clear. Iberdrola is a profit-oriented entity. It can be assumed that it expects a return on its investment in the Proposed Transaction that will exceed its cost of entering into the merger. Joint Petitioners attacked this approach in the mistaken view that Staff was calling for Iberdrola to pay ratepayers some of the money it would be paying to others. On cross examination by CPB, Staff made it clear that this was not the case. It did not treat costs paid by Iberdrola as a benefit to be provided ratepayers, but rather as a measure of the expected benefit of the transaction to the company. (Tr. 1611-1612)

D. Risks Posed By The Transaction

The risks posed by the Proposed Transaction for New York ratepayers have been extensively documented by the DPS Staff's Policy Panel. (Tr. 1134 et seq.) As noted above, the CPB considers concerns about the exercise of vertical market power to have been effectively mitigated by Joint Petitioners' Partial Acceptance Document, and we advocate adoption of the financial protections proposed by Staff as a means of limiting consumers' risk from a severe downturn in the fortunes of Iberdrola. Nevertheless, significant concerns remain, including:

- The complication of regulatory oversight caused by the size and scope of the combined entity, reductions in financial reporting and oversight and differing accounting systems. (Tr. 1246)
- Increased volatility in utility expenses caused by foreign currency valuation fluctuations. (Tr. 1236)
- The potential for "chaining" of transactions or unrecorded transactions that can increase utility expenses. (Tr. 1234, 1238)
- The very substantial proportion of Iberdrola's equity that would be represented by goodwill and intangible assets after the transaction, putting downward pressure on the company's credit rating. (Tr. 1281-1282)
- The effects of parent company financial weakness on the cost structures of NYSEG and RG&E, and the resulting rates paid by utility customers. (Tr. 1298 et seq.)

These risks can be mitigated only through the specific reporting, accounting and financial protection provisions recommended by DPS Staff, and through the offsetting value of the PBAs and rate mitigation measures discussed below. All should be incorporated as conditions to an approval of the Proposed Transaction by the Commission.

E. Asserted Benefits Of The Proposed Transaction

1. Suitability of Iberdrola for ownership of NYSEG and RG&E. Joint Petitioners devote a portion of their testimony to describing the size, experience and global success of Iberdrola as a company.[22] The apparent purpose of this discussion is to demonstrate that Iberdrola is a desirable owner for New York utilities, and that the desirability of the acquiring entity should, itself, be considered a public benefit.

In our view, this is a threshold question that must be answered in the affirmative before a balancing of the costs and benefits of the transaction can even begin. Unless particular corporate capabilities or characteristics can be translated into tangible benefits for NYSEG and RG&E ratepayers, the mere fact that Iberdrola is qualified to own utility properties is not a benefit of the transaction.

The CPB would, however, answer the threshold question in the affirmative. The record in this case gives no indication that Iberdrola is not a highly capable company.

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[22] See e.g. Tr. 485-486.

2. Expertise of Iberdrola. Joint Petitioners testify that NYSEG and RG&E will benefit from Iberdrola's expertise in utility operations derived from over one hundred years of industry experience. (Tr. 485) Again, however, they give no indication as to how the general capability of Iberdrola will be translated into tangible benefits for New York utility ratepayers. They provide no evidence of any identified deficiencies in the performance of Energy East, NYSEG or RG&E that would be alleviated by the Proposed Transaction, and they make no commitment to any new, higher standards. On cross-examination, Joint Petitioners' Policy Panel acknowledged that Iberdrola was proposing no specific improvements in electric reliability, electric service quality, gas safety or gas reliability. (Tr. 636) Indeed, as to gas service, Joint Petitioners' witnesses argued that NYSEG and RG&E already "excel and exceed in almost every performance area because we have a strategy to be the top performer, and incentives or penalties are currently in place which allow us to do that." (Tr. 246)

As discussed above, the qualifications of Iberdrola are important, but in the absence of any evidence that the company's expertise will fill a need that is currently going unmet by the incumbent utilities, those qualifications cannot be considered a benefit of the transaction. They may assure no loss of capability, but they add nothing tangible of value to ratepayers.

3. Financial Strength of Iberdrola. Joint Petitioners argue that the financial strength of Iberdrola is a positive benefit of the Proposed Transaction because it has the potential to improve Energy East's access to capital markets (Tr. 489) and, possibly, to translate into lower borrowing costs for NYSEG and

RG&E. (Tr. 504) Those lower costs should then be passed through to ratepayers, if and when the utilities' rates are reset.

By the time Joint Petitioners submitted their rebuttal testimony, the difference in bond ratings between Iberdrola and Energy East had shrunk to only one "notch," A- versus BBB+, according to Standard & Poor's. (Tr. 509) On cross-examination, Joint Petitioners' witness, Mr. Azagra, was unable to give any definitive estimate of the value of this remaining spread, and he acknowledged that the Iberdrola rating might not translate into better ratings for NYSEG and RG&E at all. (Tr. 632-633) He also admitted that he was unaware of Energy East's having any difficulty accessing capital markets. (Tr. 631)

While Iberdrola's having a higher credit rating than Energy East would seem to be a positive benefit of the Proposed Transaction, the value of the benefit appears to be rather small. First, and most obviously, there is no guarantee that the credit advantage will persist, as evidenced by the fact that it has already narrowed during the pendency of this proceeding. When the risks associated with Iberdrola's very rapid expansion and internationalization are taken into account, it begins to look truly ephemeral.

Furthermore, the parties have no definitive estimate of the credit cost savings achievable by NYSEG and RG&E. (Tr. 632) Despite the fact that a refinancing of debt at reduced rates made possible by the higher credit rating of the acquiring company would appear to be a classic example of synergy savings, Joint Petitioners have persistently maintained that no such savings exist in this case. (Tr. 634) As a result, we also have no assurance that ratepayers will see

any benefit from reduced credit costs until rates are reset after the refinancings have been effectuated. Consequently, this benefit, although apparently positive, is highly speculative and entitled to little weight.

4. Iberdrola's environmental commitment. While Iberdrola's general utility industry expertise may not have distinguished it significantly from Energy East, the depth of its environmental commitment and the scope of its expertise in the development of renewable energy resources do appear to constitute a positive benefit of the Proposed Transaction. As noted above, a number of parties with a strong interest in the environment have urged the Commission to weigh Iberdrola's renewable energy experience positively in considering its decision on the pending petition.

Initially, this benefit, too, was largely subjective and speculative, because it involved no definitive commitment. Joint Petitioners attempted to remedy this deficiency in their Partial Acceptance Document. There, they committed Iberdrola to "support and encourage" investments in renewable generation in New York by its affiliate, Iberdrola Renewables, in excess of $100 million in the next three years.[23] This commitment is clearly a welcome, positive benefit of the Proposed Transaction, but, unfortunately, it is not a very substantial one. It is, in fact, so small in relation to Iberdrola's existing renewable energy development program in this State, and so circumscribed by legal and financial contingencies, that it must be viewed as adding very little value to the benefit side of the cost-benefit analysis that will underlie the Commission's decision in this case.

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[23] Partial Acceptance Document, p. 2.

On cross-examination by Multiple Intervenors, Mr. Azagra indicated that wind generation development costs are in the range of $1.8 million to $2.0 million per megawatt. (Tr. 626) According to Exhibit 57, Iberdrola Renewables currently has 998 megawatts of wind generation projects in New York that "could potentially become operational within the next five years." This implies a development cost of roughly $1.8 to $2.0 billion. Effectively, this means that Iberdrola would meet the commitment set out in its Partial Acceptance Document if its affiliate completed 5 to 6% of its five-year project portfolio during the next three years.

Even that small commitment might never be fulfilled, however, because it is conditioned upon there being no limitations imposed by the Commission's decision in this proceeding on the ability of Iberdrola Renewables to develop renewable generation, and "no material adverse change in the fundamental economics of wind generation in New York State."[24] On cross-examination by CPB, Mr. Azagra stated that imposition of a restriction on development by Iberdrola within the NYSEG and RG&E service territories would "absolutely" be a limitation that would obviate its development commitment. (Tr. 663) Although we do not believe any such restriction should be adopted by the Commission in this case, several parties, including the DPS Staff, have supported it. Mr. Azagra also acknowledged that a change in economic factors that rendered development in New York less attractive than in other venues could be another reason for terminating the commitment. (Id.)

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[24] Id.

Ultimately, the value of this development commitment appears to be largely symbolic. Whether this case turns out well or badly from the point of view of the Joint Petitioners, there does not appear to be any inherent business reason why Iberdrola Renewables -- a separate, publicly traded, profit oriented entity -- would not continue to pursue projects already under development that may be worth 20 times the promise made by its parent in the Partial Acceptance Document.

5. Absence of harm as a benefit. At various places throughout their testimony, Joint Petitioners provide assurances that detrimental consequences of the Proposed Transaction feared by some parties will not occur. They state that:

- There are no reductions in employment in New York planned as a result of the acquisition; (Tr. 506)
- There will be no reduction in the commitment of the combined companies to the Upstate New York region; (Tr. 493) and
- DPS access to the books and records of NYSEG, RG&E and Energy East will not be diminished. (Tr. 492)

These commitments, they contend, should be considered "benefits" of the transaction.

Their contention makes no sense. The assurances that Joint Petitioners provide are responsive to concerns that have been generated by the Proposed Transaction itself. Petitioners cannot simultaneously create potential problems and then claim a benefit for promising to remove them. Without these commitments, the risks of the transaction would be even greater.

Furthermore, as to assurances concerning employment in New York, Iberdrola consistently maintained on cross-examination that "day to day, month to month and year to year decisions" about these matters would be left up to existing management, that is, Energy East. (Tr. 639, 667) By their own admission, then, the Proposed Transaction, at best, changes nothing until Iberdrola decides otherwise.

6. Positive benefit adjustment. As discussed above, Joint Petitioners deny that there will be any synergy benefits arising from the Proposed Transaction that can be shared with ratepayers. DPS Staff, with no savings projections provided by the transaction's proponents, was forced to construct an alternative measure of the financial benefits likely to be generated by the merger, and to recommend certain PBAs to assure that a reasonable portion of those benefits would inure to ratepayers.

In their Partial Acceptance Document, Joint Petitioners steadfastly continue to deny that any concessions on their part are "necessary in order for this Proposed Transaction to be approved under Section 70."[25] Nevertheless, they state that they are willing to accept, as a condition to approval of the transaction, certain PBAs proposed by DPS Staff having a total value of approximately $201 million.[26] They will also agree that the rate impact of those

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[25] Partial Acceptance Document, p. 1, n. 1.

[26] Id. p. 1.

adjustments be passed through to ratepayers immediately upon the closing of the merger.[27]

Joint Petitioners acknowledge that the magnitude of their proposed adjustment does not have any particular substantive basis. As their Policy Panel testified on cross-examination, $201 million was a number they "could live with." (Tr. 611) The PBAs they selected were ones that they felt would "make sense" and provide "value for customers" while staying within the total dollar parameter.[28] (Tr. 611-612)

Effectively, therefore, Joint Petitioners' proposed PBA condition amounts to a unilateral offer of settlement on the issue of the appropriate share of transaction-related benefits that should be imputed to ratepayers. Like any such offer in a litigated proceeding, it constitutes a positive benefit, but it must be evaluated by the Commission for adequacy in light of all of the circumstances of the case. In the CPB's view, given the potential risks of this transaction and the very substantial benefits likely to accrue to the Joint Petitioners if it is consummated, the offer is clearly insufficient. We recommend instead that approval of the Proposed Transaction be conditioned on acceptance of DPS Staff's recommendation of $646 million in PBAs and $208 million in rate adjustments.[29]

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[27] Id. p. 2.

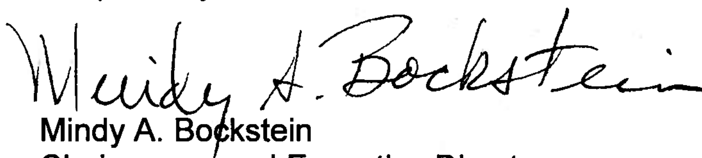
[28] Counsel for Joint Petitioners also acknowledged that the components of the $201 million figure were "fungible." (Tr. 1477)

[29] Exhibits 121 and 126 and Partial Acceptance Document p. 1. The specific amounts should be updated at the time of the Commission's order to reflect any changes that have occurred since Staff's testimony was prepared.

CONCLUSION

Based on the evidence presented in this proceeding, the CPB believes that Iberdrola has the experience and expertise necessary to assure that NYSEG and RG&E will continue to provide safe and reliable service, and also has the potential to contribute significantly to the State's efforts to develop its renewable energy resources. Notwithstanding, the Proposed Transaction presents significant risks for consumers, and should not be approved by the Commission without the conditions and changes we have recommended herein.

Respectfully submitted,



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Dated: Albany, New York
April 11, 2008