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

REPLY BRIEF ON EXCEPTIONS

OF THE

NEW YORK STATE CONSUMER PROTECTION BOARD

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Albany, New York

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REPLY BRIEF ON EXCEPTIONS OF THE NEW YORK STATE CONSUMER PROTECTION BOARD

On June 16, 2008, Administrative Law Judge ("ALJ") Raphael A. Epstein issued a Recommended Decision ("RD") in this proceeding concerning the proposed acquisition of Energy East Corporation by Iberdrola, S.A. ("Iberdrola"). The Consumer Protection Board ("CPB") filed a Brief on Exceptions ("BOE") dated June 26, 2008, in which we demonstrated that the Public Service Commission ("PSC" or "Commission") should reject the RD on three key issues. Specifically, we showed that Ibderdrola should not be prohibited from owning wind generation in NYSEG and RG&E's service territory as a condition of merger approval, but instead should be provided the opportunity to satisfy the PSC's rebutable presumption against such ownership. Further, we asserted that the combined company should not be required to divest its existing hydroelectric generation assets as a condition of the merger and the Commission should explicitly consider as a benefit of the transaction, Iberdrola's statement that it would invest $2 billion in New York if the merger is approved, and take action to

ensure that ratepayers and the State obtain reasonable benefits should the planned investment not be forthcoming.

Briefs on Exception were filed by Iberdrola and Energy East (jointly, "Petitioners"); Staff of the Department of Public Service ("DPS Staff"); The New York State Department of Environmental Conservation; Multiple Intervenors; Nucor Steel Auburn, Inc.; Independent Power Producers of New York, Inc.; Strategic Power Management, LLC; the Greater Rochester Enterprise; and jointly by the New York Association of Public Power and the New York State Rural Electric Cooperative Association. In this brief, the CPB submits its opposition to certain exceptions made by those parties. The absence of any specific opposition in this brief should not be construed as support for that position. Instead, it reflects the CPB's view that no further discussion is required or that we expect the matter to be adequately addressed by other parties. Issues are addressed in the order presented in Iberdrola's BOE, followed by matters raised by other parties.

I. IBERDROLA HAS OVERSTATED CLAIMS REGARDING THE ALLEGED BENEFIT OF DIVESTITURE OF ENERGY EAST'S FOSSIL-FUELED PLANTS.

In evaluating and weighing the purported benefits and risks of the proposed transaction, the RD found that Petitioners' offer to divest their fossil-fueled generation does not constitute a benefit because the Commission has the authority to order such divestiture irrespective of whether it approves the

proposed acquisition.[1] Iberdrola asserts that this finding is erroneous, since most of the divestiture would not have occurred in the absence of the merger and Iberdrola has committed to share up to 90% of the above-book net proceeds of the sale of the generation assets with ratepayers.[2]

Iberdrola has overstated the extent to which its proposal to sell its fossil-fueled plants is a benefit of the proposed transaction. The largest plant at issue, Russell Station, was addressed in another PSC proceeding in which RG&E stated that it would "fulfill its commitment (made on the record in RTP-0051) to file an appropriate competitive auction process with a goal of the sale of the Russell Station site to a non-affiliated entity."[3] That commitment is not attributable to the proposed transaction. In addition, Iberdrola's commitment in this proceeding to share up to 90% of the above-book proceeds of the sale with ratepayers, allowing shareholders to retain the remainder, is not a substantial benefit, since in the last sale of a plant by RG&E, the Commission permitted shareholders to retain only approximately 5% of the above-book proceeds.[4] In view of that determination, which involved the sale of a large nuclear generating station that was arguably more complex than the sale of fossil-fueled plants,

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1 RD, pp. 54 - 55.

2 Iberdrola BOE, pp. 22 – 23.

3 Case 03-T-1385, Application of Rochester Gas and Electric Corporation, Order Granting Certificate of Environmental Compatibility and Public Need, December 14, 2004, App, p. 57.

4 Cases 03-E-0765, 03-G-0766, 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 and Gas Service, Order Adopting Provisions of Joint Proposals with Conditions, May 20, 2004, p. 21.

Iberdrola's characterization of its proposal to retain at least 10% of the above-book proceeds as a benefit of the proposed transaction, is overstated.

II. IBERDROLA'S ASSERTIONS REGARDING THE BENEFIT OF ITS COMMITMENT TO INVEST $100 MILLION IN NEW YORK ARE ALSO OVERSTATED.

Iberdrola made an on-the-record commitment to invest $100 million in wind generation projects in New York over three years.[5] The Judge concluded that this should not be counted as a benefit attributable to the acquisition.[6] Iberdrola excepts, repeatedly characterizing the $100 million investment as a "commitment" and detailing the economic development and environmental benefits that it would produce.[7]

The CPB fully recognizes the potential benefit of the $100 million investment at issue. However, in assessing that promise, the Commission must also consider that it is accompanied by several conditions relating to the future economics and pricing of wind generation in New York, including that there is "no material adverse change to the existing fundamental economics of wind generation development in New York State."[8] The Judge correctly noted that these contingencies raise doubts about whether the $100 million investment commitment would be enforceable. If an investment plan is not enforceable, the Commission should discount its purported benefits.

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5 Exhibit 50.

6 RD, p. 56.

7 Iberdrola BOE, pp. 25 – 27.

8 Exhibit 50, p. 2.

That principle applies equally to the Company's apparent commitment to invest $2 billion in New York in the next five years. As explained in our BOE, the PSC should assess that plan and take action to ensure that ratepayers and the State obtain reasonable benefits, in the event that planned investment is not forthcoming.[9] We note that despite the Judge's explicit invitation to Iberdrola to clarify the relationship of the $2 billion investment plan and the $100 million commitment,[10] the Company did not even mention its widely publicized plan to invest $2 billion in the State in its BOE.

III. TO DETERMINE THE FINANCIAL PROTECTIONS THAT SHOULD ACCOMPANY APPROVAL OF THE PROPOSED ACQUISITION, THE COMMISSION SHOULD USE THE JUDGE'S "BURDENSOME" STANDARD.

Several parties including the CPB[11], DPS Staff[12] and Multiple Intervenors[13] explained that the proposed merger would create significant risks for NYSEG, RG&E and utility customers. To help insulate utility customers from those risks, these parties proposed a series of financial protections similar to what the Commission required of National Grid as a condition of its acquisition of KeySpan Corporation. These include conditions on the accounting to be used to record the acquisition, requirements to assure credit quality, dividend limitations,

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9 CPB BOE, p. 11.

10 RD, p. 35.

11 CPB IB, pp. 15 – 17.

12 DPS Staff IB, pp. 32 – 88.

13 Multiple Intervenors IB, pp. 35 – 51.

money pool rules and structural protections. The Judge concluded that in considering whether a proposed financial protection should be adopted, the PSC should determine whether it would be burdensome, and if not, the Commission should adopt that measure. If, on the other hand, the PSC finds that the safeguard would be burdensome, it should then conduct a detailed assessment of the need for, and cost of, imposing the remedial measure.[14] Iberdrola takes exception to that approach.[15]

The approach taken by the ALJ is reasonable. As correctly explained by the Judge, some of the risks of the proposed merger are unquantifiable, although they are very real and significant.[16] Thus, it may be impossible to conduct a meaningful cost/benefit analysis of the proposed safeguard. Further, even if a detailed assessment of risks is made at this time, new circumstances may dramatically alter that evaluation. For example, as conceded by Iberdrola's witness, although Iberdrola is a large and successful company today, the same description could have been applied to Enron Corporation less than a decade ago.[17] The need to protect ratepayers from unquantified risks that appear remote at this time, was recognized by the Company by their agreement to a "Golden Share" condition. That measure would prevent a bankruptcy of Iberdrola or any of its affiliates from triggering a voluntary bankruptcy of NYSEG or RG&E,[18]

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14 RD, pp. 111 – 114.

15 Iberdrola BOE, pp. 49 – 50.

16 RD, pp. 111 – 114.

17 TR 1127.

18 Iberdrola BOE, p. 58.

despite the Company's current financial strength. For that same reason, and given the general absence of PSC experience with transactions of this nature, it is eminently reasonable for the Commission to adopt safeguards to protect ratepayers unless it can be demonstrated that such measures are burdensome, as proposed by the Judge.

IV. THE FINANCIAL PROTECTIONS REQUIRED FOR THE NATIONAL GRID/KEYSPAN MERGER SHOULD GENERALLY BE APPLIED TO IBERDROLA.

In their BOE, Petitioners accept most of the financial conditions proposed to address the risks of the acquisition.[19] However, they disagree with recommendations by the ALJ that would apply to Iberdrola, various financial safeguards that were based in part on what the Commission ordered in approving the acquisition of KeySpan by National Grid. The CPB continues to recommend that as a general matter, the conditions imposed by the PSC for National Grid should be applied in this case.

Iberdrola asserts that the financial safeguards applicable to the National Grid/KeySpan merger should not serve as the model here, because "unlike the circumstances presented in Grid/KeySpan, Iberdrola has a higher credit quality than Energy East, NYSEG or RG&E," and this transaction is being financed by equity instead of debt.[20] However, the intent of financial safeguards is to protect the utilities and their customers, from risks that are known and quantifiable today,

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19 Iberdrola BOE, p. 47.

20 Id., p. 48.

as well as future uncertainties such as a significant change in Iberdrola's financial strength. Accordingly, Ibderdrola's current financial prowess does not obviate the need for the imposition of the wide range of financial safeguards that were required by the Commission in the Grid/KeySpan case. Those safeguards are generic in nature, and represent the Commission's current understanding of the types of measures required to protect ratepayers in a period of multi-national consolidation of utility holding companies. Rather than reflecting negatively on Iberdrola, these safeguards properly recognize the current complexities and risks of the energy industry.

V. NYSEG AND RG&E'S RATES SHOULD BE MADE TEMPORARY DURING THE PENDENCY OF A COMPREHENSIVE REVIEW OF THEIR REASONABLENESS.

In the event the Commission decides to approve the proposed acquisition, the Judge recommends that the PSC implement the rate reductions associated with the $201.6 million of "positive benefit adjustments" ("PBAs") and "declare the resulting rates temporary to the extent of any other, contested PBAs adopted by the Commission."[21] Under this recommendation, ratepayers would be protected from paying excessive rates, but only up to the amount of any PBAs ordered by the Commission in addition to the $201.6 million. Iberdrola excepts to the concept of temporary rates, arguing that there is no reason, or support, for such a determination.[22] In the event that the Commission disapproves the proposed

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21 RD, pp. 144 - 145.

22 Iberdrola BOE, pp. 84 - 86.

merger, the Judge recommends a comprehensive review of the utilities' rates, but does not propose that temporary rates be established.[23]

As explained in our IB, Commission action is necessary to prevent NYSEG and RG&E customers from paying excessive rates for two reasons: to ensure that ratepayers obtain the benefit of any additional PBAs, and to ameliorate current overearnings by NYSEG and RG&E.[24] The latter issue is particularly important. As DPS Staff explains, the most recent reports filed by Energy East indicate that NYSEG has earned an average of 17.17% for the years 2002 – 2006 and 10.12% for the years 2002 – 2007, while RG&E has earned 13.05% on its electric operations and 9.1% on its gas operations for the years 2004 – 2007. In contrast, in its most recent decision for a major energy utility, the Commission set rates to yield a 9.1% return.[25] Thus, should the PSC approve the proposed acquisition, it should immediately reflect the PBAs in the utilities' rates, and make the resulting rates temporary until a comprehensive review is completed. In the event that the PSC does not approve the acquisition, it should also make rates temporary. In both cases, ratepayers would be protected from paying excessive charges during the period in which the investigation is conducted.

In the event that the Commission concludes that the record in this proceeding is not sufficient to support a finding that temporary rates are

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23 RD, pp. 143 – 144.

24 CPB IB, p. 9.

25 Case 07-E-0523, Proceeding on Motion of the Commission as to the Rates, Charges, Rules and Regulations of Consolidated Edison Company of New York, Inc. for Electric Service, Order Establishing Rates for Electric Service, March 25, 2008, p. 126.

necessary, we urge it to adopt our recommendation that an order be issued directing NYSEG electric, NYSEG gas, RG&E electric and RG&E gas, to show cause why temporary rates should not be set to include the rate effect of any PBAs adopted, and/or ameliorate overearnings.[26]

VI. THE PSC SHOULD REQUIRE A COMPREHENSIVE REVIEW OF NYSEG AND RG&E'S DELIVERY RATES, RATHER THAN THE EXPEDITED EXAMINATION PROPOSED BY DPS STAFF.

The Judge recommended that the Commission conduct a thorough review of NYSEG and RG&E's delivery rates for both electric and gas operations, under a conventional 11-month schedule, irrespective of whether the acquisition is approved.[27] DPS Staff excepts, claiming that a comprehensive rate examination is not required since it would be a "distraction" from the process of merging the companies. Instead, it urges the PSC to adopt an expedited, streamlined approach to reviewing the utilities' rates, under which the companies would submit limited financial information in a summary form, to be followed by a negotiated resolution of all relevant issues.[28]

The CPB opposes DPS Staff's proposal for several reasons. First, it is now time for a comprehensive examination of delivery rates for these utilities. With the exception of NYSEG's electric operations, the Commission has not conducted an examination of the delivery rates for these companies in

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[26] CPB IB, p. 9.

[27] RD, pp. 143, 145.

[28] DPS Staff BOE, pp. 46 – 49.

approximately five years, during which time the earnings of these companies have exceeded expectations. Second, the information that DPS Staff would require the Company to submit, falls short of the PSC's own requirements for major rate cases, in terms of the level of detail and a verifiable audit trail to the utilities' books and records. Third, by limiting in advance the level of information to be provided and requiring negotiations, the expedited process proposed by DPS Staff could limit the Commission's ability to establish just and reasonable rates in the event that a fair settlement cannot be achieved. Fourth, expediting the review of delivery rates for these utilities would disadvantage intervenors with limited resources, including the CPB, a point recognized by the ALJ.[29]

Moreover, DPS Staff's assertion that a comprehensive review of the utilities' rates would distract the Companies from completing their merger, is untenable. Unlike many other recent acquisitions of utilities in New York State, the acquirer has no preexisting presence as a regulated utility in the State. Thus, "there would be no opportunity to consolidate Iberdrola's operations with those of [NYSEG and RG&E]"[30] and the utilities will continue to be "separately managed."[31] Therefore, the acquisition provides no reason to short-circuit long-established PSC practices and procedures for reviewing the rates of the State's large energy utilities.

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29 RD, p. 143.

30 Id., p. 24.

31 Iberdrola RB, p. 99.

Most importantly, if temporary rates are established as we recommend, ratepayers would be fully protected until the Commission establishes permanent rates. Thus, there would be no reason to proceed with anything other than a thorough and transparent rate review.

CONCLUSION

For the reasons explained herein and in our June 26, 2008 Initial Brief, the Consumer Protection Board recommends that the Public Service Commission modify the June 16, 2008 Recommended Decision in this proceeding so that Ibderdrola is not prohibited from owning wind generation in NYSEG and RG&E's service territory as a condition of merger approval; the combined company is not required to divest its existing hydroelectric generation assets as a condition of the merger; and that the Commission explicitly consider as a benefit of the transaction, Iberdrola's statement that it would invest $2 billion in New York if the merger is approved, and take action to make it an enforceable commitment.

Respectfully submitted,

Mindy A. Bockstein
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Douglas W. Elfner
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Dated: Albany, New York
July 3, 2008