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

BRIEF ON EXCEPTIONS

OF THE

NEW YORK STATE CONSUMER PROTECTION BOARD

Mindy A. Bockstein
Chairperson and Executive Director

Douglas W. Elfner
Director of Utility Intervention

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Albany, New York

NYS CONSUMER PROTECTION BOARD
5 EMPIRE STATE PLAZA
SUITE 2101
ALBANY, NEW YORK 12223-1556
http://www.nysconsumer.gov

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BRIEF ON EXCEPTIONS OF THE NEW YORK STATE CONSUMER PROTECTION BOARD

The Consumer Protection Board ("CPB") has demonstrated throughout this proceeding that the proposed acquisition of Energy East Corporation by Iberdrola, S.A. ("Iberdrola") should be approved by the Public Service Commission ("PSC" or "Commission") subject to several conditions. In our view, Ibderdrola has the experience and expertise necessary to assure that the New York State Electric & Gas Corporation ("NYSEG") and Rochester Gas & Electric Corporation ("RG&E") will continue to provide safe and reliable service if the proposed transaction is approved, and also has the capability and financial strength to contribute significantly to the State's efforts to develop renewable energy resources. We showed that approval of the transaction should not be subject to conditions imposing restrictions on the development of wind generation by Iberdrola's affiliates that are different from those applicable to other utilities in New York State. However, we also recommended that as a condition of approving the merger, the PSC should incorporate protections that would

insulate ratepayers from financial risks of being affiliated with Iberdrola, consistent with those it recently required in the acquisition of KeySpan Corporation by National Grid. The PSC should also ensure that the State receives benefits that are reasonable in view of the very substantial risks associated with the proposed transaction and to ensure that the acquisition satisfies the public interest standard of §70 of the Public Service Law ("PSL").

The Recommended Decision ("RD") by Administrative Law Judge ("ALJ") Raphael A. Epstein issued on June 14, 2008, reaches many of those same conclusions. However, it is the CPB's position that in several important respects, the RD is mistaken or does not properly consider all relevant information. Our exceptions are directed at those issues.

In Point I, we explain our strong opposition to the ALJ's recommendation that Iberdrola be prohibited from owning wind generation in NYSEG and RG&E's service territory. That finding is inconsistent with current PSC policy, is not required to protect ratepayers, and is contrary to the State's public policy objectives. In Point II, we address a similar concern regarding the Judge's requirement that the combined company divest its existing hydroelectric generation assets. In Point III, we address the fact that the RD does not consider as a benefit of the transaction, Iberdrola's statement that it would invest $2 billion in New York if the merger is approved. We urge the Commission to carefully consider this commitment as a key benefit of the proposed transaction and take action to ensure that it is enforceable.

I. THE PSC SHOULD REJECT THE JUDGE'S ERRONEOUS RECOMMENDATION THAT OWNERSHIP OF WIND GENERATION IN NYSEG OR RG&E'S SERVICE TERRITORY SHOULD BE PROHIBITED.

The ALJ recommends that if the Commission approves the proposed transaction, it "should impose a precondition that petitioners and their affiliates may not own or operate ... any wind generation interconnected with NYSEG's or RG&E's transmission or distribution facilities."[1] This finding is based on the Judge's conclusion that the absence of restrictions on Iberdrola's wind ownership would be contrary to the Commission's pro-competition policies.[2] The Judge erred on this point.

A. Wind Projects Larger Than 80 MW

The PSC's policy regarding vertical market power is based on a presumption, that common ownership of an energy utility and a generation facility selling its output at market prices, is to be avoided. This is intended to preclude an entity with market power, such as would be derived from ownership of a monopoly electricity distribution and transmission system, from leveraging that power to gain advantage in a different market, such as electricity generation. However, the Commission's policy explicitly provides that this presumption can be rebutted upon a demonstration that no opportunity exists for the exercise of market power, that reasonable means exist to mitigate the exercise of vertical market power, or that substantial benefits to ratepayers combined with mitigation

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1 RD, p. 61.

2 Id., p. 61 – 2.

measures warrant overcoming the presumption.[3] Thus, prior to operating any wind project larger than 80 MW, Iberdrola, or any wind generation developer affiliated with a utility, would be required to satisfy that standard. If it cannot, the Commission can deny the application.

The RD would change this well-established policy, currently applicable to all utilities operating in New York State, by prohibiting in advance, all wind generation proposed by Iberdrola or its affiliates, for all time, as a condition to approval of the proposed acquisition. That recommendation does not give proper consideration to the fact that the Commission's policy does not prohibit such generation, but is rather a presumption against such generation that may be rebutted. As a further illustration of the Judge's apparent misunderstanding of this point, the ALJ agrees with a contention by another party that "suspension of the policy statement for NYSEG and RG&E" will "open the floodgates to permit applications completely contrary to the competition policies" of the Commission.[4] Neither the CPB, nor any other party of which we are aware, has even suggested that the Commission's vertical market policy should be suspended. To the contrary, Petitioners, CPB and many other parties have stated that Iberdrola should be subject to that policy. Further, Petitioners have said, on the record, that it would accept the PSC's vertical market policy as, and to the same extent, it is applied to other utility holding companies.[5]

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[3] 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, July 17, 1998, Attachment I, p. 2.

[4] RD, p. 70.

[5] TR 626, 883.

The question raised by the RD is, what evidence is there in the record of this case, that would even justify, much less require, Iberdrola to be subject to in advance, and for all future potential projects, restrictions that do not apply to any incumbent utility or utility holding company in New York? The answer is that there is none. In fact, no party has made an effort to suggest that there is any.

In supporting his recommendation, the Judge gives heavy weight to what he characterizes as the important consideration of symbolism -- that the State should use this opportunity to signal its unwavering commitment to maintaining effective competition.[6] Conspicuously absent from the RD, however, is any discussion of whether such a signal is necessary or if it is appropriate for New York to signal that established policy regarding vertical market power must be modified to preclude investment by an entity with the expertise and resources of Iberdrola. We urge the PSC to reject the notion that it is necessary to impose barriers on Iberdrola that would not be applicable to other entities, to "signal" its policy regarding competition. If the Commission believes it necessary to articulate its policy, it is fully capable of doing so in a much more direct and productive fashion.

B. Wind Projects of up to 80 MW

The Judge also errs regarding the extent of Commission jurisdiction concerning "alternative energy production facilities" defined in PSL Section 2(2-b) with a capacity of 80 MW or less, a definition which includes wind turbines. The

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[6] RD, pp. 62, 65, 70.

legislature has explicitly precluded the Commission from exercising jurisdiction over such entities. In recommending that the Commission preclude Iberdrola and its unregulated subsidiaries from pursing the construction of alternative energy facilities, the RD is effectively contending that PSC policy regarding the proper structure of a competitive market can trump State law. In response to a CPB contention that the PSL evinces a legislative intent to allow alternative energy production facilities to be developed free from PSC scrutiny, the Judge observes that there is no evidence that the statute's purpose was to allow vertical integration.[7] However, there is also absolutely no evidence that its purpose was to bar vertical integration where alternative energy facilities are concerned. What the legislation does say, implicitly, is that the PSC has no jurisdiction to impose its policy views on matters affecting alternative energy production facilities, such as wind farms of less than 80 MW.

C. CPB Recommendation Regarding Vertical Market Power

The CPB continues to recommend that the Commission refrain from imposing any blanket restrictions on the development of wind generation by Iberdrola's affiliates. Instead, Iberdrola should be provided the opportunity to demonstrate that ownership of generation in Energy East's service territory would not create a realistic opportunity to interfere with competitive markets to the detriment of consumers. Iberdrola would have the burden of proof on this matter. We also urge the Commission to recognize, as it did when it established its

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[7] Id., p. 70.

vertical market power policy in 1998, that market power may be mitigated through vigilant and effective oversight and regulation.

II. THE RD'S FINDING THAT ENERGY EAST'S HYDROELECTRIC PLANTS SHOULD BE DIVESTED AS A PRECONDITION OF APPROVAL OF THE TRANSACTION IS ERRONEOUS AND SHOULD BE REJECTED BY THE PSC.

The Judge recommends that the Commission require divestiture of approximately 118 MW of hydropower generation currently owned by NYSEG and RG&E, as a precondition of the merger.[8] He states that the Commission should take this opportunity to advance its policies against ownership of generation by utilities.

The CPB disagrees with that recommendation. As explained in detail in our initial brief,[9] this issue is completely unrelated to the proposed transaction. The hydroelectric plants at issue are currently owned and operated by NYSEG and RG&E, and provide electricity at rates far below market prices that are used to partially offset NYSEG and RG&E's delivery rates. There is no evidence in the record that such ownership has permitted the utilities to exercise market power or interfere with development of a competitive wholesale power market. Further, the Commission has never previously required NYSEG or RG&E to dispose of its hydroelectric facilities. Therefore, the proponents of this divestiture have the burden of proving it is now required, a burden they have not met.[10]

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8 Id., p. 78.

9 CPB IB, pp. 9 – 12.

10 Id.

The Judge concludes that these arguments are "misguided."[11] He argues that the Commission has not articulated "a principled decision against divestiture of hydropower," but instead, its decisions reveal an intention to proceed incrementally by requiring the sale of non-hydroelectric units first.[12] The CPB disagrees with that conclusion. Reading into the Commission's decisions an intention to proceed incrementally with divestiture requires much more of a speculative leap than the simple assumption that the Commission chose not to require the sale of small hydroelectric plants because it viewed them as presenting no threat to the development of a competitive wholesale generation market. The Commission never said that it intended to re-examine these plants later, and it has never taken steps to require divestiture despite repeated opportunities, including in rate cases for NYSEG and RG&E, over more than a decade. Capital, operating and maintenance expenses for hydroelectric generation have been issues in at least some of those cases; they were, in fact, hotly contested in NYSEG's last electric case.[13] Never has the Commission or DPS Staff suggested that divestiture of hydroelectric plants should be pursued since it might resolve these issues.

The Judge also dismisses arguments made by CPB, Petitioners and others, that Energy East's continuing ownership of the hydroelectric facilities confers a benefit on customers by holding down the cost of delivery rates. He

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11 RD, p. 79.

12 Id., pp. 79 – 80.

13 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. See, e.g., Order Adopting Recommended Decision with Modifications, August 23, 2006, p. 62.

claims that Energy East could obtain at least some of these benefits through a supply contract with the new owners of the divested plants.[14] Although possible in theory, the CPB recommends that before ordering the divestiture of Energy East's hydroelectric facilities, the Commission ensure that such sale is truly in the ratepayers' interest. If that threshold question is answered in the affirmative, the PSC should condition such a sale on approval of a measure that preserves for ratepayers, the benefit of electricity at below-market prices produced by these plants, for many decades in the future. If the transaction is not approved, or is rejected by Petitioners based on the conditions imposed by the Commission, the hydroelectric divestiture issues should be postponed for consideration in the next rate cases for NYSEG and RG&E.

III. THE JUDGE DOES NOT PROPERLY CONSIDER THE BENEFITS OF IBERDROLA'S COMMITMENT TO INVEST $2 BILLION IN THE STATE.

The ALJ recommends that if the Commission approves the proposed transaction, it should provide financial benefits to NYSEG and RG&E customers, referred to as "positive benefit adjustments" ("PBAs"), in the amount of $646.4 million, significantly above the $201.6 million proposed by Iberdrola. The PBAs would eliminate ratepayers' responsibility for funding certain costs, such as deferrals related to losses on refunding of debt issuances, remediation of gasification sites, ice storm repairs and property taxes, thus reducing upward pressure on regulated delivery rates for NYSEG and RG&E's electric and gas operations. The Judge concludes that PBAs in the range of $646.4 million are

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[14] RD, p. 80.

required, among other things, to satisfy the PSL's requirement that the merger be approved only if it is in the public interest.[15]

However, in weighing the various costs and benefits of the proposed merger, the Judge does not properly consider Iberdrola's plans to invest $2 billion in clean energy projects in New York over the next five years. The record in this case shows that Iberdrola currently has 998 MW of wind generation in New York that could become operational within the next five years,[16] and that wind generation costs are in the range of $1.8 million to $2.0 million per MW,[17] implying a total investment of approximately $2.0 billion. After the conclusion of hearings, according to several media reports, Iberdrola apparently committed to this level of investment. Although the ALJ notes that Iberdrola's statement regarding the $2 billion investment was made after the close of hearings in this case and he invites parties to address the impact of this announcement in their briefs,[18] the Judge dismisses the value of that investment, asserting that it is "inadequate or not real,"[19] and that it would actually be detrimental to the State's interest.[20]

The CPB takes exception to that conclusion. The ALJ's finding on this matter appears to follow directly from his erroneous view that a utility should

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15 PSL §70.

16 Exhibit 57.

17 TR 626.

18 RD, p. 35.

19 Id., p. 28.

20 Id., p. 41.

never be authorized to own generation in its service territory, a predilection we address thoroughly in Points I and II. The Judge thus fails to recognize the importance of this apparent commitment, which would be an unprecedented level of investment in clean energy development by a single company in New York, and would help the State's economy. In addition, the State and its citizens could benefit substantially from Iberdrola's corporate philosophy, resources and expertise, which could be used to support the State's energy efficiency and environmental protection initiatives. We urge the Commission to carefully consider Iberdrola's apparent commitment to invest $2 billion in New York in the next five years, as a potential key benefit of the proposed transaction. The PSC should also take action to ensure that ratepayers and the State obtain reasonable benefits, should the planned level of investment not be forthcoming. This might by accomplished by linking shortfalls of actual investment in New York from the $2 billion level, to additional required rate decreases or avoided rate increases.

In the CPB's view, the $2 billion of investment over five years, when properly assessed and if made an enforceable commitment, coupled with the $201.6 million of PBAs, other benefits identified by the Petitioners and the financial protections for ratepayers identified by the ALJ,[21] satisfies the public interest requirement of the PSL.

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[21] Id., pp. 111 - 117.

CONCLUSION

The Consumer Protection Board recommends that the Public Service Commission modify the June 16, 2008 Recommended Decision in this proceeding as explained herein.

Respectfully submitted,

Mindy A. Bockstein
Chairperson and Executive Director

Douglas W. Elfner
Director of Utility Intervention

Dated: Albany, New York
June 26, 2008