STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

Joint Petition of National Grid PLC and KeySpan Corporation for Approval of Stock Acquisition and other Regulatory Authorizations.	Case 07-E-0878
Proceeding on Motion of the Commission as to the Rates, Charges, Rules and Regulations of the Brooklyn Union Gas Company d/b/a KeySpan Energy Delivery New York for Gas Service.	Case 06-G-1185
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REPLY STATEMENT OF THE NEW YORK STATE CONSUMER PROTECTION BOARD IN SUPPORT OF JOINT PROPOSAL

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Dated: July 17, 2007
Albany, New York

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REPLY STATEMENT OF THE
NEW YORK STATE CONSUMER PROTECTION BOARD

On July 11, 2007, the New York State Consumer Protection Board ("CPB") submitted a Statement in full support of the Merger and Revenue Requirement Joint Proposal ("Proposal") filed by National Grid PLC ("National Grid") in these cases on July 6, 2007. We explained why the Proposal is in the public interest, satisfies the Public Service Commission's ("Commission" or "PSC") Settlement Guidelines and should be approved expeditiously.

Several parties, including the Independent Power Producers of New York, Inc. ("IPPNY"), Astoria Generating Company, L.P. ("Astoria"), the NRG Companies ("NRG"), Multiple Intervenors ("MI"), the City of New York, Public Utility Law Project ("PULP"), and Nassau and Suffolk Counties ("Counties"), submitted statements in which they identify concerns with the Proposal, or

explain why they oppose it. The CPB has carefully reviewed those filings. Nothing therein alters our position that the Proposal is in the public interest and should be approved in its entirety by the Commission.

Electric Generators

IPPNY, NRG and Astoria oppose the Proposal on the grounds that the provisions governing the disposition of the Ravenswood generating facility contravene the Commission's policy on divestiture by transmission owners, and are unsupported by the record. Their objections are unfounded and should be rejected.

First, the generators do not provide a complete description of the PSC's divestiture policy. The Commission established a rebuttable presumption that "ownership of generation by a T&D company affiliate would unacceptably exacerbate the potential for vertical market power."[1] It stated that the presumption could be overcome if:

> the vertical market power could not be exercised because the circumstances do not give the T&D company an opportunity to exercise market power, or because reasonable means exist to mitigate market power. Alternatively, the T&D company would need to demonstrate that substantial ratepayer benefits, together with mitigation measures, warrant overcoming the presumption.[2]

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[1] Case 96-E-0900, et al., In the Matter of Orange & Rockland Utilities, Inc.'s Plans for Electric Rate Restructuring Pursuant to Opinion 96-12, Statement of Policy Regarding Vertical Market Power, July 17, 1998, pp. 1 – 2.

[2] Id., p. 2, emphasis added.

The Joint Proposal fully meets the burden set by the Commission. It mandates an attempt at divestiture of the Ravenswood Station, but also provides for mitigation of vertical market power if a sale is not completed. By requiring the financial sale of the future energy output from the plant for up to three years and a long-term bilateral contract for all of the products of the plant for a minimum of 15 years, it substantially eliminates any potential profit from the exercise of such power. If neither divestiture nor the long-term contract is accepted by National Grid and the Commission, the Proposal requires that revenues exceeding Ravenswood's cost-of-service be returned to customers. These mitigation measures, combined with substantial ratepayer benefits in the form of more than $600 million in avoided rate increases for KeySpan's customers in New York City and Long Island, meets the Commission's test for overcoming its presumption favoring physical divestiture.

Further, the Joint Proposal fully affirms the Commission's preference for physical divestiture, and establishes a schedule for accomplishing it. The purpose of that timetable is to avoid a "fire sale" by giving National Grid an opportunity to complete the divestiture in a commercially reasonable manner that will permit it to realize the full market value of the Ravenswood asset. This arrangement is ultimately important not only to National Grid shareholders, but also to consumers who will obtain financial benefits under the Proposal that would not have been available if National Grid did not have an expectation that it could sell the plant at fair market value. Forcing a distress sale in this case would benefit no one other than potential bidders for the plant.

The contention that Proposal provisions governing Ravenswood are without support in the record is patently false. CPB witness Dr. Douglas Elfner expressly testified that either long-term contracts for plant output or cost of service regulation could serve as an alternative to physical divestiture that would adequately protect the interests of consumers.[3] None of the parties now objecting to the terms of the Proposal submitted testimony in rebuttal of Dr. Elfner, or any testimony at all for that matter, despite the fact that they have been represented throughout this proceeding by experienced local counsel. NRG's assertion that its due process rights are implicated by the short time available for comment on the Proposal is absurd and an insult to the parties who have worked diligently and for a long period of time.

Astoria objects that the Proposal's fallback limitation on National Grid's earnings from Ravenswood to its cost-of-service if it fails to complete divestiture within the scheduled time is actually a carrot rather than a stick because cost of service is defined to include a return that may be higher than utilities normally earn. The argument is inapposite. Ravenswood is not a utility. It operates in an unregulated wholesale environment with no assured market for its output (in contract to utility delivery service). In a competitive market, <u>any</u> artificial limitation on earnings significantly increases the risk and reduces the attractiveness of an asset. The Proposal specifies that Ravenswood's earnings for purposes of the cost-of-service are to be limited to the average earned by companies in the Standard & Poor's 500. That average may be either lower, or higher, than for

[3] Testimony of CPB Witness Dr. Douglas W. Elfner, February 20, 2007, pp. 13-15.

unregulated electricity generating plants and gives no assurance to National Grid that retention of the plant will be a good investment. Under the circumstances, it is a reasonable, easily administered methodology.

Astoria also emphasizes that the DPS Staff initially vehemently opposed approval of the merger absent physical divestiture of Ravenswood by National Grid. DPS Staff is a signatory to the Joint Proposal. If anything, Astoria's arguments simply make the conclusion inescapable that the Proposal provides a reasonable resolution of those initial concerns.

Multiple Intervenors

The MI identifies provisions of the Proposal that it claims are contrary to the interests of Niagara Mohawk customers and may require modification. Notably, despite its concerns, MI does not oppose the Proposal.

As a threshold matter, the Proposal is presented for PSC consideration as an integrated whole. It reflects negotiations and compromise on many issues. MI states that it supports certain provisions of the Proposal, such as those that address potential market power concerns. However, it fails to recognize that those, and other provisions that it supports, are only applicable as part of the entire Proposal, including those sections that MI asserts may need modification. The MI suggestion that the provisions it does not support can be modified while the ones it supports should go undisturbed, is erroneous.

MI asserts that the Proposal should be modified to provide Niagara Mohawk's customers "their fair share of net synergy savings."[4] The Proposal specifies that "Niagara Mohawk will provide for a flow-through to its customers of a share of the net synergy savings allocable to Niagara Mohawk in accordance with Attachment 10 to the Niagara Mohawk rate plan." (Proposal, §XI.A) That rate plan, which the Commission approved in 2001, prescribes exactly how any synergy savings resulting from subsequent mergers, such as with KeySpan, are to be calculated and flowed through to ratepayers. MI unequivocally supported that rate plan, and its members have enjoyed the benefits of the delivery rate stability, stranded cost write-off and cost recovery that were part of that negotiated settlement.[5] Again, MI seems to miss the point that it cannot pick and choose among provisions of integrated proposals.

The basis for MI's view that Niagara Mohawk customers would not receive adequate financial benefits under the Proposal appears to be that KEDNY and KEDLI customers obtained the benefit of substantial rate mitigators, such as compensation for KEDNY's return to the Commission's Pension Policy Statement and imputation of a disputed property tax refund from Nassau County. (Joint Proposal, Appendix 2, p. 8; Appendix 3, p. 8) Those ratepayer benefits are not "net synergy savings" in the context of the Niagara Mohawk rate plan, and there is no regulatory requirement that they be allocated to Niagara Mohawk pursuant

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[4] Initial Statement of Multiple Intervenors, July 11, 2007, p. 12.

[5] Case 01-M-0075, Joint Petition of Niagara Mohawk Holdings, Inc., Niagara Mohawk Power Corporation, National Grid Group plc and National Grid USA for Approval of Merger and Stock Acquisition, Opinion and Order Authorizing Merger and Adopting Rate Plan, December 3, 2001, pp. 32-33.

to Attachment 10 of that company's rate plan. Instead, they are customer benefits that are the product of this negotiated agreement.

The City of New York

The City of New York is a signatory to the Proposal and fully supports it with the exception of a single provision regarding the Ravenswood generation station. It claims that this section of the Proposal does not resolve the pending in-city installed capacity market power issue. Since there is ample evidence that at least one generator in that market has exercised market power, thereby increasing the price to consumers, the City states that it "believed that it would be advisable to resolve this issue in the current merger proceeding with additional safeguards beyond those included in the Joint Proposal."[6] The CPB agrees that this market power issue continues to be a severe problem that must be addressed to protect consumers. However, that issue was not created by the proposed merger, nor will it be exacerbated if the merger is approved. In fact, it is unrelated to the Proposal and cannot be cured by this or any other potential merger.

The market power concern highlighted by the City of New York is properly a matter before the Federal Energy Regulatory Commission ("FERC"). Indeed, on the day the Proposal was filed with the PSC, FERC issued an order establishing procedures for addressing the installed capacity market rules for

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[6] The City of New York's Statement in Support of Joint Proposal, July 11, 2007, p. 11.

New York City.[7] Although an extremely important issue for consumers, the fact that it is not resolved by the Proposal is irrelevant to whether the settlement is in the public interest.

The Public Utility Law Project

The Proposal requires National Grid to offer Ravenswood for sale or offer the output of the plant for sale under a long-term contract of at least 15 years in duration. If National Grid has not accepted either a proposal for divestiture of Ravenswood or a long-term contract, the Ravenswood Station would be subject to a cost-of-service cap, under which revenues that exceed that cap would be returned to customers. The Proposal identifies the methodology to be used to determine the cost-of-service of the Ravenswood Station, including a requirement that the cost-of-service be based on KeySpan's purchase price for the plant.

PULP is a signatory of the Proposal and submitted a statement "in Support of the Merger Joint Proposal and Further Statement of Reservation."[8] It is concerned that the Proposal's methodology for quantifying the cost-of-service of the Ravenswood plant may not adequately protect consumers. In particular, it asserts that the cost-of-service would be overstated if it is based on the price that KeySpan paid to acquire Ravenswood, since the purchase price reflected the earnings potential of the asset instead of its historical cost. That argument is

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[7] 120 FERC ¶ 61, 024, Docket No. EL07-39-000, Order Establishing Paper Hearings and Referring Certain Matters for Investigation, July 6, 2007.

[8] Statement of the Public Utility Law Project in Support of the Merger Joint Proposal and Further Statement of Reservation, July 11, 2007.

incorrect. It is fair and equitable to use the price actually paid by KeySpan, and approved by the Commission, in determining Ravenswood's cost-of-service. The plant's historical cost is of no relevance in determining its cost to KeySpan.

PULP also claims, similar to the assertion of Astoria above, that the cost-of-service methodology in the Proposal is improperly based on unregulated returns in a competitive market rather than regulated returns. As explained above, neither the price nor earnings of Ravenswood Station are regulated. Limiting the equity return of that generator to the average return of companies in the Standard & Poor's 500 is reasonable.

Nassau and Suffolk Counties

Nassau and Suffolk Counties oppose the Proposal on procedural and substantive grounds. They assert that they are disadvantaged since the Proposal excludes the issue of costs for the investigation and remediation of manufactured gas plant sites. On the contrary, the Proposal specifically clarifies that future rate treatment of site investigation and remediation ("SIR") costs, including a possible incentive program to promote timely and cost-effective remediation of the sites, are to be addressed in the rate proceedings in Case 06-G-1185 and 06-G-1186. The Counties and other parties will have a full opportunity to address SIR costs in that forum.

The Counties also assert that the local economy may be negatively impacted by job losses associated with the merger. Their analysis does not adequately address, however, the impact that $325.7 million in rate reductions

will have on Long Island's economy. Job losses resulting from the merger will be spread throughout National Grid and KeySpan's operating territories, including New York, Massachusetts, New Hampshire and Rhode Island. However, the financial benefits of the merger will inure mainly to customers in New York. In particular, while customers of the companies in New York will receive more than $600 million in financial benefits, customers in New Hampshire and Massachusetts will receive $2.2 million and zero financial benefits, respectively.[9] In addition, the Counties' arguments apparently do not consider that the Proposal is supported by the utilities' labor unions and that it requires KeySpan to maintain existing customer service and operation centers on Long Island.

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[9] E.g., Worcester Telegram, July 11, 2007, http://www.telegram.com/article/20070711/NEWS/707110338/1002/BUSINESS.

CONCLUSION

For the reasons identified herein and in our July 11, 2007 Statement in these proceedings, the Commission should approve the Proposal expeditiously.

Respectfully submitted,

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