

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24

STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

Case 07-M-0906 - Joint Petition of Iberdrola, S.A.,
Energy East Corporation, RGS Energy Group, Inc., Green
Acquisition Capital, Inc., New York State Electric & Gas
Corporation and Rochester Gas and Electric Corporation for
Approval of the Acquisition of Energy East Corporation by
Iberdrola, S.A.

Evidentiary Hearing
3 Empire State Plaza
Albany, New York

Tuesday, March 18, 2008
9:00 a.m.

PRESIDING:

RAFAEL A. EPSTEIN,
Administrative Law Judge

1 JUDGE EPSTEIN: I call Case 07-M-0906, continuing
2 the evidentiary hearing in the matter of Iberdrola. Are there
3 any active parties here who did not enter an appearance
4 yesterday?

5 (No response.)

6 JUDGE EPSTEIN: No other active parties?

7 (No response.)

8 JUDGE EPSTEIN: Okay. Let's see.

9 I'll continue without the mic until they get that
10 resolved. As yesterday, we are web casting at this time, and we
11 believe that we are being monitored by telephone, but we believe
12 that parties don't have the capacity to call in because of the
13 problems we were having yesterday.

14 If anybody is looking for a room for either a
15 conference or to monitor the proceedings here using your cell
16 phone, today, there is the small conference room on the third
17 floor, the ADR room available from 12:00 to 5:00.

18 And I have been asked to note the appearance of Mr.
19 Martinez, Luis Martinez, for the Natural Resources Defense
20 Council for the limited purpose of introducing the testimony of
21 Mr. Gupta and an associated exhibit which we will do after
22 completing the cross of Petitioners' witnesses.

23 Is there any other preliminary business?

24 (No response.)

1 JUDGE EPSTEIN: Okay. Off the record.

2 (Discussion off the record.)

3 JUDGE EPSTEIN: We're back on the record, and if
4 there's no other preliminary matters, then the next order
5 of business is the cross of this panel; is that correct.

6 MR. FITZGERALD: Correct, your Honor.

7 JUDGE EPSTEIN: Do you want to call the panel?

8 MR. FITZGERALD: Yes, your Honor. The Joint
9 Petitioners call the Benefits and Public Interest Panel
10 and the Policy Panel, which consists of the same
11 individuals, Pedro Azagra, James Laurito and Robert Rude.

12 JUDGE EPSTEIN: Please rise.

13 P E D R O A Z A G R A,

14 J A M E S L A U R I T O,

15 R O B E R T R U D E,

16 having first been duly sworn by the Administrative Law Judge,
17 were examined and testified as follows:

18 DIRECT EXAMINATION

19 BY MR. FITZGERALD:

20 Q. Good morning, panel. Mr. Azagra, would you please state
21 your name and address for the record.

22 A. (Mr. Azagra) Pedro Azagra, Tomas Redondo 1, Madrid,
23 Spain.

24 Q. Mr. Laurito, would you please state your name and

1 business address for the record.

2 A. (Mr. Laurito) Yes. Jim Laurito, NYSEG and RG&E, 89 East
3 Avenue, Rochester, New York.

4 Q. Mr. Rude, would you please state your name and business
5 address for the record as well.

6 A. Robert E. Rude, 52 Farm View Drive, New Gloucester,
7 Maine.

8 Q. I'd like to begin the panel this morning with their
9 direct. Do you have before you a 27-page document, questions and
10 answers entitled, "The Direct Testimony of the Benefits and
11 Public Interest Panel," dated August 1, 2007?

12 A. (Mr. Laurito) Yes.

13 A. (Mr. Rude) Yes.

14 A. (Mr. Azagra) Yes.

15 Q. Was that document prepared by you or under your
16 direction?

17 A. (Mr. Laurito) Yes.

18 A. (Mr. Azagra) Yes.

19 A. (Mr. Rude) Yes.

20 Q. Do you have any corrections or changes to the direct
21 testimony today?

22 A. (Mr. Azagra) No.

23 A. (Mr. Rude) No.

24 A. (Mr. Laurito) No.

1 Q. If I were to ask you the questions set forth in your
2 prefiled direct testimony, would your answers be the same as set
3 forth in that testimony today?

4 A. (Mr. Rude) Yes.

5 A. (Mr. Laurito) Yes.

6 A. (Mr. Azagra) Yes.

7 Q. Do you adopt that prefiled testimony as your sworn direct
8 testimony in this proceeding?

9 A. (Mr. Laurito) Yes.

10 A. (Mr. Rude) Yes.

11 A. (Mr. Azagra) Yes.

12 MR. FITZGERALD: Your Honor, may we have the
13 prefiled direct testimony of the Benefits and Public Interest
14 Panel copied into the record as if given orally?

15 JUDGE EPSTEIN: Yes.

16 (The following is the prefiled direct testimony of
17 the benefits and public interest panel:)

18

19

20

21

22

23

24

BENEFITS AND PUBLIC INTEREST PANEL**I. INTRODUCTION**

1

2 **Q. Please state the names of the members on this Benefits and Public Interest**
3 **Panel (the "Panel").**

4 A. Our names are Pedro Azagra Blazquez, James P. Laurito and Robert E. Rude.

5 **Q. Mr. Azagra, please state your current position and business address.**

6 A. My title is Director of Corporate Development of IBERDROLA, S.A.
7 ("IBERDROLA"). My business address is Tomás Redondo 1, Madrid, Spain,
8 28033.

9 **Q. What are your current job responsibilities?**

10 A. Among other things, I am responsible for the non-organic growth of
11 IBERDROLA, which includes such transactions as mergers, acquisitions,
12 divestitures of core businesses, and the strategic planning of such opportunities.

13 **Q. Please summarize your educational background.**

14 A. I received a business degree and a law degree from Icade University in Madrid,
15 and a Master of Business Administration from the University of Chicago.

16 **Q. Please describe your work experience.**

17 A. Prior to joining IBERDROLA, I worked at Morgan Stanley from 1992 to 1996 in
18 the Investment Banking Division in London.

19 **Q. Have you previously testified before any United States federal or state**
20 **regulatory agency or a regulatory agency of another country?**

21 A. I have never provided testimony, but I have done significant work related to
22 IBERDROLA regulatory matters in Spain.

BENEFITS AND PUBLIC INTEREST PANEL

1 **Q. Please identify those areas of the testimony for which you have primary**
2 **responsibility.**

3 **A.** While we are collectively sponsoring this Panel testimony with respect to the
4 overall transaction (the "Proposed Transaction") that is described in the "Joint
5 *Petition for Approval of the Acquisition of Energy East Corporation by*
6 *IBERDROLA, S.A.*" (the "Joint Petition") to which our testimony is attached, I
7 am responsible for the portions of this testimony related to IBERDROLA's global
8 operations and experience, IBERDROLA's strategic plan, IBERDROLA's
9 commitments, IBERDROLA's business focus and philosophy, and the overall
10 purpose of the Proposed Transaction from IBERDROLA's perspective. The Panel
11 as a whole is responsible for describing the reasons why the Proposed
12 Transaction should be approved as in the public interest. I defer to Mr. Laurito
13 and Mr. Rude with respect to the specific factual statements in this testimony with
14 respect to Energy East.

15 **Q. Mr. Laurito, please state your current position and business address.**

16 **A.** My title is President and Chief Executive Officer ("CEO") of New York State
17 Electric & Gas Corporation ("NYSEG"), President and Chief Executive Officer
18 of Rochester Gas and Electric Corporation ("RG&E"). My business address is 89
19 East Avenue, Rochester, New York 14649.

20 **Q. What are your current job responsibilities?**

21 **A.** As President and CEO of NYSEG and RG&E, I am ultimately responsible for the
22 overall day-to-day operations of the companies. I am responsible, among other

BENEFITS AND PUBLIC INTEREST PANEL

1 things, for maintaining NYSEG's and RG&E's financial health, enhancing the
2 operating efficiency and reliability of NYSEG's and RG&E's electric and gas
3 businesses, and assuring that all functions are carried out in compliance with
4 local, state and federal laws and regulations and standards of good business
5 practice. I am ultimately responsible for assuring that NYSEG and RG&E
6 provide customers with safe and reliable electric and gas service.

7 **Q. Please summarize your educational background.**

8 A. I graduated from West Virginia University with a Bachelor of Science Degree in
9 Civil Engineering and have completed executive programs in financial and
10 manufacturing management at Columbia University.

11 **Q. Please describe your work experience.**

12 A. I have been President and CEO of RG&E since June 2003 and President and CEO
13 of NYSEG since May 2003. In addition, I served as NYSEG's Treasurer from
14 May 2003 to July 2003; President and Chief Operating Officer of Connecticut
15 Natural Gas Corporation and The Southern Connecticut Gas Company (Energy
16 East's two local distribution companies in Connecticut) from October 2000 to
17 May 2003; President of TEN Companies, Inc. ("TEN") (a CTG Resources, Inc.
18 affiliate) from January 1998 to October 2000; and Vice President of Business
19 Development of TEN from September 1997 to January 1998.

BENEFITS AND PUBLIC INTEREST PANEL

1 **Q. Have you previously testified in other proceedings before the New York State**
2 **Public Service Commission ("PSC" or the "Commission") or other state or**
3 **federal regulatory agency or court?**

4 A. No.

5 **Q. Please identify those areas of the testimony for which you have primary**
6 **responsibility.**

7 A. While we are collectively sponsoring this Panel testimony with respect to the
8 Proposed Transaction, my primary areas of responsibility are with respect to
9 NYSEG and RG&E service reliability, infrastructure capital investment,
10 employee matters, and community matters. I defer to Mr. Azagra with respect to
11 the specific factual statements in this testimony with respect to IBERDROLA.

12 **Q. Mr. Rude, please state your current position and business address.**

13 A. My title is Senior Vice President and Chief Regulatory Officer of Energy East and
14 Energy East Management Corporation ("EEMC"). My business address is 52
15 Farm View Drive, New Gloucester, Maine 04260-5116.

16 **Q. Please summarize your educational background.**

17 A. I graduated from the State University of New York, College at Geneseo, in 1974,
18 with a Bachelor of Arts Degree in Political Science. I obtained a Masters Degree
19 in Business Administration from Syracuse University in 1993.

20 **Q. What are your current job responsibilities?**

21 A. As Senior Vice President and Chief Regulatory Officer, I am responsible for all
22 regulatory policy and proceedings at Energy East's electric and natural gas utility

BENEFITS AND PUBLIC INTEREST PANEL

1 operating companies. I am also responsible for operating and capital budgeting at
2 Energy East.

3 **Q. Please describe your work experience.**

4 A. I have been Senior Vice President and Chief Regulatory Officer of Energy East
5 since June 2005. I served as Vice President and Controller of Energy East from
6 November 1999 to June 2005, and also served as Energy East's Principal
7 Accounting Officer prior to June 2005. In addition, I served as Controller from
8 October 1998 to November 1999; Executive Director, Corporate Planning of
9 NYSEG, October 1998 to October 2000; and Director, Corporate Planning and
10 Rates of NYSEG prior to October 1998.

11 **Q. Have you previously testified in other proceedings before the Commission or
12 other state or federal regulatory agency?**

13 A. Yes. I have testified in Commission proceedings involving electric rate
14 settlements, electric rate design and industry restructuring. For example, I have
15 testified before the Commission in Cases 94-M-0349 (NYSEG Electric and Gas
16 Rates), 96-E-0891 (NYSEG Restructuring), 01-E-0359 (NYSEG Electric Price
17 Protection Plan) and 01-G-1668 (NYSEG Gas Rates)/01-G-1683 (Deferral
18 Petition – Gas Costs). I have also testified in a number of proceedings before the
19 Connecticut Department of Public Utility Control and the Maine Public Utilities
20 Commission.

BENEFITS AND PUBLIC INTEREST PANEL

1 **Q. Please identify those areas of the testimony for which you have primary**
2 **responsibility.**

3 A. While we are collectively sponsoring this Panel testimony with respect to the
4 Proposed Transaction, my primary areas of responsibility are issues relating to the
5 previous Energy East mergers, ongoing regulatory proceedings, rates and tariffs,
6 Energy East allocation methods and accounting, and the purpose of the Proposed
7 Transaction and the reasons it should be approved from Energy East's
8 perspective. I defer to Mr. Azagra with respect to the specific factual statements
9 in this testimony with respect to IBERDROLA.

10 **Q. What is the overall purpose of the Panel's testimony?**

11 A. The purpose of our testimony is to demonstrate why the Proposed Transaction is
12 in the public interest and to provide overall support for the Joint Petition, which is
13 being filed contemporaneously with this testimony.

14 **Q. Please briefly describe the Joint Petition.**

15 A. The Joint Petition of IBERDROLA, Energy East, Green Acquisition Capital, Inc.
16 ("Green Acquisition"), RGS, NYSEG and RG&E (collectively, the "Joint
17 Petitioners") requests Commission approval, without modification or condition,
18 pursuant to Section 70 of the New York Public Service Law ("PSL"), of the
19 Proposed Transaction, pursuant to which IBERDROLA will acquire 100 percent
20 of the common stock of Energy East. More particularly, the Joint Petitioners
21 request the necessary approvals for the Proposed Transaction to be completed in
22 accordance with the provisions of the Agreement and Plan of Merger, dated as of

BENEFITS AND PUBLIC INTEREST PANEL

1 June 25, 2007, among IBERDROLA, Green Acquisition and Energy East (the
2 "Merger Agreement"), without condition or modification. Pursuant to the Merger
3 Agreement, Green Acquisition, a New York corporation and wholly-owned
4 subsidiary of IBERDROLA formed for the purpose of effectuating the Proposed
5 Transaction, will merge with and into Energy East, with Energy East as the
6 surviving entity. Therefore, as a result of the Proposed Transaction, Energy East
7 will become a wholly-owned subsidiary of IBERDROLA, and Energy East's
8 subsidiaries will become subsidiaries of IBERDROLA. The Merger Agreement
9 is attached to the Joint Petition as Exhibit 8.

10 **Q. Please describe how this testimony supports the Joint Petition.**

11 A. To obtain the Commission's consent for the Proposed Transaction, the Joint
12 Petitioners must show that the Proposed Transaction is in the public interest. This
13 testimony, in conjunction with the Joint Petition, supports such a finding.

14 **Q. Are the Joint Petitioners requesting Commission approval of the Proposed
15 Transaction by a specific date?**

16 A. Yes. The Joint Petitioners desire to complete the Proposed Transaction
17 expeditiously so that the benefits of the Proposed Transaction can begin to be
18 realized as quickly as possible, and to close the Proposed Transaction promptly
19 following satisfaction of all conditions precedent to the Proposed Transaction,
20 which include regulatory authorization by the Commission. It is important,
21 therefore, that the Commission act promptly on this Joint Petition. Accordingly,
22 the Joint Petitioners respectfully request that the Commission approve the

BENEFITS AND PUBLIC INTEREST PANEL

1 Proposed Transaction without modification or condition within six (6) months of
 2 the date of filing. A schedule calling for a decision by such time will provide a
 3 full opportunity for review, including public input.

4 **Q. Is this Panel sponsoring any exhibits?**

5 A. This Panel will address and discuss the exhibits to the Joint Petition, with the
 6 number designations and descriptions as listed in the Joint Petition. Several of the
 7 Joint Petition exhibits are referenced and described in our testimony.

8 **Q. Please describe the organization of the rest of your testimony.**

9 A. Section II of our testimony provides an Executive Summary of the benefits of the
 10 Proposed Transaction. Section III describes the Joint Petitioners, including
 11 background information about IBERDROLA's global utility operations and
 12 interests in the United States, and the mechanics of the Proposed Transaction.
 13 Finally, Section IV describes the benefits of the Proposed Transaction and
 14 demonstrates that the Proposed Transaction is in the public interest, as required by
 15 PSL Section 70.

II. EXECUTIVE SUMMARY

17 **Q. What is the overarching reason why the Commission should approve the**
 18 **Proposed Transaction?**

19 A. The Proposed Transaction should be approved because it will result in numerous
 20 benefits for NYSEG and RG&E customers and New York generally.

21 Furthermore, IBERDROLA and Energy East are making commitments that
 22 protect NYSEG and RG&E ratepayers from costs incurred to consummate the

BENEFITS AND PUBLIC INTEREST PANEL

1 Proposed Transaction, including any acquisition premium. As such, the Proposed
2 Transaction is in the public interest.

3 **Q. Is the Proposed Transaction intended to be a merger of two operating entities**
4 **for the realization of savings?**

5 A. No. The Proposed Transaction represents an acquisition by IBERDROLA at the
6 Energy East holding company level, rather than a combination of the operations
7 of individual operating companies. While the Proposed Transaction will not
8 result in the synergistic savings that sometimes accompany mergers where the
9 operations of individual operating companies are combined, New York customers
10 will nonetheless benefit from NYSEG and RG&E becoming part of
11 IBERDROLA.

12 **Q. How will New York benefit from the Proposed Transaction?**

13 A. IBERDROLA is a leading global utility and energy company with a market
14 capitalization of approximately \$70 billion (utilizing an exchange rate of
15 \$1.35/Euro). It has the financial, technological and managerial capabilities, honed
16 by over 100 years of utility experience, to acquire control of Energy East while
17 ensuring that NYSEG and RG&E continue to provide high-quality, safe, and
18 reliable service to their customers. IBERDROLA brings to New York a proven
19 record of providing high-quality electric distribution service and a demonstrated
20 commitment to innovation, infrastructure investment, service quality, efficiency,
21 clean energy policies, and sustainable development. IBERDROLA strives to
22 achieve its business objectives while meeting customer needs, with a focus on

BENEFITS AND PUBLIC INTEREST PANEL

1 security of supply and climate change issues. IBERDROLA's policies and plans
 2 affecting customers, shareholders, and employees are guided by principles of
 3 corporate social responsibility. In addition to IBERDROLA's commitment to
 4 energy efficiency and the environment, IBERDROLA is well-capitalized, has
 5 considerable liquidity, strong credit ratings, and ready access to international as
 6 well as domestic capital markets.

III. DESCRIPTION OF THE JOINT PETITIONERS AND THE PROPOSED TRANSACTION

A. Description of the Joint Petitioners

IBERDROLA

11 Q. What is IBERDROLA's corporate structure and primary business?

12 A. IBERDROLA is a corporation (*Sociedad Anónima*) organized under the Laws of
 13 the Kingdom of Spain whose shares are publicly traded on the Madrid Stock
 14 Exchange. IBERDROLA's principal place of business is located at Calle
 15 Cardenal Gardoqui, 8 48008, Bilbao, Spain. A description of IBERDROLA's key
 16 officers and management personnel is set forth in Exhibit 2 to the Joint Petition
 17 and a copy of its Certificate of Formation is attached to the Joint Petition as
 18 Exhibit 1.

19 Q. What is IBERDROLA's scope and scale of operations?

20 A. IBERDROLA is a global utility that has over 100 years of experience in the
 21 electric and gas business, including experience as a provider of electric
 22 transmission and distribution services. It is one of the largest energy companies

BENEFITS AND PUBLIC INTEREST PANEL

1 in the world with a market capitalization of approximately \$70 billion.

2 IBERDROLA provides services to approximately 22 million electric points of
3 supply and 2 million gas points of supply in Europe and the Americas, including
4 10 million electric points of supply in Spain, 7.7 million in Brazil, 3.4 million in
5 the United Kingdom and approximately 1 million in Guatemala and Bolivia.

6 IBERDROLA is also engaged in the natural gas business in Europe and the
7 Americas, as a gas supplier and developer of gas infrastructure.

8 **Q. Please describe IBERDROLA's natural gas operations.**

9 A. IBERDROLA is engaged in the natural gas business in Europe and the Americas,
10 as a gas supplier and developer of gas infrastructure. In Spain, IBERDROLA
11 supplied 150 bcf of natural gas in 2006, including 20 percent of Spain's liquefied
12 natural gas supplies. IBERDROLA also has significant investments in two
13 Spanish re-gasification plants and in the MEDGAZ pipeline, which transports
14 supplies from Algeria to Spain. IBERDROLA also is the third largest
15 independent operator of natural gas storage in North America, with almost 95 bcf
16 of storage capacity. IBERDROLA has signed long-term supply contracts for 565
17 bcf annually (247 bcf in Spain and 318 bcf in Latin America), allowing
18 IBERDROLA to reduce its exposure to fuel price volatility.

19 **Q. Please describe IBERDROLA's experience in the operation of electric
20 distribution networks.**

21 A. IBERDROLA operates an electric distribution network in Spain with over
22 218,000 kilometers (130,000 miles) of distribution and transmission lines. In

BENEFITS AND PUBLIC INTEREST PANEL

1 2006 alone, IBERDROLA invested over \$675 million in expansion and
2 improvement of its electric distribution networks in Spain. Pursuant to its
3 strategic plan, IBERDROLA focuses on reducing power failure rates, repowering
4 existing lines and using existing rights-of-way to avoid disruption from
5 construction of infrastructure improvements, reducing losses through the
6 installation of capacitor banks, increasing voltage to increase capacity, and
7 updating facilities with state-of-the-art "low-loss" transformers.

8 **Q. Is IBERDROLA currently engaged in utility or non-utility energy business**
9 **activities in the United States?**

10 **A.** IBERDROLA is not currently engaged in any traditionally regulated transmission
11 or distribution utility operations in the United States. However, in April 2007,
12 IBERDROLA completed its acquisition of Scottish Power, plc ("ScottishPower"),
13 expanding its business activities in Europe and the United States. ScottishPower
14 is involved in the generation, transmission, distribution and supply of electricity,
15 as well as the storage and supply of natural gas, in the United Kingdom. Through
16 ScottishPower's subsidiary, PPM Energy, Inc. ("PPM"), IBERDROLA is now
17 engaged in renewable generation, gas storage and associated energy management
18 activities in the United States and Western Canada. Additionally, since May
19 2006, IBERDROLA has acquired three renewable energy companies in the
20 United States (i.e., Community Energy in May 2006; MREC Partners in October
21 2006, and CPV Wind Ventures, LLC in April 2007).

BENEFITS AND PUBLIC INTEREST PANEL

1 **Q. What wind energy assets does IBERDROLA own and/or operate in New**
2 **York State?**

3 A. PPM, through certain subsidiaries, holds a 50 percent interest in Flat Rock
4 Windpower, LLC ("Flat Rock") which owns a 231 MW generating project and Flat
5 Rock Windpower II, LLC ("Flat Rock II"), which owns a 90.75 MW generating
6 project. Each of these projects is interconnected to the Niagara Mohawk Power
7 Corporation transmission system, which is operated by the New York
8 Independent System Operator, Inc. Flat Rock and Flat Rock II are both Exempt
9 Wholesale Generators, and have been authorized by the Federal Energy
10 Regulatory Commission to make sales of electric energy and related products at
11 market-based rates.

12 **Q. What, if any, wind energy projects are being developed by IBERDROLA in**
13 **New York State?**

14 A. A subsidiary of IBERDROLA is currently developing a 110 MW wind energy
15 project in Herkimer County, New York, which is expected to achieve commercial
16 operation in 2008.

17 **Q. Can you describe IBERDROLA's commitment to sustainable development?**

18 A. Sustainable development is the cornerstone of IBERDROLA's strategic plan,
19 which is premised on using technologies that are cleaner, more efficient and
20 environmentally friendly. IBERDROLA has demonstrated its commitment to
21 renewable energy and the environment by developing world-class expertise in
22 delivering sustainable, clean energy. IBERDROLA has followed a strategy of

BENEFITS AND PUBLIC INTEREST PANEL

1 growth in the renewable energy field that reflects IBERDROLA's support for the
2 Kyoto Protocol and the European Union Emissions Trading Directive.

3 **Q. How large is IBERDROLA's portfolio of renewable resources?**

4 A. IBERDROLA owns a diversified portfolio of approximately 40,000 MW of
5 electric generation, including approximately 10,000 MW of hydro power and over
6 6,800 MW of renewable wind generation resources. In 2006 alone, IBERDROLA
7 invested over \$1.32 billion in renewable technologies and has over 40,000 MW of
8 new renewable resources in the pipeline, including over 20,000 MW in the United
9 States.

10 **Q. Has IBERDROLA been recognized for its environmental sustainability**
11 **policies?**

12 A. Yes. IBERDROLA has received international recognition for its environmental
13 policies and performance, including rankings of best in class for both the Electric
14 Utilities Category for environmental behavior by Storebrand Investments and for
15 the global level in the 2006 Climate Leadership Index. Moreover, IBERDROLA
16 has been named a leader in the Worldwide Utilities Category of the Dow Jones
17 Sustainability Index, identified as one of the 50 best companies in climate
18 strategy, and is listed as one of the Global 100 Most Sustainable Corporations in
19 the World and among the top three companies in the Energy & Utilities Sector
20 Category in the Pacific Sustainability Index.

BENEFITS AND PUBLIC INTEREST PANEL

1 **Green Acquisition**

2 **Q. Please describe Green Acquisition.**

3 A. Green Acquisition is a New York corporation and a wholly-owned subsidiary of
4 IBERDROLA that was formed solely for the purpose of merging with and into
5 Energy East in the Proposed Transaction. Its function is to be IBERDROLA's
6 acquisition subsidiary and ultimately, as set forth in the Merger Agreement, it will
7 be merged with and into Energy East. At that time, the separate corporate
8 existence of Green Acquisition will cease and Energy East will be the surviving
9 corporation wholly-owned by IBERDROLA. IBERDROLA will provide Green
10 Acquisition with the financial resources needed to carry out the Proposed
11 Transaction. Green Acquisition's Certificate of Incorporation is attached to the
12 Joint Petition as Exhibit 3.

13 **Energy East**

14 **Q. What is Energy East's corporate structure and primary business?**

15 A. Energy East is a public utility holding company with operations in New York,
16 Connecticut, Massachusetts, Maine, and New Hampshire, serving approximately
17 1.8 million electric customers and 900,000 natural gas customers. Energy East's
18 corporate and administrative offices are located in New Gloucester, Maine and
19 Rochester, New York. Energy East's principal business subsidiaries are engaged
20 in regulated electric transmission, distribution and generation operations in
21 upstate New York and Maine and in regulated natural gas transportation, storage
22 and distribution operations in Connecticut, upstate New York, Maine,

BENEFITS AND PUBLIC INTEREST PANEL

1 Massachusetts, and New Hampshire. Energy East also has two service company
2 affiliates, Energy East Shared Services Corporation and EEMC, that provide back
3 office services to its affiliates, and has a 100 percent indirect ownership interest in
4 several subsidiaries that are not traditional public utilities.

RGS

6 **Q. What is RGS's corporate structure and primary business?**

7 A. RGS is a holding company organized under the laws of State of New York. As
8 we noted earlier in our testimony, RGS is a wholly-owned subsidiary of Energy
9 East. RGS is the intermediate holding company for NYSEG and RG&E. The
10 corporate headquarters of RGS are located in Rochester, New York. RGS's
11 Certificate of Incorporation is attached to the Joint Petition as Exhibit 5.

NYSEG

13 **Q. What is NYSEG's corporate structure and primary business?**

14 A. NYSEG is a regulated public utility engaged in the generation (hydro), purchase,
15 distribution and transmission of electricity, and the purchase, distribution and
16 transportation of natural gas in the central, eastern and western parts of the State
17 of New York. NYSEG has approximately 870,000 electric and 257,000 gas
18 customers. NYSEG's corporate headquarters are located in Rochester, New York
19 and its operations center is located in Binghamton, New York. NYSEG's
20 Certificate of Incorporation, as amended, is attached to the Joint Petition as
21 Exhibit 6.

BENEFITS AND PUBLIC INTEREST PANEL**RG&E**

1 **Q. What is RG&E's corporate structure and primary business?**

2 **A.** RG&E is a regulated public utility engaged principally in the business of
3 generating, purchasing, transmitting and distributing electricity, and purchasing,
4 transporting and distributing natural gas in nine upstate New York counties.
5 RG&E has approximately 359,000 electric and 297,000 gas customers. RG&E's
6 corporate headquarters and operations center are located in Rochester, New York.
7 RG&E's Certificate of Incorporation, as amended, is attached to the Joint Petition
8 as Exhibit 7.

9
10 **B. Description of the Proposed Transaction**

11 **Q. Please describe the Proposed Transaction.**

12 **A.** Pursuant to the Merger Agreement, IBERDROLA will acquire 100 percent of the
13 common stock of Energy East and the shareholders of Energy East will receive, in
14 consideration for their shares, \$28.50 in cash per share. The total consideration
15 that Iberdrola will pay to Energy East shareholders, based upon the number of
16 Energy East shares outstanding of approximately 158 million as of June 25, 2007,
17 is approximately \$4.5 billion. As noted earlier in our testimony, the Proposed
18 Transaction will be implemented by means of the merger of Green Acquisition
19 with and into Energy East, with Energy East as the surviving corporation that will
20 be a wholly owned subsidiary of IBERDROLA.

BENEFITS AND PUBLIC INTEREST PANEL

1 **Q. Does the Joint Petition contain exhibits illustrating the corporate**
2 **organizational effects of the Proposed Transaction?**

3 A. Yes. The current corporate organizational chart for Energy East, including the
4 New York utility subsidiaries of Energy East (*i.e.*, NYSEG and RG&E), is
5 attached to the Joint Petition as Exhibit 9. Exhibit 10 of the Joint Petition
6 contains the corporate organizational charts of IBERDROLA both prior to and
7 after the Proposed Transaction.

8 **Q. How will IBERDROLA finance the Proposed Transaction?**

9 A. On June 27, 2007, IBERDROLA sold 85 million new shares of common stock
10 through an accelerated private placement that was fully subscribed, providing
11 IBERDROLA with approximately \$4.5 billion for Green Acquisition to proceed
12 with the Proposed Transaction. Thus, the cash consideration payable to Energy
13 East shareholders has already been financed through the proceeds of the capital
14 issuance realized through this single equity placement, and will not result in any
15 new debt for Iberdrola, Energy East or their subsidiaries. This deal structure
16 allows IBERDROLA to maintain a solid financial position, and eliminates the
17 need for any financing contingency that needs to be satisfied prior to the closing
18 of the Proposed Transaction.

BENEFITS AND PUBLIC INTEREST PANEL

IV. PUBLIC INTEREST DEMONSTRATION

Energy East and its Utility Subsidiaries Will Benefit from IBERDROLA's Utility Expertise

1
2
3
4 **Q. You mentioned earlier in your testimony that the Proposed Transaction**
5 **represents an acquisition by IBERDROLA at the Energy East holding**
6 **company level rather than a combination of the operations of individual**
7 **operating companies that would result in synergistic savings. As that is the**
8 **case, what benefits will Energy East and its subsidiaries obtain from the**
9 **Proposed Transaction?**

10 **A. Energy East and its utility subsidiaries will obtain benefits from IBERDROLA's**
11 **global utility and other energy expertise and managerial talent. As we indicated**
12 **earlier in our testimony, IBERDROLA, through its affiliates, is a world leader**
13 **with a proven record of providing high-quality electric distribution service. It is**
14 **one of the world's largest energy companies, with approximately 22 million**
15 **electric points of supply and 2 million gas points of supply. For over 100 years,**
16 **IBERDROLA has provided high-quality, environmentally friendly utility service.**

17 **IBERDROLA has received numerous awards for corporate excellence,**
18 **leadership and achievement, including having been recognized in 2006 as Energy**
19 **Company of the Year by Platts Global Energy Awards. IBERDROLA has also**
20 **been named a leader in the Worldwide Utilities Category of the Dow Jones**
21 **Sustainability Index, identified as one of the 50 best companies in climate strategy**
22 **and listed in the Global 100 Most Sustainable Corporations in the World. In**

BENEFITS AND PUBLIC INTEREST PANEL

1 addition, IBERDROLA's Chairman and CEO, Ignacio Sanchez Galán, has been
 2 repeatedly recognized as a top energy executive. IBERDROLA's CFO, José
 3 Sáinz Armada, repeatedly has been named one of Europe's Best CFOs and
 4 IBERDROLA's Ignacio Cuenca has been recognized as Best Investor Relations
 5 Professional by Institutional Investor Research Group.

Energy East and Its Utility Subsidiaries Will Benefit From IBERDROLA's

Commitment to Energy Efficiency and the Environment

8 **Q. Will IBERDROLA's commitment to energy efficiency and the environment**
 9 **provide any benefits to New York?**

10 A. Yes. As we described earlier in our testimony, sustainable development is the
 11 cornerstone of IBERDROLA's strategic plan, which is premised on using
 12 technologies that are cleaner, more efficient and environmentally friendly.
 13 IBERDROLA has demonstrated its commitment to renewable energy and the
 14 environment by developing world-class expertise in delivering sustainable, clean
 15 energy and its significant engineering and construction resources allow it to
 16 utilize new energy efficiency and environmental technologies.

17 **Q. Please explain how IBERDROLA's commitment to energy efficiency and the**
 18 **environment will benefit New York.**

19 A. IBERDROLA is committed to encouraging Energy East's efforts to implement
 20 energy efficiency initiatives and to invest in new utility technology.
 21 IBERDROLA has a strong commitment to demand side management and other
 22 conservation efforts, such as NYSEG's and RG&E's Advanced Metering

BENEFITS AND PUBLIC INTEREST PANEL

1 Infrastructure plan. In addition, New York will benefit from certain current
2 IBERDROLA practices. For example, IBERDROLA: (1) distributes guides for
3 energy efficiency to more than 1.5 million customers; (2) promotes energy
4 efficient and electronically regulated air conditioning and heating devices;
5 (3) provides advice on energy conservation and efficiency, printed on the back of
6 the bill and forwarded to more than 9 million customers; (4) utilizes time-
7 differentiated rates; and (5) supports industrial customers and government entities
8 through energy audits to help them to achieve a better energy efficiency. Energy
9 East, NYSEG and RG&E will benefit from IBERDROLA's experience regarding
10 the implementation of renewable energy and environmental programs.

11 **Q. In what other ways will Energy East benefit from IBERDROLA's**
12 **environmental focus?**

13 **A. IBERDROLA has implemented an Environmental Policy, which includes Basic**
14 **Action Principles that allow it to attain the most demanding objectives of**
15 **European environmental policy. IBERDROLA also has established Ten**
16 **Guidelines for Corporate Responsibility.**

17 In addition, the Joint Petitioners also commit to having NYSEG and RG&E
18 cooperate with the newly formed Climate Change Office in the New York State
19 Department of Environmental Conservation, which will oversee implementation
20 of the Regional Greenhouse Gas Initiative. IBERDROLA will bring an
21 invaluable global as well as a regional and local perspective to these critical
22 environmental issues.

BENEFITS AND PUBLIC INTEREST PANEL

1 **Q. Is IBERDROLA's commitment to the environment consistent with New**
2 **York's stated policies?**

3 **A. Yes, IBERDROLA's commitments to energy efficiency, demand side**
4 **management and other conservation efforts are consistent with Governor Spitzer's**
5 **proposal to reduce demand for power by 15 percent from forecasted levels by**
6 **2015 (i.e., the "15 by 15" energy policy). As a global leader in environmentally**
7 **friendly programs, IBERDROLA also understands that renewable energy and**
8 **environmental efficiency are two of the best ways to reduce dependence on fossil**
9 **energy and to fight global warming. IBERDROLA is committed to facilitating**
10 **Energy East's efforts to implement energy efficiency initiatives and to invest in**
11 **new technology. IBERDROLA's commitment to programs that reduce customer**
12 **demand in general and peak consumption in particular, a key goal of the State of**
13 **New York's energy policy, make it a unique and valuable partner to assist**
14 **NYSEG and RG&E in their development and implementation of environmentally**
15 **friendly policies and initiatives.**

16 **Q. Are there any other aspects of IBERDROLA's environmental focus that**
17 **would provide benefits to New York?**

18 **A. Yes. As part of IBERDOLA's commitment to the environment, IBERDROLA is**
19 **the largest producer of wind energy in the world, with over 6,800 MW of wind**
20 **capacity. In 2006 alone, IBERDROLA invested over \$1.32 billion in renewable**
21 **technologies and has over 40,000 MW of new renewable resources in the**
22 **pipeline, including over 20,000 MW in the United States. IBERDROLA would**

BENEFITS AND PUBLIC INTEREST PANEL

1 be willing to explore how its expertise, capacity and resources to develop
2 renewable generation could assist the State in meeting its energy goals.
3 IBERDROLA's strategic plans are, therefore, consistent with the State's energy
4 policies.

5 **A. The Proposed Transaction Allows NYSEG and RG&E to be Part of a**
6 **Financially Strong Company System**

7 **Q. Please describe IBERDROLA's financial strength.**

8 A. IBERDROLA is one of the largest energy companies in the world. It currently
9 has a market capitalization approximately \$70 billion. Standard and Poor's has
10 awarded IBERDROLA an "A" level rating for its long-term credit, thus
11 recognizing IBERDROLA's strength and the stability of its financial results.
12 IBERDROLA's financial strength was demonstrated following the announcement
13 of the Proposed Transaction, when IBERDROLA issued 85 million new shares of
14 common stock through an accelerated private placement that was fully
15 subscribed. Thus, the capital markets have already provided IBERDROLA with
16 approximately \$4.5 billion for the Proposed Transaction and demonstrated
17 IBERDROLA's capacity and ability to raise financial resources.

18 **Q. Will IBERDROLA's financially strong position provide any additional**
19 **benefits to Energy East?**

20 A. Yes. The Proposed Transaction will provide Energy East (and thus RG&E and
21 NYSEG) with greater access to both U.S. and global financial markets than they
22 would have in the absence of the Proposed Transaction. IBERDROLA's ability

BENEFITS AND PUBLIC INTEREST PANEL

1 to quickly sell 85 million new shares of common stock through a fully-subscribed
2 accelerated private placement shows how access to capital can be a benefit of
3 IBERDROLA's financial strength. By providing enhanced access to capital, the
4 Proposed Transaction will allow NYSEG and RG&E to continue to provide high-
5 quality, safe and reliable service.

6 **B. IBERDROLA is Committed to Excellence in Customer Service and**
7 **Reliability**

8 **Q. What impact will the Proposed Transaction have on customer service and**
9 **reliability?**

10 **A. IBERDROLA has demonstrated through its global operations its competence and**
11 **commitment in providing high-quality service and ensuring the delivery of safe**
12 **and reliable energy supply. IBERDROLA understands the need to invest in**
13 **infrastructure to support the goal of enhanced reliability. From 2005 to the end of**
14 **2007, IBERDROLA will have made capital investments of approximately \$4**
15 **billion in transmission and distribution facilities globally, demonstrating its**
16 **commitment to investing in improvements that promote a secure and reliable**
17 **energy infrastructure.**

18 IBERDROLA has maintained its focus on improving service quality for its
19 approximately 22 million electric points of supply and 2 million gas points of
20 supply around the world through development and improvement of its energy
21 infrastructure. For example, with respect to standard measures of service
22 interruption, IBERDROLA's focus on operational excellence is evident in its

BENEFITS AND PUBLIC INTEREST PANEL

1 superior performance as measured by the Customer Average Interruption
 2 Duration Index ("CAIDI") and the System Average Interruption Frequency Index
 3 ("SAIFI"). Relative to U.S. benchmarks, IBERDROLA over the last 3 years has
 4 delivered results that would rank in either the first or second quartile of U.S.
 5 utilities. IBERDROLA's CAIDI of 1.70 hours for operations in Spain and the
 6 United Kingdom would rank near the top of the second quartile. The SAIFI
 7 performance of 1.16 average interruptions for operations in Spain and the United
 8 Kingdom is in the first quartile performance of U.S. utilities.

9 **Q. Will the Proposed Transaction change NYSEG's or RG&E's proposed**
 10 **infrastructure projects?**

11 A. No. IBERDROLA seeks no changes to the planned transmission and distribution
 12 improvements being undertaken by NYSEG and RG&E. With respect to new
 13 infrastructure projects, the Proposed Transaction will provide NYSEG and RG&E
 14 with additional financial stability and a greater ability to access to capital.

15 **C. The Proposed Transaction Will Have No Adverse Impact on New York**
 16 **Ratepayers**

17 **Q. Are the Joint Petitioners making commitments regarding the recovery of**
 18 **transaction costs and the acquisition premium associated with the Proposed**
 19 **Transaction?**

20 A. Yes. The Joint Petitioners commit not to seek recovery of costs incurred to
 21 consummate the Proposed Transaction from New York ratepayers. In addition,
 22 the premium paid for Energy East common stock resulting from the Proposed

BENEFITS AND PUBLIC INTEREST PANEL

1 Transaction will remain on the books of IBERDROLA and its wholly-owned
2 affiliates, and will not be recorded on the books of any of the companies acquired,
3 including Energy East, RGS, RG&E, and NYSEG. To be clear, the Joint
4 Petitioners will not seek recovery of any acquisition premium associated with the
5 Proposed Transaction in rates from New York ratepayers.

6 **Q. Will the Proposed Transaction have any impact on the regulatory cost**
7 **accounting and allocation methods that NYSEG and RG&E currently use?**

8 A. No. There are no plans to modify the existing regulatory cost accounting and
9 allocation methods and reporting system utilized today for NYSEG and RG&E.

10 **Q. Will the Proposed Transaction impair access by the New York State**
11 **Department of Public Service Staff to the books and records of NYSEG and**
12 **RG&E?**

13 A. No. Neither the location of, nor Staff's access to, the books and records of
14 NYSEG and RG&E will change in connection with the Proposed Transaction.

15 **Q. Are there any anticipated changes to rates or services provided to customers**
16 **as a result of the Proposed Transaction?**

17 A. No. The Petitioners are not seeking to modify the existing rate plans of NYSEG
18 and RG&E as part of the Proposed Transaction. Customers will also continue to
19 be able to interact with their respective utility at its existing corporate
20 headquarters and operations centers, the locations of which will not change in
21 connection with the Proposed Transaction. In addition, no utility company
22 operations, plant, equipment, franchises, permits, or other assets of RG&E or

BENEFITS AND PUBLIC INTEREST PANEL

1 NYSEG will change or be transferred in connection with the Proposed
2 Transaction. No restructuring that could result in any transfer of franchises, assets
3 or permits would occur without first seeking any necessary Commission approval
4 under Section 70.

5 **Q. Will the Proposed Transaction adversely impact New York communities?**

6 A. IBERDROLA is committed to the local communities it serves. IBERDROLA
7 will not seek any reductions in any community activities, charitable benefits or
8 other initiatives in which RG&E and NYSEG are currently involved.

9 **D. The Proposed Transaction Will Not Enhance the Ability to Exercise Market**
10 **Power in New York**

11 **Q. Will the Proposed Transaction have any adverse impact with respect to the**
12 **exercise of market power in New York?**

13 A. No. As demonstrated in the affidavit of William H. Hieronymus that is attached
14 to the Joint Petition and that was submitted to FERC in connection with the
15 Proposed Transaction, the Proposed Transaction will have no adverse impact with
16 respect to market power in New York. As Dr. Hieronymus explains, the Joint
17 Petitioners' combined share of NYISO installed capacity is well below 5 percent,
18 and the combination of these shares clearly has an immaterial effect on market
19 concentration.

20 **Q. Does this complete your direct testimony at this time?**

21 A. Yes, it does.

1 MR. FITZGERALD: Let the record reflect that a copy
2 is being provided to the Judge and to the reporter.

3 Q. And did you have, panel, any exhibits to your direct
4 testimony of benefits, particularly Exhibits 1 through 3
5 and 5 through 10?

6 A. (Mr. Rude) Yes.

7 A. (Mr. Laurito) Yes.

8 A. (Mr. Azagra) Yes.

9 Q. Were those exhibits prepared by you, under your direction
10 or supervision?

11 A. (Mr. Rude) Yes.

12 A. (Mr. Laurito) Yes.

13 A. (Mr. Azagra) Yes.

14 MR. FITZGERALD: Your Honor, because the exhibits
15 were attached to the Joint Petition that was filed, we
16 would ask, for efficiency, that we would mark those as a
17 single exhibit.

18 JUDGE EPSTEIN: Yes. Actually, I think what we
19 should do, if I'm understanding you correctly, is take
20 the entire Joint Petition as well as the 19 Tabs that
21 were attached to it and mark it as Number 41.

22 MR. FITZGERALD: We have no objection to that, your
23 Honor.

24 JUDGE EPSTEIN: Okay. Do you have a copy of that

1 for the reporter?

2 MR. FITZGERALD: Yes, your Honor, we do.

3 JUDGE EPSTEIN: Okay.

4 MR. FITZGERALD: Your Honor, while that's being
5 provided, may I continue with the panel?

6 JUDGE EPSTEIN: Yes.

7 MR. FITZGERALD: Thank you.

8 Q. Panel, do you have before you the 78-page document --

9 (Interruption of proceeding.)

10 (Exhibit Number 41 one was marked for

11 identification.)

12 BY MR. FITZGERALD:

13 Q. Panel, I think that we were blocked by some noise. I'll
14 start over with that again. Do you have a 78-page document,
15 question and answer format, entitled, "The Rebuttal Testimony,
16 Joint Petitioners' Policy Panel," dated January 31, 2008?

17 A. (Mr. Laurito) Yes.

18 A. (Mr. Rude) Yes.

19 A. (Mr. Azagra) Yes.

20 Q. Was that document prepared by you or under your
21 direction?

22 A. (Mr. Laurito) Yes.

23 A. (Mr. Rude) Yes.

24 A. (Mr. Azagra) Yes.

1 Q. I understand you have some changes or corrections to your
2 rebuttal testimony; is that correct?

3 A. (Mr. Azagra) Yes.

4 Q. Mr. Azagra, could you read those into the record for us
5 today?

6 A. On page 7, line 21, after the words "credit ratings," we
7 should include or insert "as compared to Energy East." And in
8 line 23 of the same page, we should delete the words "with an"
9 and insert instead "given Energy East's." And we should add an S
10 at the end of the word "rating." In page 10, line 5, we should
11 add a P as in pole after what it says, and we are missing the P
12 of the Standard & Poor's. The P in Poor's is missing there. On
13 page 49, line 6, we should delete the word "cost" and insert the
14 word "cash." And that's all.

15 Q. Thank you.

16 JUDGE EPSTEIN: Mr. FitzGerald, I'm sorry. I need a
17 copy of the rebuttal, if you have it.

18 MR. FITZGERALD: Certainly, your Honor. Let the
19 record reflect that a corrected copy of the Joint
20 Petitioners' Policy Panel rebuttal testimony was provided
21 to the reporter and to the Judge.

22 Q. Panel, if I were to ask you the questions set forth in
23 your rebuttal testimony, would your answers be the same as set
24 forth in your testimony as corrected?

1 A. (Mr. Laurito) Yes.

2 A. (Mr. Rude) Yes.

3 A. (Mr. Azagra) Yes.

4 Q. Do you adopt this testimony as your sworn rebuttal
5 testimony in this proceeding?

6 A. (Mr. Laurito) Yes.

7 A. (Mr. Rude) Yes.

8 A. (Mr. Azagra) Yes.

9 MR. FITZGERALD: Your Honor, may we have the
10 rebuttal testimony as Joint Petitioners' Policy Panel as
11 corrected copied into the record as if given orally?

12 JUDGE EPSTEIN: Yes.

13 (The following is the prefiled rebuttal testimony of
14 the joint petitioners' policy panel:)

15

16

17

18

19

20

21

22

23

24

JOINT PETITIONERS' POLICY PANEL**I. INTRODUCTION**

1

2 Q. Please state the names of the members of this Policy Panel for the record.

3 A. Our names are Pedro Azagra Blazquez, James P. Laurito and Robert E. Rude.

4 Q. Are you the same Pedro Azagra Blazquez, James P. Laurito and Robert E. Rude
5 who submitted Direct Testimony in this proceeding on August 1, 2007 (the "Joint
6 Petitioners' Direct Testimony")?

7 A. Yes.

8 Q. Have your positions or business addresses changed since the Joint Petitioners'
9 Direct Testimony was submitted?

10 A. No, they have not.

11 Q. What is the overall purpose of your testimony?

12 A. The purpose of this testimony is to respond to portions of the direct testimony of
13 the Department of Public Service Staff ("Staff") Policy Panel ("Staff Policy
14 Panel"), which is comprised of the testimony of Thomas A. D'Ambrosia, Patrick
15 J. Barry, Maynard Bowman, Michael Salony and Stephen A. Berger. Other
16 witnesses also rebut portions of the Staff Policy Panel on behalf of the Joint
17 Petitioners, including Steven Fetter, William Hieronymus, Eugene Meehan, Jeff
18 Makhholm and the Rate Adjustment Panel. We refer to those witnesses as
19 appropriate. In the time available since receipt of the Staff Policy Panel's 317
20 pages of testimony and an even greater volume of accompanying exhibits, we
21 have attempted to be as thorough as time permits in our review of that proposed
22 evidence for matters requiring response. It is possible, however, that one or more

JOINT PETITIONERS' POLICY PANEL

1 such matters may have escaped our notice. Accordingly, to the extent that a
2 particular matter raised in the testimony or exhibits of the Staff Policy Panel is not
3 expressly accepted or rebutted herein, any such matter is rejected by this Panel.

4 In addition, we respond to testimony filed by various intervenors.

5 Q. Mr. Azagra, please identify those areas of testimony for which you have primary
6 responsibility.

7 A. While we are collectively sponsoring this Panel testimony with respect to the
8 proposed transaction, my primary areas of responsibility are issues relating to: (1)
9 the benefits of the proposed transaction; (2) the matters raised by the Staff Policy
10 Panel regarding the U.S. Production Tax Credit ("PTC"), Spanish tax issues, and
11 alleged benefits to current employees, stakeholders and others; and (3) the
12 reporting, financial and affiliate risks identified by the Staff Policy Panel. Both
13 Mr. Rude and I address issues relating to (1) the consolidation of information
14 technology ("IT") systems, and (2) goodwill. Mr. Rude and Mr. Laurito will
15 address the remainder of the Panel's rebuttal to the testimony of the Staff Policy
16 Panel and intervenors.

17 Q. Does the Panel testimony address Staff's responses to information requests
18 submitted by the Joint Petitioners that are related to the Staff Policy Panel's direct
19 testimony?

20 A. Yes. We have reviewed several such responses by Staff and have specifically
21 addressed some of the responses in our rebuttal testimony. However, additional
22 analysis will be required as there was insufficient time to complete our review of
23 these responses in the time provided to submit this Panel testimony. We further

JOINT PETITIONERS' POLICY PANEL

1 note that in certain responses, Staff has indicated that it intends to revise certain
2 exhibits and we reserve the right to modify this Panel testimony at hearing to
3 address any changes to Staff's exhibits.

4 Q. Is this Panel sponsoring any exhibits?

5 A. Yes. Exhibit __ (JPP-1) contains a copy of the interrogatory responses and
6 workpapers referenced in this Panel's testimony. Exhibit __ (JPP-2) is a
7 transcript from former Chairwoman (and current Commissioner) Acampora's
8 November 13, 2007 remarks to Lehman Brothers. Exhibit __ (JPP-3) consists of
9 an S&P report showing removal of "Watch Negative" and replacing it with a
10 "Stable" outlook for Iberdrola, S.A. ("Iberdrola"). Exhibit __ (JPP-4) consists of
11 a Moody's report showing "Stable" outlook and "A3" rating for Iberdrola.
12 Exhibit __ (JPP-5) demonstrates that Iberdrola's gross and net operating profits
13 were up well over 20% in the first nine months of 2007 as compared to the same
14 period of the previous year. Exhibit __ (JPP-6) includes a stock price
15 comparison. Exhibit __ (JPP-7) is a U.S. Securities and Exchange Commission
16 ("SEC") issuance regarding financial reporting requirements. Exhibit __ (JPP-8)
17 is the Synergy Appendix A from the Joint Proposal in Case No. 01-M-0404 –
18 Energy East/RGS Merger.

II. EXECUTIVE SUMMARY

19
20 Q. Please summarize your testimony.

21 A. The acquisition of Energy East Corporation ("Energy East") by Iberdrola
22 ("Proposed Transaction") presents New York with a unique opportunity to

JOINT PETITIONERS' POLICY PANEL

1 advance the State's energy and economic development policies. Iberdrola not
2 only possesses immense financial strength (including credit ratings significantly
3 higher than that of Energy East) but also global utility expertise, a demonstrated
4 commitment to service quality, sustainable development and infrastructure
5 investment, and expertise as the largest producer of renewable wind energy in the
6 world. These attributes uniquely position Iberdrola to assist the State in meeting
7 its Renewable Portfolio Standard and the Governor's "15 by 15" clean energy
8 goal. Consummation of the Proposed Transaction will benefit New York by
9 advancing the State's renewable energy policies, a fact recognized by several
10 intervenors. In addition, the Proposed Transaction supports economic
11 development by maintaining existing utility jobs in upstate New York while
12 ensuring that New York ratepayers will bear none of the costs associated with the
13 Proposed Transaction.

14 Despite the benefits of the Proposed Transaction and a lack of public
15 opposition, Staff treats the Proposed Transaction as if it were a repeat of the
16 National Grid/KeySpan merger. As explained by the Rebuttal Testimony of Mr.
17 Meehan in further detail, the Proposed Transaction is significantly different than
18 many of the transactions that have been presented to the Commission, including
19 the National Grid/KeySpan merger. Rather, in many important respects, the
20 Proposed Transaction is similar to certain other "first mover" transactions in the
21 State. A comparison of the Iberdrola/Energy East merger to transactions that
22 involved a combination of operating companies or other potential synergies, is
23 therefore inappropriate. As Dr. Makholm explains in his testimony, Staff also

JOINT PETITIONERS' POLICY PANEL

1 mischaracterizes the Proposed Transaction as it relates to the public interest
2 standard in New York.

3 Staff inappropriately seeks to modify existing rate plans and orders in this
4 Section 70 merger proceeding. This proceeding should not be turned into a rate
5 case, and Staff's rate case issues are more appropriately addressed in a subsequent
6 rate proceeding designed to deal with those matters. As discussed in detail in the
7 Rate Adjustment Panel testimony, Staff's proposal to impose onerous conditions
8 on the Proposed Transaction, including write-offs, reserve increases, earnings
9 sharing changes, and rate plan modifications, is inequitable and inadvisable,
10 particularly in light of the many and substantial positive impacts of the Proposed
11 Transaction on NYSEG and RG&E customers and the State as a whole. Staff's
12 proposed rate plan modifications are inappropriate and, in the event they are
13 nonetheless deemed relevant to the proceeding, they suffer from serious flaws.
14 While the Joint Petitioners' Rate Adjustment Panel rebuts Staff's calculations
15 regarding various Proposed adjustments to rates, the focus of this proceeding is
16 and must remain on the Proposed Transaction, not on issues that should be raised,
17 if at all, by Staff in future rate proceedings.

18 Staff also alleges various theoretical risks and speculates about potential
19 harms, including imagined vertical market power concerns and a non-existent
20 negative reaction by the credit rating agencies to the merger. Dr. Hieronymus
21 testifies that the Proposed Transaction does not raise vertical or horizontal market
22 power concerns. Dr. Makhholm and Mr. Fetter demonstrate that Staff's concerns
23 about credit quality are misplaced.

JOINT PETITIONERS' POLICY PANEL

1 At their core, Staff's positions themselves do not appear to be consistent
2 with the public interest. They reflect a strong aversion to large holding companies
3 and the emerging global nature of the utility business (in particular, gas and
4 electric utilities), despite the fact that a number of New York utilities already are
5 owned by non-U.S. entities. Staff's concerns are not shared by other
6 governmental and regulatory bodies that have jurisdiction over the Proposed
7 Transaction, including other states and federal agencies that have approved the
8 Proposed Transaction (Connecticut, Maine, New Hampshire, and the Federal
9 Energy Regulatory Commission) and other New York State and public interest
10 organizations that have intervened in this proceeding (*e.g.*, New York State
11 Department of Environmental Conservation, Empire State Development, Greater
12 Rochester Enterprise, and the Natural Resources Defense Council).

13 **III. BENEFITS OF THE PROPOSED TRANSACTION**

14 Q. Mr. Azagra, the testimony submitted by Staff, as well as certain other intervenors
15 in this proceeding, suggests there are no benefits associated with the Proposed
16 Transaction (*see, e.g.*, Staff Policy Panel at 16-17). Can you summarize the
17 benefits New York customers will realize from the Proposed Transaction?

18 A. As I explained in the Joint Petitioners' Direct Testimony, it is true that the
19 Proposed Transaction does not provide immediate, measurable benefits in the
20 form of merger synergies because the Proposed Transaction is an upstream
21 transfer of control rather than a consolidation of operating companies. Since
22 Iberdrola does not have any other regulated utility interests in the region or

JOINT PETITIONERS' POLICY PANEL

1 elsewhere in the U.S. (*i.e.*, this is a “first mover” transaction), the Proposed
 2 Transaction is not anticipated to result in any tangible and quantifiable synergistic
 3 benefits.

4 Q. Although the Proposed Transaction will not result in any synergy savings, will the
 5 Proposed Transaction nonetheless provide benefits to the State of New York?

6 A. Yes. The Proposed Transaction will benefit customers of NYSEG and RG&E, as
 7 well as the economy of the State of New York, in several important respects.

8 These benefits are sufficient to satisfy the public interest standard, in particular
 9 given that the Proposed Transaction does not raise any of the potential risks that
 10 the Commission has been faced with in other transactions. Specifically:

- 11 • Financial Stability – Customers of NYSEG and RG&E will benefit from
 12 Iberdrola’s financial stability. Iberdrola’s market capitalization is
 13 approximately \$67 billion (utilizing a currency exchange rate of
 14 \$1.35/Euro), and Iberdrola has long-term “A” category credit ratings that
 15 are and have been higher than the credit ratings of Energy East. NYSEG
 16 and RG&E will obtain the financial stability and other benefits associated
 17 with becoming subsidiaries of a well-capitalized, multi-national, widely
 18 diversified energy holding company with a higher credit rating. For
 19 example, assuming no changes in market conditions, it is likely that the
 20 borrowing costs for NYSEG and RG&E should be lower as subsidiaries of
 21 Iberdrola (with 1-3 notches higher “A” category credit ratings) ^{as compared to} than the ^{Energy} ^{East}
 22 borrowing costs would be if NYSEG and RG&E did not become affiliates
 23 of Iberdrola (^{given Energy East’s} ~~with a~~ lower “BBB” level credit rating). The financial

JOINT PETITIONERS' POLICY PANEL

1 strength and stability associated with NYSEG and RG&E becoming
2 subsidiaries of an "A" category rated company and the associated benefits
3 to New York customers are discussed further below.

- 4 • Global Energy Experience and Best Practices – Customers of NYSEG and
5 RG&E will benefit from Iberdrola's extensive global utility expertise,
6 which the Commission has recognized as a benefit in water utility "first
7 mover" transactions within the State. Iberdrola has been in the utility
8 business for 100 years and is a world leader with high-quality, reliable and
9 environmentally friendly electric distribution service to 22 million electric
10 points of supply and 2 million gas points of supply in Europe and the
11 Americas. Iberdrola is committed to sharing information about best
12 practices among its operating utility subsidiaries, including NYSEG and
13 RG&E. As discussed further below, such sharing of information has
14 produced benefits for other utility subsidiaries acquired by Iberdrola.
- 15 • Focus on Renewable Development and the Environment – Customers of
16 NYSEG and RG&E, as well as the State of New York, will benefit from
17 Iberdrola's significant presence in New York because of Iberdrola's
18 corporate philosophy, which incorporates a significant focus on energy
19 efficiency, clean technology and the environment. Iberdrola is the world's
20 leading producer of electricity from wind energy, with approximately
21 7,000 MW of wind capacity installed, and nearly 50% of Iberdrola's
22 approximately 41,000 MW of total installed capacity is emissions-free. A
23 number of states in the U.S. recognize the environmental benefits of

JOINT PETITIONERS' POLICY PANEL

1 renewable resources as well as the economic benefits that communities
2 derive from the development of such resources, and there is competition
3 among the states in terms of attracting investment in wind projects within
4 their borders. Iberdrola is willing to work with the State of New York to
5 further the State's renewable energy goals, including meeting its
6 aggressive RPS goals. Iberdrola has substantial expertise, capacity and
7 resources at its disposal, and is uniquely positioned to assist the State in
8 meeting these goals.

- 9 • Economic Development and Jobs – The Proposed Transaction will
10 reinforce ongoing efforts to maintain and revitalize the economy of upstate
11 New York. While many horizontal utility mergers and acquisitions
12 eliminate jobs, the Proposed Transaction includes no job reduction
13 proposal, which helps to sustain economic development in the State of
14 New York. Moreover, under the Agreement and Plan of Merger between
15 Iberdrola and Energy East, employee compensation and benefits will
16 remain substantially unchanged for a period of at least 18 months after the
17 Proposed Transaction becomes effective. These aspects of the Proposed
18 Transaction should be viewed as providing benefits to upstate New York.

19 A. Benefits of Iberdrola's Financial Strength

20 Q. Mr. Azagra, please explain how Iberdrola's financial strength can be expected to
21 benefit customers of NYSEG and RG&E.

22 A. Customers of NYSEG and RG&E should realize a variety of benefits from the
23 Proposed Transaction because Iberdrola is a larger, stronger holding company

JOINT PETITIONERS' POLICY PANEL

1 than Energy East. As I have previously explained, Iberdrola is a \$67 billion
2 company and is currently rated "A3" by Moody's and "A-" by S&P, both with
3 stable outlooks. Iberdrola is currently rated "A" by Fitch with a negative outlook.
4 By contrast, Energy East is rated "BBB" by Fitch, "Baa2" by Moody's and
5 "BBB+" by S&P, all with negative outlooks. The Proposed Transaction should
6 provide NYSEG and RG&E with greater access to capital at a lower cost than
7 they would have on a stand-alone basis as subsidiaries of Energy East, thereby
8 allowing NYSEG and RG&E to continue providing high-quality, safe, and
9 reliable service.

10 As I explained in the Joint Petitioners' Direct Testimony, Iberdrola's
11 successful issuance of \$4.5 billion of equity to fund the acquisition of Energy East
12 is a good example of Iberdrola's level of access to the capital markets.
13 Iberdrola's issuance of equity to fund the Proposed Transaction protects
14 ratepayers from the risks of debt financing utilized in other transactions, such as
15 the risks that former Chairwoman (and current Commissioner) Acampora recently
16 explained accompanied the financing of the National Grid/KeySpan merger (*e.g.*,
17 negative credit rating differential and use of debt financing). See Exhibit __ (JPP-
18 2). From the perspective of stable commercial dealings and cost of credit, it will
19 be more favorable for NYSEG and RG&E to be subsidiaries of Iberdrola than
20 Energy East (which has a lower credit rating and a negative outlook from all three
21 ratings agencies, as compared to Iberdrola).

22 Q. The Staff Policy Panel has suggested that Iberdrola's financial strength "is of no
23 consequence to the New York utilities" (at 62). Can you describe more

JOINT PETITIONERS' POLICY PANEL

1 specifically the benefits to NYSEG and RG&E that could be realized due to
2 Iberdrola's higher credit ratings?

3 A. The credit rating of a parent company can affect the credit rating of its
4 subsidiaries. Therefore, while it is not possible to quantify with precision the
5 direct benefits associated with Iberdrola's stronger credit rating, it is reasonable to
6 assume that the cost of debt capital for NYSEG and RG&E should be lower if
7 they are subsidiaries of Iberdrola given that Iberdrola maintains a stronger credit
8 rating than Energy East. For example, it is my understanding that S&P has a
9 consolidated ratings approach. As such, the ratings for NYSEG and RG&E are
10 currently linked to those of Energy East. Correspondingly, after the Proposed
11 Transaction occurs, S&P may also consolidate Energy East's rating with that of
12 its new parent, Iberdrola, thereby also enhancing the view of NYSEG and RG&E
13 by the applicable credit rating agencies, and providing even greater financial
14 stability to NYSEG and RG&E. There are generally known basis point spreads
15 associated with different credit ratings, and, over time, the differential between
16 Iberdrola and Energy East's credit ratings may translate into measurable cost
17 savings for NYSEG and RG&E's respective regulated services, assuming other
18 factors remain constant. The differential between Iberdrola's and Energy East's
19 respective credit ratings could result in a measurable reduction in NYSEG's and
20 RG&E's capital costs, and thereby provide a direct benefit to their ratepayers.

JOINT PETITIONERS' POLICY PANEL

1 Q. What impacts do the recent events in the global capital markets have on your
2 conclusion that Iberdrola's higher credit rating will provide benefits to NYSEG
3 and RG&E?

4 A. These recent events make it even more difficult for lower-rated companies, such
5 as Energy East, NYSEG and RG&E, to raise debt and equity on favorable terms.
6 Iberdrola's stronger "A" category credit ratings is therefore even more significant
7 in terms of providing superior access to the capital markets. This is demonstrated
8 by the increase in average basis point spreads on bonds for "BBB" rated utility
9 companies to approximately 205 basis points from 103 basis points one year ago.
10 The spread of "A" rated utilities has widened to a much lesser extent.
11 Additionally, the difference in spreads between "A" and "BBB" rated companies
12 has increased from 17 basis points to 35 basis points for the same period. Thus,
13 today's volatile capital markets create an even greater opportunity for NYSEG
14 and RG&E ratepayers to benefit from Iberdrola's stronger "A" category credit
15 ratings.

16 Q. The Staff Policy Panel points out that Iberdrola was recently downgraded by S&P
17 and Moody's (at 62). Can you address this issue?

18 A. Iberdrola was recently downgraded by S&P from "A" to "A-," and placed on
19 negative watch pending the completion of the initial public offering of 20% of the
20 equity of Iberdrola Renovables, S.A. ("Iberdrola Renewables"), a subsidiary of
21 Iberdrola (the "Iberdrola Renewables IPO"). After the successful completion of
22 the Iberdrola Renewables IPO, however, S&P removed the "Watch Negative" and
23 replaced it with a "Stable" outlook for Iberdrola. See Exhibit __ (JPP- 3). The

JOINT PETITIONERS' POLICY PANEL

1 downgrade from "A2" to "A3" by Moody's was the result of Iberdrola's
2 acquisition of ScottishPower, plc ("ScottishPower"), the Iberdrola Renewables
3 IPO and Iberdrola's growth strategy. However, Moody's has made it clear that
4 Iberdrola has a "Stable" outlook and that the "A3" rating is a forward-looking
5 rating that already takes into consideration Iberdrola's Strategic Plan 2008-2010
6 (see IBER-0137S, Exhibit __ (JPP-1)) and the effect of the Proposed Transaction.
7 See Exhibit __ (JPP-4).

8 Q. Are you concerned that there could be future downgrades of Iberdrola's credit
9 rating to a "B" category rating?

10 A. No. The current ratings are forward-looking ratings and are either mid-level "A"
11 category ratings with stable outlooks, or a mid-to-high level "A" category rating
12 with a negative outlook. While there is no way of predicting future events that
13 could impact Iberdrola's credit rating, Iberdrola is unquestionably committed to
14 undertaking all reasonable efforts to maintain its current "A" category ratings.
15 Quite simply, doing so is good for Iberdrola's business, and for its customers and
16 shareholders.

17 The Staff Policy Panel apparently believes that there are a variety of
18 factors, including concerns regarding the Proposed Transaction, that could lead to
19 further downgrades (see, e.g., at 151-58). I, and more importantly the capital
20 markets, do not believe that this is probable. Iberdrola's most recent financial
21 results demonstrate that it is on track to maintain its current, strong "A" category
22 credit ratings. For example, in the first nine months of 2007, Iberdrola's gross
23 and net operating profits were up well over 20% as compared to the same period

JOINT PETITIONERS' POLICY PANEL

1 of the previous year. *See* Exhibit __ (JPP-5). In addition, the equity markets have
2 reacted favorably to Iberdrola's growth strategy. Iberdrola had a market
3 capitalization of approximately €13 billion at the end of 2001. As of December
4 31, 2007, the market capitalization of Iberdrola reached €52 billion, making it the
5 fifth largest utility in the world by that measure. A comparison of the stock prices
6 of Iberdrola and Energy East from January 2004 through January 2008 illustrates
7 that the equity markets have viewed Iberdrola, even after the close of the
8 ScottishPower acquisition and the announcement of the Proposed Transaction,
9 much more favorably than Energy East. *See* Exhibit __ (JPP-6). Additionally, I
10 note that Staff has not identified any analyst report, communication or other
11 document that has placed Iberdrola on credit watch for a downgrade other than for
12 the one reason already resolved by the Iberdrola Renewables IPO. *See* IBER/EE
13 IR No. 27, Exhibit __ (JPP-1).

14 Finally, there is no basis to presume that, even in the unlikely event that
15 Iberdrola's credit ratings were downgraded, such downgrade would result in any
16 direct harm to NYSEG or RG&E. Iberdrola's "A" category ratings are one to
17 three notches above that of Energy East (rated "BBB"/"BBB+"). As such, even if
18 Iberdrola were downgraded (which I believe to be improbable), there is no
19 credible suggestion that Iberdrola's credit rating would fall below that of Energy
20 East.

21 Q. Mr. Rude, the Staff Policy Panel alleges that S&P put NYSEG and RG&E "on
22 watch for a downgrade" in part as a result of the announcement of the Proposed
23 Transaction (at 167). Do you agree with Staff's suggestion that the Proposed

JOINT PETITIONERS' POLICY PANEL

1 Transaction caused this negative outlook?

2 A. Absolutely not. As discussed in further detail in the Rebuttal Testimony of Mr.
3 Fetter, the ratings agencies placed Energy East, NYSEG and RG&E on negative
4 outlook in September 2006, shortly after the Commission issued its August 2006
5 rate order in the NYSEG electric proceeding, and approximately 9 months prior to
6 the announcement of the Proposed Transaction. Accordingly, NYSEG's and
7 RG&E's negative outlooks are completely unrelated to the Proposed Transaction.

8 Q. Do you agree with the Staff Policy Panel's claim that the Proposed Transaction
9 had a negative impact on NYSEG's recent financing (*e.g.*, at 175-176)?

10 A. No, I emphatically disagree. As discussed in further detail in the Rate Adjustment
11 Panel, the 30 basis point differential that Staff noted between NYSEG's debt
12 issuance and those of its peers was caused by several factors, including ratings
13 differences in Staff's proxy group and the relative size and frequency of NYSEG
14 offerings compared to the proxy group, and was wholly unrelated to the Proposed
15 Transaction. For the reasons described above, I agree with Mr. Azagra that the
16 Proposed Transaction offers significant opportunities for NYSEG and RG&E to
17 benefit from Iberdrola's stronger, "A" category credit ratings.

18 **B. Iberdrola's Global Utility Expertise**

19 Q. Mr. Azagra, can you please explain how Iberdrola's expertise will benefit New
20 York ratepayers?

21 A. As I discussed in the Joint Petitioners' Direct Testimony, Iberdrola has 100 years
22 of experience in the utility business and is a world leader that provides high-
23 quality, reliable and environmentally friendly distribution service to 22 million

JOINT PETITIONERS' POLICY PANEL

1 electric points of supply and 2 million gas points of supply in Europe and the
2 Americas. Iberdrola is an innovative and diversified holder and manager of utility
3 and other energy assets with a well-demonstrated commitment to infrastructure
4 investment, service quality and sustainable development. As I noted in the Joint
5 Petitioners' Direct Testimony, Iberdrola's focus on service quality and operational
6 excellence is evident in its superior performance as measured by the Customer
7 Average Interruption Index (CAIDI) and the System Average Interruption
8 Frequency Index (SAIFI). Relative to U.S. benchmarks, Iberdrola over the last
9 three years has delivered results that would rank in either the first or second
10 quartile of U.S. utilities. Moreover, Iberdrola has always been committed to
11 sharing information about best practices among its operating utility subsidiaries,
12 and will do so with Energy East, NYSEG and RG&E. *See* IBER-0030, Exhibit
13 __ (JPP-1). It is my understanding that the Commission has valued such global
14 expertise in other utility mergers (*e.g.*, the Thames/Long Island Water Company
15 merger).

16 Finally, the Joint Petitioners wish to emphasize that reliability, safety and
17 customer service will remain top priorities for both NYSEG and RG&E after the
18 consummation of the Proposed Transaction.

19 Q. The Staff Policy Panel has suggested that the Proposed Transaction will not
20 benefit New York ratepayers because Iberdrola has stated it will continue to rely
21 on Energy East's, NYSEG's and RG&E's existing management (*see, e.g.*, at 74).
22 Can you respond?

JOINT PETITIONERS' POLICY PANEL

1 A. Iberdrola values Energy East's, NYSEG's and RG&E's local management, and
2 anticipates enhancing this existing management with leading local and national
3 professionals after the closing of the Proposed Transaction. Iberdrola's reliance
4 on local management does not, however, mean that Iberdrola will not be able to
5 help improve the operations of Energy East, NYSEG and RG&E for the benefit of
6 their customers. Rather, Iberdrola will be in a position to share information
7 regarding best practices. Indeed, while Iberdrola has traditionally relied on local
8 management for the operations of other, non-Spanish entities that it has acquired,
9 Iberdrola has nonetheless had a measurable and positive influence on these
10 operations. For example, even though Iberdrola has continued to rely on local
11 management for its utility subsidiaries in Brazil and Guatemala, local
12 management at those utilities instituted various programs and upgrades as a result
13 of Iberdrola's practice of sharing information about best practices among its
14 operating subsidiaries.

C. Renewable Benefits

16 Q. Mr. Azagra, please explain Iberdrola's expertise in developing renewable
17 resources, such as wind farms.

18 A. As I described in the Joint Petitioners' Direct Testimony, Iberdrola is the largest
19 producer of wind energy in the world with 7,000 MW of wind capacity.¹ In 2006
20 alone, Iberdrola invested over \$1.32 billion in renewable technologies and
21 currently has over 41,000 MW of new renewable resources in the pipeline,

¹ Capacity numbers are as of September 30, 2007.

JOINT PETITIONERS' POLICY PANEL

1 including over 21,000 MW in the United States.² With this expertise, Iberdrola is
2 uniquely positioned to assist the State in meeting its renewable energy goals.

3 Q. What are the State's renewable energy goals?

4 A. It is my understanding, based on information on the Commission's website and
5 other publicly-available information, that New York's 2002 State Energy Plan
6 warned of the possible consequences of New York's heavy dependence on fossil
7 fuel. Therefore, at the request of Governor Pataki and after a study period, the
8 Commission on September 24, 2004 adopted an RPS. The RPS establishes the
9 State's goal of increasing the proportion of renewable electricity used by New
10 York consumers to at least 25% by 2013. The Commission designated the New
11 York State Energy Research and Development Authority as the central
12 procurement administrator of the State's RPS program. Under this program, the
13 major investor-owned utilities collect revenues from ratepayers for the purpose of
14 achieving a mandatory RPS target set at 24% of retail electricity consumption.
15 The remaining 1% of the overall 25% goal comes from voluntary purchases made
16 by retail customers. The Commission itself noted that the primary benefits
17 expected from implementing the RPS Program were in (1) diversifying the
18 generation resource mix to improve energy security and independence; (2)
19 attracting the economic benefits from renewable resource generators,
20 manufacturers, and installers to the state; and (3) improving New York's
21 environment by reducing air emissions and other adverse environmental impacts
22 of electricity generation. In addition to the State's RPS, Governor Spitzer

² Capacity numbers are as of September 30, 2007.

JOINT PETITIONERS' POLICY PANEL

1 announced the "15 x 15" clean energy strategy in April 2007 to reduce the State's
2 electricity consumption by 15% from forecasted levels by 2015. As part of this
3 strategy, Governor Spitzer recognized the need to phase out less secure and dirtier
4 power plants, and outlined a plan to make New York an ideal environment for
5 investment in renewable energy projects.

6 Q. Please respond to the Staff Policy Panel's argument (at 29) that, given Iberdrola's
7 affiliated wind projects and development activities in New York, the Proposed
8 Transaction would actually prevent the State from meeting its RPS goals.

9 A. The Staff Policy Panel's argument that the Proposed Transaction would prevent
10 the State from meeting its RPS goals is not only counterintuitive, it is illogical.
11 As I have described, given Iberdrola's expertise in the development of renewable
12 resources, it is uniquely positioned to assist the State in meeting its renewable
13 energy goals. The Staff Policy Panel's position is based entirely on the
14 unsupported allegation that, if Energy East becomes affiliated with Iberdrola's
15 affiliated wind projects, other wind developers will not invest in New York,
16 despite all of the economic incentives for them to do so. In fact, Staff recognizes
17 the very extensive wind projects already in the New York Independent System
18 Operator ("NYISO") interconnection queue (*see* IBER/EE IR No. 1, Exhibit __
19 (JPP-1)), and the announcement of the Proposed Transaction does not appear to
20 have had any impact on such activities.

21 Despite the Staff Policy Panel's stated concerns on this point, there has
22 been no suggestion by Staff or any other party in this proceeding that any
23 developer has in fact scaled back its projects or withdrawn from the State as a

JOINT PETITIONERS' POLICY PANEL

1 result of the Proposed Transaction. No wind developer has even intervened in
2 this proceeding, much less suggested that Iberdrola's acquisition of Energy East
3 would adversely impact wind development in New York. In fact, neither the
4 Independent Power Producers of New York ("IPPNY") nor any generation
5 developer has raised any concerns in this proceeding with respect to potential
6 vertical market power issues associated with the operating and planned wind
7 projects in New York owned by Iberdrola's affiliates. It is worth emphasizing
8 that a number of parties in this proceeding that have direct interests in increasing
9 wind development in New York State – including the New York State
10 Department of Environmental Conservation, the Natural Resources Defense
11 Council and the Greater Rochester Enterprise – are on record as stating that the
12 Commission should treat Iberdrola's renewables expertise as a benefit when
13 evaluating the Proposed Transaction. Dr. Hieronymus provides further support in
14 his rebuttal testimony for the conclusion that the Proposed Transaction will have
15 no adverse effect on wind development activities in New York. Finally, I note
16 that in Iberdrola's extensive and global wind experience, it has not witnessed any
17 adverse impact on the level of wind development activities in the regions where
18 Iberdrola owns both transmission/distribution businesses and wind generation.

19 Q. Do you have any comments with respect to the Staff Policy Panel's conclusion
20 that, given Iberdrola's wind development activities in New York, the Proposed
21 Transaction will create the potential for the Joint Petitioners to exercise vertical
22 market power (*see, e.g.*, at 124-25)?

JOINT PETITIONERS' POLICY PANEL

- 1 A. The Rebuttal Testimony of Dr. Hieronymus explains in detail why the Proposed
2 Transaction does not raise any vertical market power concerns. I would also like
3 to provide some comments with respect to the factual parts of this discussion. As
4 an initial matter, in response to concerns raised by the Staff Policy Panel (at 45-
5 46), I note that the existence of antitrust claims against Iberdrola's
6 transmission/distribution subsidiaries in other parts of the world is not relevant to
7 the Commission's review of the Proposed Transaction, much less suggestive of
8 any potential vertical market power issues associated with the Proposed
9 Transaction. In fact, Staff admits that it has not compared the number of claims
10 against Iberdrola with those of other domestic or foreign public utilities or public
11 utility holding companies. See IBER/EE IR No. 12, Exhibit __ (JPP-1).
- 12 Q. Do you agree with the Staff Policy Panel's recommendation that, if the
13 Commission approves the Proposed Transaction, it should require the divestiture
14 of Iberdrola's affiliated wind projects in New York (at 288)?
- 15 A. Not at all. Dr. Hieronymus explains why Iberdrola's affiliated wind projects in
16 New York could not be used in the exercise of vertical market power. I would
17 like to add that the Staff Policy Panel's position on these projects does not make
18 any sense in light of the State's aggressive renewable energy goals, and
19 Iberdrola's ability to help the State meet those goals. Staff is the only party in this
20 proceeding that is recommending the divestiture of these affiliated wind projects.
- 21 Q. Do you have any other comments on the Staff Policy Panel's recommendation
22 that Iberdrola's affiliated wind projects in New York be divested as a condition to
23 approval of the Proposed Transaction?

JOINT PETITIONERS' POLICY PANEL

1 A. The Staff Policy Panel believes that there is a contradiction inherent in Iberdrola's
2 claim that it will be able to provide substantial benefits toward meeting the State's
3 RPS targets, although its current operational and planned wind projects in New
4 York are relatively *de minimis* (at 141-42). Staff fails to recognize that the State's
5 renewable energy goals are very aggressive, and it is unlikely that those goals
6 could be met through investment by a reduced number of developers. Rather, it is
7 more likely that the State will need to rely on all available renewable developers
8 to meet its goals. Given Iberdrola's expertise with the development of renewable
9 projects, it is uniquely positioned to help the State meet those goals. Thus, the
10 Commission should not discount the contribution that the Iberdrola group of
11 companies could make to this effort.

12 Q. How is the Proposed Transaction related to meeting the State's renewable energy
13 goals? Wouldn't Iberdrola and its affiliates continue to develop wind projects in
14 New York regardless of the Proposed Transaction?

15 A. Certainly, the decision as to whether to develop a particular wind project is based
16 on the economics of the project. That being said, a number of states in the U.S.,
17 in recognition of the environmental benefits of renewable resources as well as the
18 economic benefits that communities derive from the development of such
19 resources, are encouraging wind development activities within their borders.
20 Iberdrola and its affiliates simply cannot invest in each state that is trying to
21 attract renewable developers. Rather, renewable investment will be targeted to
22 those states where there is a familiarity with the market opportunities, the RPS
23 standards, and other applicable regulatory frameworks, as well as the general

JOINT PETITIONERS' POLICY PANEL

1 receptiveness within the state to such development. Logically, if Iberdrola has a
2 significant presence in New York (such as through its affiliation with Energy
3 East) and has made a positive determination with respect to these considerations
4 in New York, then it and its affiliates may be more likely to target New York sites
5 for additional wind development. I would also like to point out that, while there
6 are a number of wind developers that are currently evaluating options in New
7 York, Iberdrola's affiliates have a most impressive track record with respect to the
8 completion of such projects. In fact, Iberdrola is one of only a handful of
9 developers that has successfully completed and placed in service wind projects in
10 New York. Any suggestion that Iberdrola and its affiliates should somehow be
11 excluded from this effort is simply contrary to the State's renewable energy
12 policies.

13 Q. Do you have any comments on the Staff Policy Panel's conclusion that Horizon
14 and Gamesa should be included in any discussion of Iberdrola's wind
15 development activities (at 129-30) and its suggestion that Iberdrola could
16 influence the production and sale of wind generation equipment through its
17 affiliation with Gamesa (at 142-43)?

18 A. The Staff Policy Panel misunderstands the nature of Iberdrola's limited
19 relationships with Horizon and Wind Gamesa. Let me clarify this.

20 With respect to Horizon Wind, although Iberdrola holds a 9.5% equity
21 interest in Energías de Portugal, S.A. ("EDP"), which holds a 70% ownership
22 interest in Horizon Wind, Iberdrola may not exercise voting rights that represent
23 more than 5% of EDP's voting share capital and does not have any seats on the

JOINT PETITIONERS' POLICY PANEL

1 EDP board. Iberdrola has no access to non-public information on Horizon
2 Wind's development activities, and is not involved in the decision-making with
3 respect to those activities.

4 With respect to Gamesa, Iberdrola holds an approximate 23.9% interest in
5 Gamesa Corporación Tecnológica, S.A., a publicly-traded entity. However, there
6 are structural protections in place to prevent Iberdrola and its affiliates from
7 obtaining any competitive information on Gamesa's operations and, as such, the
8 only information available to Iberdrola with respect to Gamesa's U.S. operations
9 is information that is publicly available. In addition, there are structural
10 protections in place to prevent Iberdrola from voting on matters related to
11 Gamesa's development activities in the U.S. Thus, there is no commonality of
12 control or access to non-public information as between the Iberdrola's affiliated
13 projects, on the one hand, and the Gamesa or Horizon Wind projects, on the other.

14 Q. You mentioned earlier that IPPNY has not raised any concerns in this proceeding
15 with respect to potential vertical market power issues associated with Iberdrola's
16 currently operating and planned affiliated wind projects in New York. Do you
17 have any comments on IPPNY's testimony in this proceeding?

18 A. Yes. While IPPNY does not recommend the divestiture of these projects, it does
19 request (at 25) that the Commission require the Joint Applicants to "commit to not
20 construct or otherwise acquire any ownership interests in other electric generating
21 facilities located in RG&E's and NYSEG's respective service territories." I
22 presume that what IPPNY is seeking here is a prohibition against the
23 interconnection of affiliated generation projects to NYSEG or RG&E

JOINT PETITIONERS' POLICY PANEL

1 transmission facilities. Dr. Hieronymus explains in detail why such a
2 commitment is simply not necessary.

3 Q. Do you have any suggestions as to how to address IPPNY's concern?

4 A. As Dr. Hieronymus describes in his testimony, the Commission already has
5 certain regulatory oversight of the development and acquisition of generation in
6 New York, including in the NYSEG and RG&E service territories. Additionally,
7 neither NYSEG nor RG&E will develop additional utility-owned generation to be
8 included in rate base unless authorized.

9 Q. The Staff Policy Panel expresses some concerns with the number of Iberdrola's
10 U.S. affiliates and the use of Special Purpose Entities ("SPEs") for these
11 businesses (at 216-18). Can you address this issue?

12 A. An SPE is a corporate entity, usually a limited liability company or a limited
13 partnership, that is created to fulfill a specific objective, such as isolating financial
14 risk, such as bankruptcy, taxation or regulatory risk. An SPE's debt is generally
15 non-recourse, which means that, in the event of a default, the lender's recovery is
16 limited to the collateral (typically the SPE's assets). Thus, by definition, the
17 liabilities within Iberdrola's SPE subsidiaries would not flow upstream to
18 Iberdrola or any of its affiliates. As such, the fact that many of Iberdrola's
19 subsidiaries are structured as SPEs should be reassuring to the Commission, rather
20 than a concern.

21 Moreover, all of Iberdrola's existing affiliates in the U.S. are unregulated
22 entities involved in wholesale electricity generation and natural gas storage
23 development and operation, as well as energy trading – and the use of SPEs is

JOINT PETITIONERS' POLICY PANEL

1 standard with respect to these types of businesses throughout the country. It is my
2 understanding that virtually all, if not all, of the competitive wholesale generators
3 located in New York are also structured as SPEs, which facilitates their use of
4 traditional project financing structures. It is also my understanding that
5 competitive wholesale generators that are affiliated with transmission owners in
6 other states (such as FPL Energy, Constellation Energy, Duke, Exelon and many
7 others) are often structured as SPEs. In fact, it would be unusual if individual
8 energy project companies were financed and constructed without utilizing SPEs.
9 These traditional structures are not complicated or unusual; rather, they reflect
10 prudent practice for entities involved in the generation business.

11 Q. Can you address the Staff Policy Panel's concerns with respect to transactions
12 between NYSEG and RG&E and their unregulated affiliates (at 222-23)?

13 A. Later in my testimony I will explain the specific structures that will be in place to
14 govern these types of transactions and ensure that no affiliate abuse occurs. At
15 this point, I would like to address the Staff Policy Panel's misstatements about the
16 nature of the marketing contracts between Community Energy, Inc. ("CEI"), a
17 partially-owned subsidiary of Iberdrola, and NYSEG and RG&E (at 230-32).
18 These contracts were executed well before Iberdrola and Energy East began
19 discussing a potential merger and, as such, represent arm's length transactions
20 that were negotiated significantly before these entities had become affiliates. The
21 affiliate rules that are already in place will help maintain the arm's-length nature
22 of these contracts after the Proposed Transaction occurs. I would also like to
23 point out that the Staff Policy Panel incorrectly states CEI sells power to NYSEG

JOINT PETITIONERS' POLICY PANEL

1 and RG&E customers under these agreements, and that NYSEG and RG&E are
2 restricted from marketing any non-CEI energy to customers in their respective
3 service territories. In fact, CEI only markets renewable energy certificates, and
4 does not make any power sales under these contracts or otherwise.

D. Economic Development and Job Retention

5
6 Q. Mr. Azagra, the Staff Policy Panel states that the Proposed Transaction may
7 cause, among other things, job losses (at 316). Does Iberdrola anticipate that the
8 Proposed Transaction will result in any job losses?

9 A. No. In addition, Iberdrola has committed that existing employee compensation
10 and benefits will remain substantially unchanged for a period of at least eighteen
11 months after consummation of the Proposed Transaction.

12 Q. Why do you anticipate that the Proposed Transaction will not result in any job
13 losses?

14 A. Typically, when a merger results in synergistic savings, a component of those
15 savings stems from the elimination of jobs. By contrast, Iberdrola does not own
16 any regulated utilities in the U.S., and therefore the Proposed Transaction does
17 not involve the combination or elimination of corporate or utility operating
18 functions, which are necessary to produce such savings (and often result in job
19 losses).

20 Q. What impact will the Proposed Transaction have on the New York economy?

21 A. The Proposed Transaction will have a positive economic impact on the
22 revitalization of the upstate New York economy, and this benefit is recognized by
23 other parties to this proceeding. In particular, the Greater Rochester Enterprise

JOINT PETITIONERS' POLICY PANEL

1 notes that Iberdrola's position as a global energy leader will help upstate New
2 York to compete on the global stage for jobs and investment, recruit new
3 companies to the region, and provide the financial ability for continued
4 investments in infrastructure (at 7-9). Additionally, Empire State Development
5 states that potential investment in NYSEG and RG&E by a leading international
6 energy company is a "key opportunity to assist the State in the implementation of
7 upstate economic development objectives" (at 1). I agree with these parties that
8 have acknowledged Iberdrola's positive impact on economic development in
9 upstate New York as a benefit of the Proposed Transaction, and I believe that the
10 State of New York would want to attract transactions of this nature.

IV. NO SYNERGIES/IMPUTED BENEFITS

11
12 Q. Does the Staff Policy Panel claim that the Proposed Transaction will result in any
13 synergistic benefits?

14 A. Yes. The Staff Policy Panel claims that Iberdrola will obtain significant tax
15 benefits as a result of the Proposed Transaction in the form of PTCs for wind
16 energy projects, as well as Spanish tax credits (*see, e.g.*, 78-79). The Staff Policy
17 Panel also suggests that there are synergy benefits related to IT consolidation (at
18 97) and certain alleged benefits to current employees, stakeholders and others
19 resulting from the Proposed Transaction.

JOINT PETITIONERS' POLICY PANEL

1 Q. Does the Panel agree with the Staff Policy Panel's claim that these synergistic
2 benefits exist?

3 A. No. The Joint Petitioners have not identified any synergistic benefits resulting
4 from the Proposed Transaction. This is consistent with other "first mover"
5 transactions, in which a non-U.S. entity undertakes its first acquisition of a
6 regulated utility business in the U.S. While the Commission's treatment of
7 synergy versus non-synergy transactions is discussed primarily in the Rebuttal
8 Testimony of Mr. Meehan, it is the Joint Petitioners' understanding that the
9 Commission has historically not required a sharing of imputed synergies in these
10 "first mover" cases, because such cases do not result in any actual synergies or
11 cost savings resulting from a combination of utility operations at the utility or
12 holding company level. Thus, as the Proposed Transaction is a "first mover"
13 transaction, the Joint Petitioners do not believe it would be appropriate for the
14 Commission to impute synergies here. The Commission will have the
15 opportunity to review any long-term benefits that may arise from the Proposed
16 Transaction in future rate proceedings.

17 Moreover, although affiliates of Iberdrola have existing wind and thermal
18 generation and gas storage businesses in the U.S., these unregulated entities are
19 all owned by a separate parent company, Iberdrola Renewables, which is only
20 80% owned by Iberdrola and 20% publicly traded on the Spanish stock
21 exchanges. These existing unregulated entities have a different business focus
22 than Energy East and their day-to-day operations would continue to be separately
23 managed after the consummation of the Proposed Transaction. Accordingly,

JOINT PETITIONERS' POLICY PANEL

1 Iberdrola's current U.S. affiliates do not offer any potential for synergistic savings
2 with respect to Energy East, and Staff should not invent synergies that do not
3 exist.

4 **A. Production Tax Credits**

5 Q. Mr. Azagra, what is Staff's argument with respect to PTCs?

6 A. Staff believes that Iberdrola does not pay enough U.S. income taxes to be able to
7 utilize the full value of the PTCs associated with its affiliated wind projects and
8 that, through the acquisition of Energy East, "it will acquire taxable income
9 sufficient to enable it to utilize at least some and perhaps all of the PTCs that it
10 has generated" (at 82). Staff estimates that Iberdrola could obtain up to \$50
11 million of PTCs per year based on the existing level of its ownership interests in
12 wind power facilities, assuming that each of these facilities qualifies for PTCs.
13 Staff also estimates that if Iberdrola constructs all of its planned generation for
14 2007-2008, assuming that all of such projects are available for PTCs, it could
15 generate up to \$150 million in PTCs per year by 2008. Staff does not provide any
16 basis for these estimates, other than very rough estimates that are based upon a
17 calculation of Staff's estimate of 100% of the value of existing and future PTCs,
18 regardless of how they are and would be otherwise utilized.

19 Q. For background, can you explain what PTCs are?

20 A. The PTC mechanism was created by federal legislation (the Energy Policy Act of
21 1992) as a subsidy to encourage power developers to expand renewable
22 generation development in the U.S. The amount of the federal PTC for qualifying
23 wind facilities is currently 2.0 cents per kWh of electricity produced in the U.S.

JOINT PETITIONERS' POLICY PANEL

1 from wind and sold to an unaffiliated third party. Because PTCs result in a
2 reduction of U.S. federal tax liability, the entity (or consolidated tax group of
3 entities) claiming such benefit must have sufficient offsetting U.S. federal tax
4 liability in order to fully utilize the PTCs from affiliated wind projects. The PTC
5 mechanism will expire at the end of 2008 (*i.e.*, 11 months from now), unless
6 extended by Congress.

7 Q. Are there any synergistic PTC-related benefits resulting from the Proposed
8 Transaction?

9 A. No. There simply are no PTC-related benefits of the Proposed Transaction. Let
10 me start off by describing the ownership structure for Iberdrola's affiliated wind
11 projects in the U.S. that have, or in the future may be, eligible for PTCs. Each of
12 these projects is a wholly- or partially-owned, indirect subsidiary of Iberdrola
13 Renewables, which, as I noted above, is owned 80% by Iberdrola, with the
14 remaining shares traded on the Spanish stock exchanges. Any PTCs that may be
15 available with respect to Iberdrola Renewables' wind projects in the U.S. are
16 wholly unrelated to the Proposed Transaction: those PTCs exist regardless of
17 whether the Proposed Transaction is consummated and regardless of Energy
18 East's tax liability. In addition, PTCs associated with Iberdrola Renewables'
19 operating wind projects have already been utilized sufficiently to develop and
20 finance these existing projects. Furthermore, the availability of PTCs for any
21 wind projects that Iberdrola Renewables may develop in the future is uncertain,
22 and any such future PTCs would likely be utilized using investment structures
23 similar to those in place for its wind projects that are already in operation.

JOINT PETITIONERS' POLICY PANEL

1 Q. Can you explain why there are no PTC-related benefits resulting from the
2 Proposed Transaction?

3 A. Yes. The PTCs associated with Iberdrola Renewables' wind projects have
4 already been utilized by third-party equity investors sufficient to develop and
5 finance these existing projects.

6 Q. Please explain what you mean when you say that these PTCs have been "utilized"
7 by third-party equity investors.

8 A. Iberdrola Renewables' affiliates have entered into a number of structured
9 institutional partnership investment transactions related to their operational wind
10 farms. Under these so-called "tax equity" structures, a non-affiliated equity
11 investor that is a partial owner of the project can utilize the PTCs to offset its own
12 U.S. federal taxable income. These structures facilitate Iberdrola Renewables'
13 wind growth beyond its own tax capacity.

14 Q. Can you explain how these "tax equity" structures work?

15 A. Assume for the sake of this discussion that a wind farm is an indirect, wholly-
16 owned subsidiary of Iberdrola Renewables. Once that project becomes
17 operational (or close to becoming operational), it is transferred to a holding
18 company that is also an indirect, wholly-owned subsidiary of Iberdrola
19 Renewables. A percentage of that holding company is then sold to an unaffiliated
20 equity investor that has the capacity to utilize the project's PTCs to offset its tax
21 liability. The investor makes an up-front cash payment and subsequent payments
22 over time, based on the project's forecasted energy production. The tax benefits,
23 along with the project's income and cash flows, are allocated to the investor and

JOINT PETITIONERS' POLICY PANEL

1 Iberdrola Renewables, disproportionately in favor of the investor. Once the
2 investor has received an agreed-upon after-tax return or some other objective
3 standard has been met, the sharing ratios may “flip” so that the investor would
4 receive a smaller portion of the PTCs and income, and Iberdrola Renewables
5 would receive a larger portion. Iberdrola Renewables, through its affiliates,
6 maintains operational and management control over the project, and provides
7 O&M services.

8 Q. Are these tax equity structures standard in the wind industry?

9 A. Yes, there is a strong demand for tax-advantaged investments in the U.S. market,
10 and numerous entities in the financial community are involved in providing tax
11 equity investment for renewable projects. Such investors include commercial
12 banks, insurance companies and investment funds that are primarily interested in
13 the available tax benefits, and not the long-term ownership of the wind projects.
14 In fact, tax equity structures are so common in the wind industry that the U.S.
15 Internal Revenue Service recently issued special rules for these structures.

16 Q. Will Iberdrola Renewables' subsidiaries be eligible for PTCs for wind farms that
17 they may develop in the future?

18 A. Determining the availability of PTCs for future wind projects is a speculative
19 exercise for a number of reasons. First, the completion of any wind development
20 project depends upon a variety of development risks and other factors. As the
21 completion and operation of development projects are not certain, the availability
22 of any PTCs associated with those projects is also uncertain. Second, the
23 availability of any PTCs for those future projects is uncertain given that the PTC

JOINT PETITIONERS' POLICY PANEL

1 mechanism is currently scheduled to expire on December 31, 2008. As I noted
2 above, while we anticipate that Congress may extend the PTC mechanism beyond
3 2008, there is no guarantee that this will happen. Third, the amount of the PTC is
4 based on the amount (in kWh) of electricity actually generated by a project.
5 Given the intermittent and unpredictable nature of wind, the amount of PTCs
6 available to any future project (assuming that the project is actually constructed is
7 eligible for PTCs under a Congressional extension of the PTC mechanism) would
8 also be uncertain.

9 Furthermore, the decision as to how to utilize any future PTCs that may
10 become available will be made by Iberdrola Renewables, taking into
11 consideration its tax liability and the tax liability of those entities with which it is
12 consolidated for tax purposes.

13 Q. How important is the availability of PTCs for a particular development project?

14 A. The decision to develop a particular wind project is determined by the economics
15 of that project, including the potential availability of any associated PTCs. In
16 other words, the unavailability of PTCs would certainly have an adverse impact
17 on Iberdrola Renewables' decision as to whether to invest in a particular
18 development project. Again, I would like to emphasize that these PTCs are
19 wholly unrelated to the Proposed Transaction or to the rates and operations of
20 NYSEG and RG&E.

JOINT PETITIONERS' POLICY PANEL

1 Q. Do you believe that it would make for good public policy if the Commission were
2 to find that the Proposed Transaction results in PTC-related synergistic benefits?

3 A. Absolutely not. As I described above, PTCs were created by federal legislation to
4 put wind projects on a competitively level playing field with non-renewable
5 generation resources and thereby encourage power developers to expand wind
6 generation development in the U.S. Since the Energy Policy Act of 1992 was
7 enacted, the PTC mechanism has been extended five times, with only two of these
8 extensions occurring prior to the expiration of the then-current PTC provisions.
9 The significance of the PTC mechanism as an incentive to the U.S. wind industry
10 is demonstrated by the "boom and bust" cycles that it has experienced during
11 those periods when the mechanism was allowed to lapse or its extension was
12 uncertain. For a state regulator to effectively eliminate or even dilute this
13 incentive, in particular in the context of a wholly-unrelated transaction, would
14 clearly subvert the Congressional goal of encouraging the development of wind
15 generation. The Rebuttal Testimony of Mr. Meehan also addresses this issue and
16 explains that it would be improper as a policy matter for the Commission to
17 interfere with the incentives provided by Congress for the development of
18 renewable resources. The Rebuttal Testimony of Dr. Makholm further explains
19 why any PTCs associated with Iberdrola's affiliated wind projects are not a
20 relevant issue to ratepayers of NYSEG and RG&E.

21 Q. Do you have any comments on the Staff Policy Panel's specific calculations that
22 Iberdrola could obtain up to \$50 million of PTCs per year based on the existing

JOINT PETITIONERS' POLICY PANEL

1 level of its ownership interests in wind power facilities, and up to \$150 million in
2 PTCs per year by 2008?

3 A. The Staff Policy Panel doesn't provide any proper basis for its calculations. It
4 appears that the Staff Policy Panel has simply provided an estimate of existing
5 and future Iberdrola Renewables' wind capacity multiplied by 100% of the
6 estimated PTC value. As explained above, because existing projects already have
7 already utilized their PTCs, and because any PTCs for future projects are
8 speculative at best, the expected value of PTCs to potentially offset against any
9 Energy East tax liability should be zero.

10 **B. Spanish Tax Benefits**

11 Q. Mr. Azagra, the Staff Policy Panel has concluded that Iberdrola will receive
12 certain tax benefits under Spanish law in connection with the Proposed
13 Transaction and that these benefits should be treated as synergies in this
14 proceeding (at 78-80). Please respond.

15 A. It would not be appropriate to consider these speculative Spanish tax "benefits" as
16 synergies in this proceeding, because there is no certainty that Iberdrola will ever
17 be able to obtain any tax offset or goodwill amortization associated with the
18 Proposed Transaction under Spanish law. First, the Staff Policy Panel refers to
19 Article 12(5) of the Spanish Corporate Income Tax Law (the "CIT Law"), which
20 provides that financial goodwill related to the acquisition of shares in qualifying
21 foreign subsidiaries may be amortized for tax purposes at a maximum yearly rate
22 of 5% over 20 years. I note as an initial matter that Article 12(5) may operate as a
23 tax deferral, rather than as a straight deduction. If and when an acquired company

JOINT PETITIONERS' POLICY PANEL

1 level of its ownership interests in wind power facilities, and up to \$150 million in
2 PTCs per year by 2008?

3 A. The Staff Policy Panel doesn't provide any proper basis for its calculations. It
4 appears that the Staff Policy Panel has simply provided an estimate of existing
5 and future Iberdrola Renewables' wind capacity multiplied by 100% of the
6 estimated PTC value. As explained above, because existing projects already have
7 already utilized their PTCs, and because any PTCs for future projects are
8 speculative at best, the expected value of PTCs to potentially offset against any
9 Energy East tax liability should be zero.

10 **B. Spanish Tax Benefits**

11 Q. Mr. Azagra, the Staff Policy Panel has concluded that Iberdrola will receive
12 certain tax benefits under Spanish law in connection with the Proposed
13 Transaction and that these benefits should be treated as synergies in this
14 proceeding (at 78-80). Please respond.

15 A. It would not be appropriate to consider these speculative Spanish tax "benefits" as
16 synergies in this proceeding, because there is no certainty that Iberdrola will ever
17 be able to obtain any tax offset or goodwill amortization associated with the
18 Proposed Transaction under Spanish law. First, the Staff Policy Panel refers to
19 Article 12(5) of the Spanish Corporate Income Tax Law (the "CIT Law"), which
20 provides that financial goodwill related to the acquisition of shares in qualifying
21 foreign subsidiaries may be amortized for tax purposes at a maximum yearly rate
22 of 5% over 20 years. I note as an initial matter that Article 12(5) may operate as a
23 tax deferral, rather than as a straight deduction. If and when an acquired company

JOINT PETITIONERS' POLICY PANEL

1 is sold, the amount of the financial goodwill which has been amortized pursuant
2 to Article 12(5) may be recaptured in the taxable base of the seller. Moreover, the
3 amortization of goodwill pursuant to Article 12(5) is subject to significant legal
4 restrictions imposed by tax authorities in Spain. In particular, recent rulings by
5 these authorities have questioned whether the acquisition of a holding company
6 (*i.e.*, where the top tier entity is not the operating utility company, as is the case
7 with Energy East) may actually generate goodwill eligible for amortization. *See*
8 IBER-0148, Exhibit __ (PP-2).

9 Q. Are there any other reasons why it is speculative to assume that Iberdrola will
10 receive any tax benefit under Article 12(5) in connection with the Proposed
11 Transaction?

12 A. Yes. For the reasons described above, it is uncertain whether any or all of the
13 goodwill associated with the Proposed Transaction will be eligible for
14 amortization under Article 12(5). By way of example, Iberdrola has not yet been
15 able to determine whether any or all goodwill from its ScottishPower acquisition,
16 which closed in April 2007, will be eligible for amortization under Article 12(5).

17 Q. Does the Staff Policy Panel identify any other potential tax benefits under the CIT
18 Law?

19 A. Yes. The Staff Policy Panel also references Article 37 of the CIT Law (at 80),
20 which provides a tax offset for companies purchasing shares in foreign companies
21 to the extent the purchase leads to increased export activities. The European
22 Competition Commission has declared offsets under Article 37 incompatible with
23 the common market and requested that Spain gradually repeal Article 37 by 2010.

JOINT PETITIONERS' POLICY PANEL

1 Additionally, the Spanish tax authorities have interpreted Article 37 as requiring a
2 “direct and immediate relationship” between the investment (*i.e.*, the acquisition
3 of a foreign entity by the Spanish company) and the export activities of the
4 Spanish company before the offset can be utilized. Accordingly, it is uncertain
5 whether Iberdrola will be eligible to obtain any tax offset under Article 37 of the
6 CIT Law. *See* IBER-0147, Exhibit __ (PP-2). Additionally, as discussed in the
7 Rebuttal Testimony of Mr. Meehan, it does not seem appropriate for the
8 Commission to suggest that potential tax savings or deferrals offered by the
9 Spanish government to holding companies should be treated as synergies of any
10 proposed acquisition, including this Proposed Transaction. Finally, I note that the
11 provisions of Article 12(5) and Article 37 of the CIT Law are mutually exclusive:
12 the purchase price to which the deduction based on financial goodwill is applied
13 under Article 12(5) is automatically ineligible for the tax offset provided under
14 Article 37. For all of these reasons, Iberdrola did not consider any Spanish tax
15 savings or deferral under Article 12(5) or 37 of the CIT Law in its valuation of the
16 Proposed Transaction.

C. Benefits from IT Consolidation

17
18 Q. The Staff Policy Panel has taken the position that the Proposed Transaction could
19 result in synergistic savings stemming from possible IT consolidation (at 97-98).

20 Does the Panel anticipate any such savings?

21 A. No, and Iberdrola did not consider any savings from IT consolidation in
22 evaluating the Proposed Transaction. As an initial matter, all ascertainable IT
23 savings associated with Energy East were already realized beginning in 2002

JOINT PETITIONERS' POLICY PANEL

1 when it acquired the last of its various operating companies, RG&E, and ending
2 in 2004 with the implementation of the SAP system to support financial and work
3 management functions. In addition, there are currently no plans to consolidate IT
4 operations among Energy East, NYSEG, RG&E and Iberdrola's unregulated
5 generation and natural gas affiliates in the U.S. due to the significant challenges
6 associated with combining the IT functions of regulated and non-regulated
7 operations.

8 Q. Mr. Rude, did Energy East elect to consolidate its regulated and unregulated
9 operations on a single IT platform when it engaged in its most recent IT
10 consolidation?

11 A. No. Energy East made the decision in 2002 to create a new shared service
12 organization to support just its regulated utility operating companies.
13 Consolidating these IT functions in Rochester, New York, was part of the plan.
14 Prior to this consolidation, each Energy East utility had its own IT department.
15 Detailed planning and work supporting the IT consolidation began late in 2002
16 and continued through the end of 2005. IT consolidation was successful because
17 the basic requirements the Energy East utilities have for IT services are relatively
18 consistent across those utilities. This allows IT work processes to be standardized
19 and leveraged across the utilities. It is unlikely that non-regulated entities would
20 have the same IT service requirements as Energy East's regulated utility
21 subsidiaries.

JOINT PETITIONERS' POLICY PANEL

1 Q. Mr. Rude, what were the main steps required for IT consolidation among Energy
2 East's utilities?

3 A. One of the first steps in the IT consolidation effort was to define the new
4 organization, develop new functional responsibilities, and develop a single set of
5 processes to support multiple utilities. The majority of the organizational changes
6 took effect in May 2003. The new organization included a centralized IT Help
7 Desk, a centralized Network Operations Center, and a centralized Data Center.
8 Additionally, the Network, Technical and IT Support Service teams were
9 consolidated in Rochester, New York, where they standardized operations and
10 worked under the direction of a single management team.

11 Q. What were the next steps for IT consolidation?

12 A. The second step was contract consolidation. The consolidated IT entity sought to
13 re-bid and/or renegotiate several of its largest contracts with better pricing and
14 terms. Over the consolidation period, new contracts were negotiated in the areas
15 of telecommunications, mainframe hardware and software, disaster recovery and
16 help desk services. The third step was technical consolidation. While the
17 organizational changes were being made work was being done to consolidate the
18 physical technology IT supports. Data Centers were consolidated to Rochester,
19 resulting in data center closures in Hartford, Connecticut, Bridgeport,
20 Connecticut, and Ithaca, New York. Additionally, the technology in the Augusta,
21 Maine, data center was converted from a primary location to a back up location
22 for the Rochester facility. A new network design was implemented to connect the
23 Energy East utilities to one another and the Rochester Data Center. Additionally,

JOINT PETITIONERS' POLICY PANEL

1 network infrastructure standards were developed and implemented to reduce the
2 complexity and cost of operating the network. A corporate desktop was
3 developed to standardize the desktop operating systems, office productivity tools
4 (*e.g.*, email, word processing, spreadsheets, etc), remote connectivity tools and
5 collaboration tools. In the process, corporate PCs were refreshed and
6 standardized in 2005.

7 Q. Please explain why the fourth step related to applications makes it difficult to
8 obtain the type of synergies Staff alludes to in the combination of regulated and
9 non-regulated entities.

10 A. IT Application consolidation was driven by the implementation of SAP. In 2004,
11 Energy East implemented a suite of applications in SAP including, HR, Payroll,
12 Finance, Accounting and Materials management. This allowed those areas of the
13 business to consolidate under the shared service umbrella. Upon completion of
14 the Back Office implementation, the utility-specific Application teams that
15 supported those applications were consolidated onto a single central team. A
16 similar process took place in 2005, when the work management applications at
17 the Energy East utilities were replaced with SAP. After the SAP implementation,
18 support for work management applications was consolidated on a central team.
19 Each of these applications share considerable community of interest for regulated
20 entities but would be markedly different for unregulated entities that require
21 different services.

JOINT PETITIONERS' POLICY PANEL

1 Q. What were the guiding principles of the integration work undertaken by Energy
2 East in the IT area?

3 A. The integration focus was limited to the regulated T&D businesses. These
4 businesses were the common denominator for investments that fostered additional
5 commonality that could yield material merger related synergies. Branching IT
6 consolidation into other areas including unregulated activities would have diluted
7 the returns for the integration efforts. In part this dilution would have occurred
8 because of the unique nature of the regulated businesses versus all other
9 businesses. The need to segregate regulated utility shared service company
10 activities from unregulated subsidiary activities must also be recognized.

11 Q. Mr. Azagra, did any IT consolidation savings result from Iberdrola's acquisition
12 of ScottishPower and, if so, why wouldn't Iberdrola anticipate similar savings
13 with respect to Energy East?

14 A. Prior to Iberdrola's acquisition of ScottishPower, ScottishPower had a uniquely
15 high IT cost base arising from the fact that it obtained its IT services from a large
16 number of suppliers, at high costs and without disciplined procurement budgeting
17 and control at a central level. There were approximately 400 service level
18 agreements and over 400 applications being used in ScottishPower. In addition,
19 ScottishPower had not moved to the industry standard SAP application. By
20 contrast, as discussed above and as the Staff Policy Panel has acknowledged (at
21 97), Energy East's utility subsidiaries, including NYSEG and RG&E, already
22 have implemented the SAP system. In addition, given the IT consolidation that
23 has already occurred, Energy East and its subsidiaries do not have the same IT

JOINT PETITIONERS' POLICY PANEL

1 supplier management issues that were faced by ScottishPower. As such, a similar
2 opportunity for IT consolidation savings does not exist with respect to the merger
3 between Iberdrola and Energy East. For these same reasons, the Proposed
4 Transaction will also not create any stranded costs with respect to NYSEG's and
5 RG&E's SAP system, as the Staff Policy Panel suggests (at 97).

6 Additionally, the regulated T&D business represented only €3 million per
7 annum of the announced expected synergies in Iberdrola's acquisition of
8 ScottishPower. This amount was made up of some relatively limited expected
9 savings in joint procurement of capital investments, and is consistent with the
10 very limited nature of operational synergies in cross-border combinations
11 involving a regulated T&D utility. Finally, I note that there has been no IT
12 consolidation between ScottishPower's U.S. operations and Iberdrola's U.S.
13 operations since Iberdrola's acquisition of ScottishPower last year.

14 Q. Is it likely that there could be synergies in combining United States and Spanish
15 IT systems?

16 A. Iberdrola has not undertaken an evaluation of whether any cost savings could be
17 achieved by integrating common IT platforms between Energy East and Iberdrola.
18 See IBER-0095, Exhibit __ (PP-2). A variety of factors (including among other
19 things, geographic separation, time-zone differences and accounting standards)
20 would make such integration difficult, even to the extent that there were IT
21 platforms in common between Energy East and Iberdrola.

JOINT PETITIONERS' POLICY PANEL

1 Q. Please summarize the Panel's view of the potential IT integration synergies
2 suggested by Staff.

3 A. The Panel believes that material IT synergies have already been achieved by the
4 integration of the Energy East utilities' IT systems. Any alleged additional
5 synergies created by seeking to integrate unregulated affiliates would be
6 inconsistent with our efforts to avoid cross-subsidization between regulated and
7 unregulated operations.

8 **D. Alleged "Benefits" To Current Employees, Stakeholders And Others**

9 Q. The Staff Policy Panel states that the Proposed Transaction will result in
10 substantial benefits to Energy East shareholders, executives and other third parties
11 (for example, investment bankers, advisors and attorneys) that should be shared
12 with ratepayers (at 87-89). Can the Panel respond to this assertion?

13 A. This Staff argument is difficult to understand from a practical or logical
14 perspective. These are costs to consummate a transaction that is in the best
15 interests of the State. Put simply, the payments identified by the Staff Policy
16 Panel are just the cost of doing business, and would be similarly incurred by any
17 other potential acquirer of utilities in New York. In this case, these costs will
18 have no effect on customers of NYSEG and RG&E. As the Panel has previously
19 explained and as discussed in greater detail below, Iberdrola has committed that
20 its shareholders will bear the costs of the Proposed Transaction and that NYSEG
21 and RG&E will not seek recovery in rates of any such costs. To somehow claim
22 that these transaction costs are "benefits" to anyone defies logic. As discussed in
23 detail in the Rebuttal Testimony of Mr. Meehan, the Staff Policy Panel's assertion

JOINT PETITIONERS' POLICY PANEL

1 that these "benefits" should be shared with ratepayers would be a bad policy for
2 the Commission to adopt as it attempts to impose additional costs on parties
3 interested in investing in New York utilities without regard to whether such
4 purposed "benefits" are attributable to effects on New York utility operations.

5 **V. WRITE-OFFS, WRITE-DOWNS, RESERVES, AND RATE PLAN**
6 **MODIFICATIONS**

7 Q. Is the Panel generally addressing the Staff Policy Panel's and Staff's
8 recommendations regarding write-offs, write-downs, reserves and rate plan
9 modifications in your rebuttal testimony?

10 A. No. These topics are primarily being addressed in the Rate Adjustment Panel and
11 the Rebuttal Testimony of Mr. Meehan. However, the Panel would like to
12 address certain issues raised by the Staff Policy Panel with respect to goodwill.

13 Q. Does the Panel agree with Staff's definition of goodwill for regulatory purposes as
14 "the excess of the purchase price over original cost"?

15 A. Yes. It provides a workable definition of goodwill in this context.

16 Q. What are the three categories of goodwill that are discussed by the Staff Policy
17 Panel?

18 A. These three categories are the goodwill associated with the Energy East/RGS
19 transaction ("RGS Goodwill"), the goodwill associated with Iberdrola's purchase
20 of Energy East ("New Goodwill"), and existing goodwill on Iberdrola's books.

21 While the Rebuttal Testimony of Dr. Makhholm addresses the overall treatment of
22 goodwill, this Panel will briefly address Staff's proposed treatment of these three

JOINT PETITIONERS' POLICY PANEL

1 categories of goodwill.

2 Q. Mr. Rude, was the transaction that resulted in the RGS Goodwill approved by the
3 Commission?

4 A. Yes. In its *Order Adopting Provisions of Joint Proposal with Modifications*,
5 issued February 27, 2002 in Cases 01-E-0359 and 01-M-0404, the Commission
6 approved the merger that created the RGS Goodwill as in the public interest.

7 Q. Is the RGS Goodwill included on Energy East's books or on RG&E's books?

8 A. The RGS Goodwill resides on the books of RGS. The RGS Goodwill was not
9 "pushed-down" to NYSEG or RG&E. The RGS Merger Joint Proposal approved
10 by the Commission states that "the cost of such business combination [i.e. the
11 merger] shall not be 'pushed' down below the New RGS level, and the goodwill
12 created in this transaction shall not appear on the books of either RG&E or
13 NYSEG." See Section III.G of the Energy East / RGS Merger Joint Proposal
14 approved in Case 01-M-0404.

15 Q. Does the RGS Goodwill increase or decrease as a result of the Proposed
16 Transaction?

17 A. Neither. The RGS Goodwill is not changed by the Proposed Transaction.

18 Q. Have New York ratepayers paid for the RGS acquisition premium?

19 A. No. The premium was not recovered from New York ratepayers.

20 Q. Staff notes that Iberdrola has made no commitments concerning the existing
21 goodwill associated with the Energy East/RGS transaction that is currently
22 recorded on Energy East's books. Is this correct?

23 A. Yes. The Joint Petitioners' have not proposed to take any steps with the pre-

JOINT PETITIONERS' POLICY PANEL

1 existing RGS Goodwill.

2 Q. How has Staff proposed to treat the RGS Goodwill?

3 A. The Staff Policy Panel recommends that Iberdrola remove the RGS Goodwill
4 from Energy East's books (at 92-93).

5 Q. Do you support this recommendation?

6 A. No. First, the RGS Goodwill currently resides on the books of RGS, not Energy
7 East. In any event, it would be unprecedented for an unregulated entity (in this
8 case RGS or Energy East) to be required by the Commission to move goodwill
9 upstream to another unregulated entity. The RGS Goodwill was placed on the
10 books of RGS prior to the Proposed Transaction and is unrelated to and
11 unaffected by the Proposed Transaction, and it would therefore be inappropriate
12 to require Iberdrola to remove the RGS Goodwill from Energy East's books as a
13 condition to the Proposed Transaction.

14 Q. What rationale, if any, does Staff offer to support its recommendation?

15 A. Staff states that "the acquisition of Energy East involves the purchase of Energy
16 East's assets; among those assets is the goodwill on Energy East's books." Staff,
17 however, mischaracterizes the nature of the Proposed Transaction, which involves
18 the purchase of Energy East's stock and not its individual assets.

19 Q. Staff also argues that the "push up" of RGS Goodwill will improve financial
20 transparency by avoiding the fact that existing goodwill has been a continuing
21 source of controversy in the utilities' rate cases because it allegedly "clouds the
22 true picture of Energy East's financial health." Do you agree with this argument?

23 A. No. The RGS Goodwill has not in any way "clouded" the picture of Energy

JOINT PETITIONERS' POLICY PANEL

1 East's financial health. The RGS goodwill is clearly recorded on RGS's books
2 and is therefore clearly separate from RG&E's and NYSEG's books. In fact,
3 even where goodwill is recorded on the books of other Energy East utility
4 companies in other jurisdictions, no regulatory body with jurisdiction has
5 struggled with transparency or alleged the existence of any "cloud." This concern
6 is clearly without merit.

7 Q. What, if anything, should happen to the RGS Goodwill as a result of the Proposed
8 Transaction?

9 A. Nothing should happen to the RGS Goodwill. It is unrelated to, and unaffected
10 by, the Proposed Transaction and should therefore remain on the books of RGS.
11 The placement of the RGS Goodwill on RGS' books was approved by the
12 Commission when it approved the RGS transaction and Staff has failed to justify
13 its unprecedented request to move goodwill from one unregulated holding
14 company to another unregulated entity.

15 Q. Mr. Azagra, has the Staff Policy Panel raised any concerns regarding the goodwill
16 on Iberdrola's books?

17 A. Yes. The Staff Policy Panel has raised a number of concerns regarding the
18 amount of goodwill on the books of Iberdrola and the potential impairment of that
19 goodwill. There is no basis for the Staff Policy Panel's concerns on this issue. As
20 an initial matter, goodwill is not a primary indicator of the risk profile of a
21 company, as described in further detail in the Rebuttal Testimony of Mr. Fetter,
22 and the Staff has been unable to point to any credit report about Iberdrola that
23 even mentions goodwill. *See* IBER/EE IR No. 51, Exhibit __ (JPP-1).

JOINT PETITIONERS' POLICY PANEL

1 Furthermore, the goodwill on Iberdrola's balance sheet is a result of
2 historical transactions, and has been estimated based on the fair value of those
3 historic transactions, based on the expected cash flows generated through each
4 historic acquisition. Under both the International Financial Reporting Standards
5 ("IFRS") and U.S. Generally Accepted Accounting Principles ("U.S. GAAP"),
6 goodwill is recorded at a ^{cash} ~~cost~~ generating unit ("CGU") level. Thus, Iberdrola's
7 goodwill only would be impaired if its expected future cash flows were no longer
8 sufficient to support the amount of goodwill on a CGU level. Given Iberdrola's
9 strong cash flow and earnings growth, and the high opinion of Iberdrola by the
10 capital markets (as reflected in its ratings by the credit ratings agencies, and both
11 its successful capital increase to finance the Proposed Transaction and the
12 successful Iberdrola Renewables IPO) it is completely unrealistic and unfounded
13 to assume that any significant portion, much less all, of the goodwill recorded
14 across all of its various CGU levels could suddenly become impaired as suggested
15 by the Staff Policy Panel. Finally, it is important to note that Iberdrola has
16 consistently committed that no goodwill in connection with the Proposed
17 Transaction will be recorded on the books of NYSEG or RG&E. The Rebuttal
18 Testimony of Dr. Makholm explains that because Goodwill will not be pushed
19 down to the books of Energy East, NYSEG or RG&E, it will have no affect on
20 rates, or ratepayer interests.

JOINT PETITIONERS' POLICY PANEL**VI. REPORTING, FINANCIAL AND AFFILIATE RISKS IDENTIFIED BY
THE STAFF POLICY PANEL****A. Diminished Transparency and Reporting**

Q. Mr. Azagra, do you agree with the Staff Policy Panel's suggestion that the Proposed Transaction will result in diminished financial transparency and reporting?

A. No. The Staff Policy Panel states that "[d]ifferences in accounting standards and language, coupled with a complex organizational structure, and the unfamiliarity of Iberdrola with New York regulators and their policies all pose a risk for the customers of NYSEG and RG&E" (at 24-25). These risks are without foundation, and they unfairly disregard the track record of other stable and successful foreign utility investments in the United States. In particular, it is my understanding that there are a number of utilities within the State of New York that are successfully operated by foreign companies, including United Water, American Water, Niagara Mohawk and KeySpan.

Moreover, Iberdrola will continue to comply with all U.S. laws and regulations regarding financial reporting. As made clear by the SEC, both U.S. GAAP and the IFRS under which Iberdrola prepares and reports its financial statements are high-quality accounting standards that are similar to one another in many respects and rapidly converging. See Exhibit __ (JPP-7). Iberdrola also will make appropriate persons available to respond to specific inquiries regarding the differences in these two accounting standards. Additionally, Energy East will

JOINT PETITIONERS' POLICY PANEL

1 continue to use U.S. GAAP for all financial reporting and will comply with
2 existing and any applicable requirements of the Sarbanes-Oxley Act.

3 Nonetheless, the Joint Petitioners wish to acknowledge the Staff Policy
4 Panel's financial transparency and reporting concerns. While we believe that no
5 further commitments are required here in order for this Proposed Transaction to
6 be found to be in the public interest, the Joint Petitioners are willing to commit to
7 the following additional financial transparency and reporting measures to further
8 ensure that the Commission and the public will have robust access, in English and
9 in New York, to the following information related to Iberdrola, Energy East,
10 NYSEG, and RG&E:

- 11 • **Books & Records** - The Commission will have access, in English and in New
12 York, to (1) the books/records of NYSEG and RG&E, and (2) any
13 books/records of Iberdrola or any Iberdrola affiliates that are related to
14 NYSEG or RG&E. The Commission will have access, in English and in New
15 York, to any minutes of the Iberdrola Board of Directors, and any sub-
16 committee thereof, to the extent that such minutes discuss Energy East,
17 NYSEG or RG&E. Iberdrola also shall translate such other documents as the
18 Commission determines to be reasonably necessary to fulfill its statutory
19 duties.
- 20 • **Audit Reports** - The Commission will have access, in English and in New
21 York, to all internal and external audit reports and recommendations for
22 NYSEG and RG&E, and for any Iberdrola affiliate with respect to the
23 provision of goods and services for compensation to NYSEG or RG&E.

JOINT PETITIONERS' POLICY PANEL

- 1 • **Financial Statements** - Iberdrola's consolidated balance sheets, income
2 statements and cash flow statements will be made available to the
3 Commission, in English and in New York, on an annual basis and in a format
4 that is mutually agreed to between Iberdrola and the Commission Staff.
5 Audited financial statements will be in accordance with IFRS as, as issued by
6 the International Accounting Standards Board, consistent with SEC
7 requirements. Additionally, Iberdrola agrees to provide specific answers to
8 particular questions raised by the Commission and its Staff with respect to
9 IFRS.

10 The commitments should adequately address any concerns regarding financial
11 transparency and reporting issues.

12 Q. Mr. Azagra, do you believe that the translation of documents should be a major
13 issue in connection with the Proposed Transaction?

14 A. No. As a global company with significant existing operations in the U.S. and the
15 United Kingdom, and given its numerous U.S. investors, Iberdrola already
16 translates key documents into English in the ordinary course of business. Indeed,
17 a substantial amount of information, including all key financial information, is
18 already routinely made available publicly in English on Iberdrola's website.
19 Moreover, Iberdrola will need to communicate with Energy East, NYSEG and
20 RG&E in English and documents related to the management of these entities will
21 be prepared in and/or translated into English accordingly.

22 Additionally, the concerns raised by the Staff Policy Panel regarding the
23 translation of documents in the Maine Public Utilities Commission's review of

JOINT PETITIONERS' POLICY PANEL

1 the Proposed Transaction (at 47) were based solely upon the onerous number of
2 document translations requested by one party to that proceeding on issues that
3 were unrelated to the Proposed Transaction and that proceeding. That party has
4 subsequently signed a comprehensive settlement agreement that resolves all
5 issues raised in that proceeding, including translation issues, and the Maine
6 Commission has voted to approve that settlement. Iberdrola translated all
7 documents requested by the Maine Advisory Staff in that proceeding. Thus, the
8 Staff Policy Panel should not be concerned about translation issues in connection
9 with the Proposed Transaction, particularly in light of the reporting commitments
10 that I discussed above.

B. Data Security

11
12 Q. Mr. Azagra, do you agree with the Staff Policy Panel's data security concerns
13 regarding vulnerabilities in the New York electric grid, as well as sensitive
14 personal customer data, and "the possibility that this information could wind up in
15 the wrong hands" after the Proposed Transaction (at 292)?

16 A. No. Iberdrola has put robust protections in place to protect its information
17 systems against unwanted access, either by authorized or unauthorized personnel,
18 with the aim of ensuring the confidentiality and integrity of the information
19 processed by those systems. Access to Iberdrola's information systems from the
20 outside may only be made through safe, encrypted channels. These measures
21 apply to all office information systems, as well as to systems related to power
22 production and gas and electric distribution. Iberdrola's information systems
23 follow the most demanding practices in the world, including those in the United

JOINT PETITIONERS' POLICY PANEL

1 States. In fact, Iberdrola participates with other U.S. electrical utilities in the
2 Electric Power Research Institute's Cybersecurity Assessment Program, which
3 focuses on North American Electric Reliability Corporation security standards.
4 Finally, I note that Iberdrola has no intention to merge its information control
5 systems with those of Energy East.

6 Nonetheless, the Joint Petitioners want to acknowledge the Staff Policy
7 Panel's data security concerns and are willing to commit to the following
8 measures to ensure further that critical energy infrastructure information, as well
9 as sensitive personal data of NYSEG and RG&E customers, remains secure:

- 10 • **Data Security** – The Joint Petitioners commit that information about
11 vulnerabilities in the New York electric grid and the gas pipeline network, in
12 all media formats, shall remain within the headquarters of NYSEG and
13 RG&E. The Joint Petitioners also commit that customer data (*e.g.*, names,
14 addresses, telephone numbers, social security numbers, credit reports) shall
15 remain, in all media formats, within the headquarters or customer service
16 centers of NYSEG and RG&E.

C. Credit Quality Risks

17
18 Q. Mr. Azagra, do you agree with the Staff Policy Panel's concerns about Iberdrola's
19 financial status and credit downgrade?

20 A. No. The Staff Policy Panel incorrectly states that Iberdrola's capital investment
21 program "has caused concern at the credit agencies" and that the credit agencies
22 are also concerned "about the high degree of leverage Iberdrola plans to deploy
23 and how its large investment program will be financed" (at 23). The Staff Policy

JOINT PETITIONERS' POLICY PANEL

1 Panel also suggests that declines in Iberdrola's credit quality could have a
2 negative impact on the credit ratings of NYSEG and RG&E, as well as their
3 ability to raise capital. As described more fully in the Rebuttal Testimony of Mr.
4 Fetter, these concerns have no foundation. As the third largest "investor-owned"
5 utility in Europe with an impeccable track record and stable "A" category credit
6 ratings, Iberdrola's access to the capital markets at terms and pricing that are
7 consistent with its "A" category credit ratings is not in question. Additionally,
8 Iberdrola's current strong "A" category credit ratings already take into account
9 Iberdrola's capital structure and its future investment program, including the
10 information described in Iberdrola's Strategic Plan 2008-2010.

11 The Proposed Transaction does not raise any of the credit issues raised in
12 the National Grid/KeySpan transaction, in which the parent company had a lower
13 credit rating than the target utility and utilized significant debt to finance the
14 transaction. As a result of that transaction, KeySpan's standalone "A" rating fell
15 to National Grid's lower "A-" rating. If the Proposed Transaction were to have a
16 similar impact, then Energy East's credit rating would actually improve 1-2
17 notches, which would amount to a substantial improvement in its credit quality.

18 Finally, the Joint Petitioners are willing to commit to the following credit
19 quality measures to ensure further that this Commission receives all relevant
20 information related to the credit ratings of Iberdrola, Energy East, NYSEG and
21 RG&E, and that the customers of NYSEG and RG&E are protected in the
22 unlikely event that Iberdrola experiences a credit downgrade:

JOINT PETITIONERS' POLICY PANEL

- 1 • **Credit Ratings** - Iberdrola, Energy East, NYSEG and RG&E will maintain
2 credit ratings with at least two generally accepted ratings agencies (*e.g.*, S&P
3 and Moody's).
- 4 • **Reporting of Credit Events** - If there is a "Credit Event" (defined as the
5 downgrade of Iberdrola's, Energy East's, NYSEG's or RG&E's credit rating
6 below "BBB"/"Baa3", or credit rating of "BBB-"/"Baa3" with a "Watch
7 Negative", by at least two major credit reporting agencies (*e.g.*, S&P and
8 Moody's)), NYSEG and RG&E will make a timely filing notifying the
9 Commission of any such Credit Event, and subsequent filings with the
10 Commission every three months, identifying (1) the current credit rating
11 during such Credit Event and (2) a plan to remedy such Credit Event, until
12 such Credit Event is eliminated.
- 13 • **Ratings Agency Presentations and Reports** - Iberdrola, Energy East,
14 NYSEG or RG&E, as applicable, will provide the Commission on a
15 confidential basis with copies of all slide presentations to credit ratings
16 agencies relating to Energy East, as well as all rating agency reports relating
17 to Energy East or any Energy East subsidiaries, on an on-going basis.
- 18 • **Cost of Debt** - NYSEG and RG&E ratepayers shall not be responsible for any
19 increase in NYSEG's or RG&E's cost of debt caused by Iberdrola's financial
20 status. For ratemaking purposes, the Commission may impute a reasonable
21 cost of debt that is based on NYSEG's and RG&E's stand-alone risk profile.

22 Although the likelihood of a Credit Event occurring is extremely remote, the
23 above measures, along with Iberdrola's commitment to maintain its current strong

JOINT PETITIONERS' POLICY PANEL

1 "A" category credit ratings, should address the Staff Policy Panel's concerns on
2 these issues.

D. Capital Structure Risks

3
4 Q. Mr. Azagra, do agree with the Staff Policy Panel's concerns regarding Iberdrola's
5 capital structure?

6 A. No. The Staff Policy Panel raises a number of concerns regarding Iberdrola's
7 "leveraged capital structure" (at 179) and the "amount of dividends that NYSEG
8 and RG&E will have to upstream to Iberdrola once the merger is consummated"
9 (at 179). As discussed in the Rebuttal Testimony of Dr. Makhholm and Mr. Fetter,
10 these concerns are without merit and are largely irrelevant to the Commission's
11 protection of the customers of NYSEG and RG&E. In particular, the recent
12 Iberdrola Renewables IPO raised \$6.5 billion in equity to support Iberdrola's
13 renewable capital expenditure program, and fully addressed the leverage concerns
14 of the ratings agencies. Additionally, Iberdrola clearly states in its Strategic Plan
15 2008-2010 that up to 72% of its capital expenditure program will be financed by
16 means of the Iberdrola Renewables IPO, operational cash flow, and divestments
17 of over three billion euros. *See* IBER-0137S, Exhibit __ (JPP-1). The remaining
18 28% of Iberdrola's capital expenditure program will be financed by means of
19 debt, thus resulting in a net reduction of Iberdrola's debt/capital ratio.

20 On the issue of dividend restrictions, it should be noted that Iberdrola's
21 dividend policy is an integral part of its Strategic Plan 2008-2010 that has been
22 assessed by the credit agencies as part of the larger credit analysis that led to
23 Iberdrola's "A" category credit ratings. It is also my understanding that the

JOINT PETITIONERS' POLICY PANEL

1 Commission has not required dividend restrictions of the kind proposed by the
2 Staff Policy Panel (*see, e.g.*, at 273-276) in any non-synergy transaction in New
3 York in the past 11 years.

4 Nonetheless, Joint Petitioners are willing to commit to the following
5 additional (and in Joint Petitioners' view, unnecessary) measures to ensure further
6 that the customers of NYSEG and RG&E are protected from any remote
7 theoretical risks that might be raised by Iberdrola's capital structure:

- 8 • **Minimum Common Equity Ratio** - NYSEG and RG&E will at all times
9 maintain common equity capital at levels equal to or greater than 38% of total
10 adjusted capital (including common equity, preferred equity, long-term debt,
11 short term debt, capitalized leases, Current Maturities of Long-Term Debt
12 and Current Maturities of Capitalized Long-Term Leases). Notwithstanding
13 the foregoing, NYSEG and RG&E shall maintain the right to petition the
14 Commission for an exception to this condition. One-time events, such as
15 mandated changes in accounting, that temporarily affect equity will be
16 reported to the Commission and excluded from the common equity ratio
17 calculation.
- 18 • **No Cross Default** - There will be no cross default provisions in any joint
19 credit arrangements among NYSEG and RG&E, on the one hand, and
20 Iberdrola and its affiliates, on the other hand, unless otherwise authorized by
21 the Commission.
- 22 • **Money Pool Participation** - NYSEG and RG&E may participate in Iberdrola
23 money pools provided the other participants in such money pools are limited

JOINT PETITIONERS' POLICY PANEL

1 to regulated utility affiliates of Iberdrola in the U.S., unless otherwise
2 authorized by the Commission. Iberdrola shall not borrow from money pools
3 in which NYSEG and RG&E are participants.

- 4 • **Dividend Policy** - NYSEG and RG&E will maintain their respective dividend
5 policies with due regard for the financial performance and needs of NYSEG
6 and RG&E, irrespective of the financial performance and needs of Iberdrola.
7 Iberdrola will report to the Commission in the event that the dividend payout
8 for any year is more than 100% of income available for dividends calculated
9 on a two-year rolling (eight calendar quarter) average basis.

E. Ring Fencing

10
11 Q. Mr. Azagra, do you agree with the Staff Policy Panel's recommendation that
12 "substantial ring fencing covenants" are necessary "to protect the interests of New
13 Yorkers by assuring that both NYSEG and RG&E are in a position to provide safe
14 and adequate service at a reasonable price to the public" (at 242).

15 A. No. Ring fencing covenants are intended to insulate utility customers from the
16 potential credit issues of a parent company. As I have discussed above, Iberdrola
17 is a stronger, more financially stable parent company than Energy East, and
18 NYSEG and RG&E are therefore poised to benefit financially from the Proposed
19 Transaction. Accordingly, ring fencing provisions are not necessary in
20 connection with the Proposed Transaction. I also note that the National
21 Grid/KeySpan merger, in which ring fencing covenants were required, is not
22 analogous to the Proposed Transaction since National Grid was a lower-rated
23 company and used debt to finance its merger with KeySpan.

JOINT PETITIONERS' POLICY PANEL

1 For these same reasons, other extreme measures that have been proposed
2 by the Staff Policy Panel, such as a “golden share” to provide a veto right with
3 respect to voluntary bankruptcy petitions, are not appropriate for the Proposed
4 Transaction. It is my understanding that the National Grid/KeySpan merger is the
5 only instance in which the Commission has required the “golden share,” a
6 mechanism that former Chairwoman (and current Commissioner) Acampora has
7 described as “unusual.” See Exhibit __ (JPP-2). The Rebuttal Testimony of Dr.
8 Makhholm addresses further why a “golden share” is an unnecessary and
9 inadvisable measure. I do note, however, that certain commitments made by the
10 Joint Petitioners in this Panel testimony may serve as ring fencing protections,
11 including commitments regarding separate accounting and financial statements
12 for NYSEG and RG&E, limitations on NYSEG and RG&E assets transfers,
13 dividend restrictions, and prohibitions against guarantees, pledges or other credit
14 support by NYSEG and RG&E in favor of Iberdrola or its affiliates.

F. Affiliate Transaction Risks

16 Q. Mr. Azagra, do you agree with the Staff Policy Panel’s suggestion that the
17 Proposed Transaction will create incentives for cross-subsidization and raise other
18 affiliate transaction issues (at 26-27)?

19 A. No. The Staff Policy Panel suggests that the magnitude of Iberdrola’s
20 unregulated operations “creates an incentive to misallocate costs” and that the
21 “complexity of its corporate structure would make it difficult to follow audit trails
22 for its complex transactions” (at 27). The Staff Policy Panel also expresses
23 concern about Staff’s ability to effectively monitor affiliate transactions “which

JOINT PETITIONERS' POLICY PANEL

1 may take place overseas, be recorded in a foreign currency (Euros), may be
2 treated on an international accounting basis, and may be in a foreign language” (at
3 26-27). The Staff Policy Panel also proposes a number of revisions to the existing
4 safeguards that are in place for affiliate transactions, which Staff claims will be
5 “inadequate since they may not be able to capture the nuances and unknowns
6 related to the future dealings between Iberdrola, Energy East, and the utilities” (at
7 294).

8 As more fully described in the Rebuttal Testimony of Dr. Makholm, the
9 Staff Policy Panel’s concerns with respect to affiliate transactions are without
10 merit. Iberdrola’s organizational structure is not particularly complex; it is similar
11 to that of any organization with a variety of operating utilities and an unregulated
12 entity that holds separately financed generation projects. In fact, it is my
13 understanding that there are already utility holding companies with operations in
14 New York with significantly more complex organizational structures than
15 Iberdrola (*e.g.*, Suez). Moreover, Iberdrola has significant experience in the
16 ownership of both regulated and unregulated operating companies, and will fully
17 comply with the Commission’s, and the FERC’s, standards, regulations and
18 policies with respect to the relationship between its regulated and unregulated
19 affiliates (*e.g.*, Standards of Conduct, Codes of Conduct, etc.). Nonetheless, the
20 Joint Petitioners are willing to commit to the following measures to ensure further
21 that there are no potential incentives for cross-subsidization among NYSEG,
22 RG&E and Iberdrola’s unregulated affiliates:

JOINT PETITIONERS' POLICY PANEL

- 1 • **Cost Allocations** – NYSEG and RG&E will continue to utilize Energy East's
2 cost allocation methodologies and Energy East will allocate centralized costs
3 from Iberdrola to NYSEG or RG&E only to the extent that such costs are
4 properly chargeable to utility operations and accepted by the Commission.
5 Costs charged by Iberdrola or its affiliates to Energy East and any of its U.S.
6 affiliates that either directly or indirectly affect NYSEG's or RG&E's costs of
7 service shall be based on Energy East's approved cost allocation
8 methodology, unless otherwise permitted by the Commission.
- 9 • **Separate Accounting and Financial Statements** - NYSEG and RG&E will
10 maintain separate and independent accounting records and financial
11 statements from that of Iberdrola and all other affiliates.
- 12 • **Asset Transfers** - NYSEG and RG&E will not transfer or sell material assets
13 or facilities to Iberdrola or any affiliate without prior approval of the
14 Commission. All asset sales to these entities will be on an arm's-length basis,
15 and be subject to market vs. book value tests.
- 16 • **No Lending** - NYSEG and RG&E will not loan funds to Iberdrola or any
17 unregulated affiliate, either through a money pool or otherwise, unless
18 otherwise authorized by the Commission..
- 19 • **No Credit Support** - NYSEG and RG&E will not provide guarantees,
20 collateral, or pledge or provide any other type of credit support for the benefit
21 of Iberdrola or any affiliate.

22 These commitments should fully resolve any potential concerns regarding
23 chaining transactions, costs allocation or other affiliate transaction issues.

JOINT PETITIONERS' POLICY PANEL

1 Q. Staff has proposed in Exhibit __ (PP-25) modifications to the Standards
2 Pertaining to Affiliates and the Provision of Information, which were set forth as
3 Appendix B to NYSEG's 2002 Merger Joint Proposal. The document is
4 commonly referred to as the Code of Conduct. Does the Panel believe that Staff's
5 proposed changes are necessary or appropriate?

6 A. No. As Staff acknowledges, the existing affiliated transaction rules are adequate
7 to govern the relationship between Energy East holding and services companies,
8 NYSEG, and RG&E. Staff's primary justification for seeking to change the Code
9 of Conduct is that it, "may not be able to capture the nuances and unknowns
10 related to the future dealings between Iberdrola, Energy East and the utilities" (at
11 294).

12 Q. What is the Panel's overall view of Staff's proposed changes?

13 A. We disagree with the unilateral nature of the changes and believe that they should
14 be rejected. The existing Code of Conduct, which has already been approved by
15 the Commission, should remain in place, except for those provisions discussed
16 elsewhere in this Panel testimony.

G. Other Commitments

17
18 Q. Are there any other commitments that the Joint Petitioners are willing to make to
19 ensure that the ratepayers of NYSEG and RG&E are not adversely affected by the
20 Proposed Transaction?

21 A. Yes. The Joint Petitioners continue to make the following commitments, both of
22 which were included in the Joint Petitioners' Direct Testimony:

JOINT PETITIONERS' POLICY PANEL

- 1 • **Acquisition Premium** - NYSEG and RG&E will not seek recovery of the
2 acquisition premium being paid by Iberdrola in the Proposed Transaction,
3 either directly or indirectly, from customers in any proceeding.
- 4 • **Transaction Costs** - NYSEG and RG&E will not seek recovery in rates of
5 any transaction costs for the Proposed Transaction in any proceeding.
6 Transaction costs include investment bank fees, legal fees, transfer or other
7 taxes, severance or change of control related payments, incremental costs for
8 stock options and restricted stock and any other costs incurred either to
9 complete or as a result of the Proposed Transaction.

10 While the Staff Policy Panel has suggested that this final commitment not to seek
11 recovery from New York ratepayers of any costs incurred to consummate the
12 Proposed Transaction is insufficient to prevent those costs from improper
13 allocation at some time in the future (at 95), this concern is without foundation.
14 The Commission clearly has the means to ensure the Joint Petitioners remain in
15 compliance with this explicit commitment, and the Joint Petitioners have all the
16 proper incentives to comply with a merger condition of this nature.

VII. EXISTING RG&E AND NYSEG GENERATION

17

18 Q. Mr. Rude, the Staff Policy Panel asserts that there are indications that RG&E does
19 not intend to fulfill its commitment to sell the Russell Station to a non-affiliated
20 company after the completion of the Rochester Transmission Project ("RTP") (at
21 131-132). How do you respond to Staff's assertion?

JOINT PETITIONERS' POLICY PANEL

1 A. Staff is incorrect. RG&E will comply with Commission orders and meet RG&E's
2 existing obligations unless the Commission otherwise so determines. To be clear,
3 the Commission has ordered RG&E to auction the Russell Station after
4 completion of the RTP. As explained below, there are certain facts that have
5 changed since the Commissions' determination on this issue, and RG&E believes
6 it is important for the Commission to be aware of these changes. If the
7 Commission makes no determination that alters the Commission order to auction
8 Russell Station to an unaffiliated third party, then RG&E will proceed to develop
9 protocols to conduct the auction after RTP begins operation.

10 Q. When would RG&E present its repowering scenario to the Commission?

11 A. In the absence of the consummation of the Proposed Transaction, RG&E had
12 planned to make a filing with the Commission in June 2008 demonstrating the
13 need for repowering, an assessment of alternatives to the re-powering of Russell
14 Station, the expected costs and in-service date of its proposed re-powering
15 project, and proposed ratemaking treatment. RG&E requests that the Commission
16 provide an opportunity for RG&E, Staff, and any other interested parties to
17 evaluate thoroughly the possibility of Russell Station being re-powered as a
18 regulated project owned by RG&E. Since RG&E (like all other electric utilities
19 in New York) remains a provider of last resort under the Public Service Law, it is
20 incumbent upon RG&E to examine all options to meet this responsibility,
21 including utility-owned generation. Any auction of the Russell Station should not
22 commence until the Commission has a chance to review and rule on RG&E's
23 repowering proposal.

JOINT PETITIONERS' POLICY PANEL

1 Q. Please provide background information on this issue.

2 A. In December 2004, the Commission granted RG&E a certificate of environmental
3 compatibility and public need for the RTP based on a Joint Settlement Agreement
4 reached among the parties. The Joint Settlement Agreement approved in that
5 proceeding called for an auction of the Russell Station after completion of the
6 RTP but did not contemplate the changes in the Rochester system that have
7 subsequently taken place. The Joint Proposal, which was signed by RG&E, the
8 Department of Public Service, the Department of Environmental Conservation
9 and the Department of Agriculture and Markets, at page 30 states that “[t]he RTP
10 would also be in the public interest because it would allow RG&E to fulfill its
11 commitment (made on the record in RTP-0051) to follow an appropriate
12 competitive auction process with the goal of the sale of the Russell Station site to
13 a non-affiliated entity.” The Rochester system has experienced additional growth
14 since that time and RG&E has identified a localized reliability need within the
15 system that cannot, and was not designed to, be met by the RTP. Based on a
16 preliminary analysis, RG&E believes it can meet the reliability need through the
17 repowering of Russell Station at its current site.

18 Q. In addition to the Russell Station, Staff has recommended the divestiture of all
19 existing generation owned by NYSEG & RG&E. Do you agree with this
20 recommendation?

21 A. No. If the goal is to avoid vertical market power, the sale of the Carthage Plant,
22 which is a market-based unit owned by an unregulated affiliate, and certain hydro
23 and gas peaking facilities will not impact that goal. Staff appears to want to force

JOINT PETITIONERS' POLICY PANEL

1 the utilities to sell any and all generation, without any meaningful analysis of
2 ratepayer impacts. The Rebuttal Testimony of Dr. Hieronymus shows that there
3 are no market power concerns associated with this generation.

4 Q. You testified that Staff is seeking the sale of the hydro units. Is there any harm to
5 ratepayers if hydro assets must be sold?

6 A. Yes. The hydro facilities provide benefits to consumers. They are renewable
7 resources, which New York is seeking to encourage. Hydro also provides a hedge
8 against the volatility of market prices. Significantly, NYSEG and RG&E have
9 owned these hydro facilities for decades and have never been required by the
10 Commission to divest them.

VIII. Attempt to Compare Other Offers to the Proposed Transaction

11
12 Q. Mr. Rude, did Energy East entertain other offers or review certain strategic
13 initiatives prior to its acceptance of Iberdrola's offer?

14 A. Yes. However, those strategic initiatives did not involve the acquisition of
15 Energy East and are not comparable to the Proposed Transaction. As described in
16 Energy East's Schedule 14A Proxy Statement filed September 26, 2007, Energy
17 East was approached towards the end of the first quarter of 2007 about the
18 possible sale of certain of its operating subsidiaries. In April, management and
19 the Board of Directors also began to consider, on a preliminary basis, the possible
20 acquisition of a small electric utility company.

21 Q. What was the result of the proposed acquisition of a small electric company and
22 the sale of certain of Energy East's operating subsidiaries?

JOINT PETITIONERS' POLICY PANEL

1 A. Neither transaction was consummated.

2 Q. Why not?

3 A. As indicated in Energy East's Schedule 14A Proxy Statement filed September 26,
4 2007, the Board of Directors discussed the potential benefits of those two
5 strategic transactions and determined that the benefits of completing those
6 transactions were outweighed by the benefits associated with the Proposed
7 Transaction with Iberdrola.

8 Q. Staff objects to the need for confidentiality regarding various details of the
9 tentative transactions and the identity of the involved parties. Is the identity of the
10 parties and the specific assets involved in exploration of these types of proposed
11 transactions customarily kept confidential?

12 A. Yes. It is normal for parties to explore sensitive strategic initiatives only after
13 confidentiality has been guaranteed. In fact, Energy East and the two interested
14 parties entered into confidentiality agreements for both transactions. These
15 agreements place restrictions on Energy East's ability to reveal specific
16 information.

17 Q. The Staff Policy Panel alleges that Energy East has refused to provide information
18 on the proposed transactions (at 35-36). Is this accurate?

19 A. It is not accurate. Energy East provided information to Staff regarding the
20 transactions. There was a good faith dispute over the relevance of some of the
21 information requested and that dispute has been resolved by Administrative Law
22 Judge Epstein's ruling.

23 Q. Are the alternative transactions described in the Proxy Statement valid for

JOINT PETITIONERS' POLICY PANEL

1 comparison purposes?

2 A. No. They provide no useful basis for comparison to Iberdrola's proposed
3 acquisition of Energy East. The two transactions are irrelevant since neither
4 involved an alternative bid for the sale of Energy East. In other words, the sale of
5 Energy East to a third party was not at issue in those transactions.

6 Q. The Staff Policy Panel claims that "since there were competing proposals, by
7 proceeding with the Iberdrola transaction Energy East could be forgoing or could
8 have foregone other transactions that offered synergy savings for customers" (at
9 36). Do you agree that the two transactions identified in the Proxy Statement are
10 competing proposals in the sense utilized by Staff?

11 A. As we testified previously, there were no "competing proposals" for the purchase
12 of Energy East. Any alleged synergies or other benefits to New York ratepayers,
13 had the proposed acquisition of a small electric company or the sale of certain
14 Energy East operating subsidiaries been completed, were not quantified and any
15 attempt to do so after the fact would be exceedingly speculative since the terms of
16 the transactions were not finalized and neither transaction was consummated. We
17 also note that the Commission has approved many "first mover" transactions in
18 the past.

19 Q. Do you agree with the Staff Policy Panel's allegations that the Board of Energy
20 East "in evaluating several competing proposals ... should have considered each
21 option's chance of being approved in all jurisdictions, including New York" (at
22 35)?

23 A. No. As we noted previously, there were no "competing proposals" and none of

JOINT PETITIONERS' POLICY PANEL

1 the alternative transactions required New York approval.

2 **IX. RGS Merger Commitments**

3 Q. Mr. Rude, do you agree with the Staff Policy Panel's statements that Energy East
4 has "not completely" followed through on its commitments when it acquired RGS
5 (at 64)?

6 A. No. Energy East reasonably met its RGS merger commitments to the
7 Commission, even though changed circumstances required some modification in
8 how they were met.

9 Q. Is there a specific document that contains the RGS merger commitments?

10 A. Yes. The commitments made by Energy East to the Commission with respect to
11 its acquisition of RGS were set forth in full in the Joint Proposal and the 2002
12 Merger Order adopting that Joint Proposal, *Order Adopting Provision of Joint*
13 *Proposal with Modifications*, issued February 27, 2002 in Cases 01-E-0359 and
14 01-M-0404.

15 Q. What specific claims does Staff make regarding Energy East's commitments?

16 A. First, Staff alleges that RG&E's proposed rate filing in 2003 with a 6% increase
17 was contrary to the company's commitment to provide stable rates. Staff,
18 however, ignores the fact that the rates approved by the Commission actually
19 froze RG&E's electric and gas base delivery rates through December 31, 2008 and
20 limited overall increases in RG&E electric and gas revenues to \$7.4 million
21 (about 1.4%) and \$7.2 million (2.2%), respectively. RG&E thus satisfied its
22 commitment to provide stable rates. Staff also alleges that RG&E failed to

JOINT PETITIONERS' POLICY PANEL

1 increase its financial strength due to a downgrading of its debt. As noted in the
2 Rebuttal Testimony of Dr. Makholm and Mr. Fetter, debt ratings are subject to
3 various factors, including cash flow, which for regulated utilities is driven
4 ultimately by the Commission's rate orders. Staff further ignores the inherent
5 financial strength in RG&E becoming part of a far larger financial organization.
6 With regard to the announcement of layoffs noted by Staff, at the time of the RGS
7 Merger Petition, the petitioners in that transaction had no plans to reduce
8 workforce. However, workforce reductions were ultimately necessary in light of
9 the amount of synergies the Commission required as part of its merger approval.
10 In addition, very few of these reductions involved involuntary separations. Staff
11 also alleges that the petitioners' commitment to the region in that transaction was
12 reduced rather than enhanced when Energy East's headquarters were moved to
13 Maine. Staff ignores the fact that Energy East strengthened its commitment to the
14 region by maintaining the headquarters of RGS, NYSEG and RG&E in
15 Rochester, New York. In addition, significant shared service operations,
16 including supply chain and IT, were established in Rochester. Finally, Staff
17 argues that three RGS Directors were not placed on Energy East's Board as
18 committed. Staff did not mention the circumstances surrounding these issues,
19 which have already been addressed in prior proceedings before the Commission.
20 In particular, one of the directors was elected but unable to serve and another
21 chose to retire. The remaining RGS director was elected to Energy East Board
22 and continues to serve to this day. There was no agreement on alternative
23 directors for the other two positions.

JOINT PETITIONERS' POLICY PANEL

1 Q. Have you reviewed the Staff Exhibit __ (PP-21)?

2 A. Yes. This exhibit compares the value of Staff's proposed Positive Benefits
3 Adjustments in the current proceeding with Staff's calculation of customer
4 benefits from the National Grid/KeySpan transaction and the earlier Energy
5 East/RGS merger.

6 Q. With respect to the Energy East/RGS merger, what calculation does Staff make
7 regarding the level of customer benefits?

8 A. Staff's filed Exhibit __ (PP-21) shows that Staff has calculated that customers of
9 NYSEG and RG&E received almost \$821.7 million in cumulative reductions over
10 five years, or approximately 12.6% of five-year delivery revenues.

11 Q. Do you agree with this characterization of the benefits from that transaction?

12 A. No.

13 Q. Has Staff indicated that it made a calculation mistake on its filed Exhibit __ (PP-
14 21)?

15 A. Yes. In Staff data response IBER/EE IR No. 73, Exhibit __ (JPP-1), Staff states,
16 "(i)n preparing this workpaper, Staff corrected errors to Exhibit __ (PP-21), and
17 included the corrections in the workpaper. A revised Exhibit will be filed at a
18 later time." Staff apparently realizes that its initial calculation of the Energy
19 East/RGS merger benefits was incorrect. However, Staff's revised calculation is
20 also incorrect and misleading. We will discuss both of Staff's calculations below.

JOINT PETITIONERS' POLICY PANEL

1 Q. How did Staff develop its initial calculation of \$822 million in merger benefits
2 related to the EE/RGS merger?

3 A. While Staff has not provided backup, we believe that Staff used the
4 "NYSEG/RG&E Synergy Estimate, Synergy Allocation Appendix A," which was
5 a table of projected annual merger benefits filed with the Joint Proposal in Case
6 01-M-0404 – Energy East/RGS Merger. The Synergy Appendix A showed a five
7 year total net benefit figure of \$164.3 million for the four Companies (NYSEG
8 and RG&E electric and gas). The Synergy Appendix A is attached as Exhibit __
9 (JPP-8). It appears that Staff incorrectly multiplied total five-year net synergy
10 benefit by another 5 years (\$164.3 x 5 years) to arrive at its comparison amount of
11 \$821.7 million shown on Exhibit __ (PP-21).

12 Q. How has Staff revised its calculation?

13 A. Staff has apparently revised its EE/RGS merger benefit calculation to now equal
14 \$383.4 million?

15 Q. Do you agree with either calculation?

16 A. No. For several reasons both calculations are incorrect. Staff's initial
17 computation utilized a five-year amount and then multiplied it by another five
18 years (\$164.332 million from Appendix A times 5 years). Staff effectively
19 measured 25 years of net synergy benefits. Staff's revised calculation utilizes
20 only the "year 5" benefit amount of \$76.673 million and then multiplies it by 5
21 years. Even in its revised calculation, Staff does not utilize the five-year amount
22 that was used by the Commission itself in approving that merger. Instead Staff

JOINT PETITIONERS' POLICY PANEL

1 has created a calculation that is misleading and an incorrect basis for its
2 comparison schedule.

3 Q. Why is Staff's revised calculation misleading?

4 A. Because Staff did not utilize the five-year synergy amount from the Energy
5 East/RGS merger. Appendix A of the Energy East/RGS merger clearly shows a
6 total five-year synergy savings of \$164.332 million. This amount should then be
7 multiplied by 50% to reflect the 50/50 sharing between customers and
8 shareholders.

9 **X. THE CITY OF ROCHESTER'S ALLEGATIONS**

10 Q. Mr. Laurito, does the City of Rochester ("City") support the merger?

11 A. In its testimony, the City states that it believes it could support the merger if
12 certain "concerns" were resolved.

13 Q. What are those concerns?

14 A. The City alleges at page four of its testimony that it has an existing "right-of-way
15 facilities issue" with RG&E, and asks Iberdrola to commit to a "satisfactory
16 resolution." The City is also concerned with the aesthetics of "unsightly" utility
17 poles and wires. Utility plants, in the form of poles, wires, and related equipment,
18 are the basic infrastructure of energy distribution. This infrastructure traditionally
19 has been constructed largely above-ground given that such construction is the
20 most cost-effective way of providing reliable electric service. Recent legislation
21 has required placing electric facilities underground for certain new construction,
22 and in statutorily defined "visually significant" areas (such as state parks). RG&E

JOINT PETITIONERS' POLICY PANEL

1 makes significant effort to locate its distribution lines in places that are out of
2 public view, to the greatest degree possible. I note that none of these concerns is
3 in any way related to the Proposed Transaction.

4 Q. Is RG&E responsible for the resolution of the City's concern?

5 A. While there generally is no legal basis for requiring underground installation at
6 utility expense for aesthetics alone, RG&E is committed to working with the City
7 on a project-by-project basis to do what it can, under its tariff, to accommodate
8 the City's development interests. This may include involving the Commission
9 where necessary.

10 Q. The City also references discussions with RG&E involving the purchase by the
11 City of street lighting facilities still owned by RG&E. What is the status of those
12 discussions?

13 A. The City and RG&E have been in regular communication on the sale of these
14 facilities and are currently negotiating a fair sale price and other relevant terms
15 and conditions.

16 Q. The City alleges that several RG&E facilities are characterized by "substantial
17 unresolved environmental issues" (at 5-8). Can you comment on each of these
18 facilities and the steps RG&E has taken, and continues to take, to deal with
19 associated environmental issues?

20 A. Yes. The City identifies three RG&E facilities in which it has particular interest.
21 It should be noted that the City's interest in these facilities is driven by a
22 downtown development strategy that incorporates RG&E property into the City's
23 vision. I will address each facility in turn.

JOINT PETITIONERS' POLICY PANEL

1 Q. What about Beebee Station?

2 A. Beebee Station is a generating facility that was retired in substantial part in 1999.
3 The site still is home to a small gas turbine electric peaking facility and two
4 substations. It is also the location of a former manufactured gas plant ("MGP")
5 site. As such, it is included among other similar sites in a Voluntary Cleanup
6 Agreement ("VCA") entered into by RG&E and the New York State Department
7 of Environmental Conservation ("DEC") in 2003. Pursuant to the VCA, RG&E is
8 preparing a remedial investigation work plan for submittal to the DEC for review.
9 Upon approval by the DEC the investigation will be performed and the results
10 captured in a remedial plan targeted to be initiated, based on current planning and
11 assumptions, in 2012.

12 Q. Can you comment on the various buildings on the site referenced in the City's
13 testimony?

14 A. Concurrent with activities under the VCA, RG&E has initiated projects to survey
15 building materials on the property in anticipation of the eventual demolition or
16 sale of the buildings, and remediation of the site. Additionally, RG&E has begun
17 moving the substation facilities to a new location. That relocation work is
18 expected to be completed by mid-2009. Demolition of certain facilities has
19 already begun, with two stacks to be razed by March 2008, weather dependent.

20 Q. Why has it taken so long to prepare the site for future use?

21 A. The Beebee site is large and complex, having been used for a variety of utility
22 purposes for more than ninety years. Preparing the site for a new commercial use
23 is expensive and time consuming. It is also subject to regulatory oversight by

JOINT PETITIONERS' POLICY PANEL

1 several agencies, each with its own agenda and timetable. However, RG&E has
2 clearly demonstrated by the many ongoing activities at that site and the
3 expenditure of associated funds that it has a real commitment to managing the site
4 in a responsible manner with all interests, including the City's, being considered.

5 Q. What about Andrews Street?

6 A. The Andrews Street facility, described by the City's witness as "an unresolved
7 brownfield site" (at 7), is in the midst of an active remedial program overseen by
8 the DEC. The site has a varied history, first being utilized as an MGP from the
9 mid-1800s. It was later the location of RG&E's energy control center ("ECC").
10 The building housing the ECC was demolished in 2000. RG&E received an offer
11 to purchase the site from a private developer. At the City's request, however, that
12 offer was rejected in cooperation with the City's development plans. RG&E
13 completed a site investigation and submitted its report to the DEC in January
14 2006. The DEC has yet to respond to that report. Notwithstanding the DEC's
15 timetable, RG&E is currently preparing a remedial plan for the site so that
16 remediation can begin as soon as possible.

17 Q. Why do you believe the DEC has not yet responded to the investigation report?

18 A. The report identified less contamination than was speculated, and given scarce
19 DEC resources and other RG&E environmental projects, the DEC may have
20 directed resources to sites of greater concern.

21 Q. What remains to be done at the site?

22 A. Upon DEC approval, the investigation report will be used to finalize a remedial
23 plan which, by current estimates, is targeted to be completed and implemented by

JOINT PETITIONERS' POLICY PANEL

1 late 2009. Total costs expended to date on all activities associated with preparing
2 the site for future use are approximately \$1,000,000 plus demolition costs.

3 Contrary to the City's allegations, the Andrews Street site is at the tail end of the
4 regulatory process that will make it available for commercial use.

5 Q. What interest does the City have in the 81 South Avenue facility?

6 A. That RG&E facility, which currently houses a substation and breaker for Station
7 26, dates back to the late 1800s, and is built on the foundation of an even earlier
8 structure important to the City for historical purposes. The City desires public
9 access to that facility as a part of a to-be-constructed pedestrian passageway
10 between the Rochester Riverside Convention Center and the Blue Cross Arena,
11 via an old aqueduct.

12 Q. Does RG&E object to the City's interest in access to the facility?

13 A. No. Subject to a review of the facility's structural condition and consideration of
14 any necessary safety enhancements and other issues required for public access,
15 RG&E believes that the City's interest can be accommodated.

16 **XI. CONCLUSION**

17 Q. Does this complete the Panel's rebuttal testimony at this time?

18 A. Yes, it does.

1 BY MR. FITZGERALD:

2 Q. Panel, I would like to turn now to your exhibits. Were
3 the following exhibits prepared by you or under your direction
4 and supervision, or were they provided by another party in
5 response to an information request for discovery in this
6 proceeding: Your Exhibit JPP-1, consisting of responses or
7 attachments of responses to Multiple Intervenor 4, Iber 0030,
8 attachment to CPT, CPB 5-S, Iber 0137-S, DPS Staff responses to
9 Iber EEIR Number 1, Iber EEIR Number 12, Iber EEIR Number 27,
10 Iber EEIR Number 51 and Iber EEIR Number 73, Exhibit JPP-2, which
11 is remarks from former Chairwoman Patricia Acampora to Lehman
12 Brothers, Exhibit JPP-3, an S&P report entitled, "Spain's
13 Withdrawal Affirmed at A Minus A-2 on IPO Completion," Exhibit
14 JPP-4, which consists of Moody's credit opinion dated December
15 13th, 2007, Exhibit JPP-5, a 76-page Iberdrola quarterly report,
16 Exhibit JPP-6, which is a one-page stock price comparison sheet,
17 Exhibit JPP-7, a 111-page U.S. Securities Exchange Commission
18 financial statement prepared in accordance with international
19 financial reporting standards, Exhibit JPP-8, which is Appendix A
20 from the Joint Proposal in Case 01-M-0404? Do you also have an
21 additional Exhibit JPP-9 entitled, "The Joint Petitioners'
22 Partial Acceptance," consisting of four text pages and one table
23 which was distributed to the parties on March 14th, 2008?

24 A. (Mr. Laurito) Yes.

1 A. (Mr. Rude) Yes.

2 A. (Mr. Azagra) Yes.

3 MR. FITZGERALD: Your Honor, we'll distribute a copy
4 of Exhibit JPP-9 at this point and give it to the reporter and to
5 any parties who need one.

6 Q. Just to be clear, were these exhibits prepared by you or
7 under your direction?

8 A. (Mr. Azagra) Yes.

9 A. (Mr. Laurito) Yes.

10 A. (Mr. Rude) Yes.

11 Q. Do you have any corrections or changes to your Exhibits
12 JPP-1 through JPP-9?

13 A. (Mr. Laurito) No.

14 A. (Mr. Rude) No.

15 A. (Mr. Azagra) No.

16 MR. VAN RYN: Your Honor, may I interrupt for a
17 moment? I know that in this proceeding objections to exhibits
18 are properly going to be heard at the end of the hearings.
19 However, I do not believe that this document is properly defined
20 as an exhibit. Instead, it's in the nature of surrebuttal, late
21 filed surrebuttal. Looking at this, I think the appropriate
22 remedy at this point is that Staff will attempt to do
23 supplemental direct when it puts its Policy Panel on. However,
24 Staff may not be able to address all these issues this raises

1 through supplemental oral or direct, and I would, therefore, also
2 reserve the right to file supplemental testimony at a later time
3 addressing anything we feel we did not adequately address on
4 direct here. If that necessitates that we come back for an
5 additional hearing, so be it.

6 MR. SCHWARTZ: Your Honor, may I respond?

7 JUDGE EPSTEIN: Yes.

8 MR. SCHWARTZ: Your Honor, this document is not
9 intended, nor is it, in fact, to be a supplemental piece that
10 modifies in any way what has been produced already in this
11 proceeding. What it is is an attempt to partially reduce the
12 number of issues and contentions in this proceeding. So what we
13 have done very carefully and what this panel has done very
14 carefully, is to look at what's been proposed by other parties,
15 including Staff, with citations and to say that we accept and
16 that the panel accepts certain of those items in order to
17 minimize and reduce the issues outstanding in this proceeding.

18 So this is not intended to be any document that
19 results from any independent study or any independent analysis
20 that this panel or the Joint Petitioners had undertaken. To the
21 extent that this document proves problematic, these are the same
22 concepts this panel on cross-examination would be willing to say
23 in response to each individual issue that they would accept. And
24 so, therefore, we dispute Mr. Van Ryn's contention here that this

1 creates a necessity to then create another round of testimony for
2 evidentiary submission in this process.

3 In fact, it's our view that to the extent that your
4 Honor believes that that would be the case, that we would be in
5 just as good a position to withdraw this document, which may not
6 be in the interests of the other parties and the efficiency of
7 this process and to, instead, have these witnesses respond to
8 questions by the other parties and to Staff on each of these
9 questions as to whether, in fact, they accept a reduction in the
10 issues of this proceeding.

11 This document is merely here in order to promote
12 that level of efficiency so that in one place we lay that out.
13 We provided it in advance to the parties prior, instead of doing
14 it here in this process. It is not intended to, in fact, expand
15 the scope of this proceeding or create additional rounds.

16 JUDGE EPSTEIN: All right. Well, Mr. Schwartz, I
17 agree with you that it's useful for narrowing the scope of the
18 discussion in the hearing. So I like the idea of having it
19 available. If, as I believe the question before us is simply
20 whether this is an exhibit or surrebuttal, it sounds like a
21 question that's not material, except that I'd like to resolve it
22 in a way that doesn't create any confusion as to what the
23 parties' rights are from this point on. I don't want to say that
24 it's an exhibit, if that forecloses staff from making the

1 argument that you just heard, that because of the timing, it has
2 generated a right on their part to file additional testimony.

3 If -- well, I'm thinking out loud, which is always a
4 dangerous game, but if it's testimony, if we put it in the
5 transcript as surrebuttal, I don't see that anybody is
6 prejudiced; am I right.

7 MR. VAN RYN: I agree, and I'd just like to point
8 out, too, that we will attempt to address this on supplemental
9 direct orally. I am merely reserving the right to later file
10 testimony. I'm not sure that we would need to do so, and I'm
11 trying to think about a process, a more efficient process for
12 handling that, and I'd like some time, more time to think about
13 that.

14 Let's see how supplemental direct goes, and perhaps
15 we can discuss the procedures thereafter.

16 MR. SCHWARTZ: Your Honor, can I make one other
17 statement about that? I think that that's a workable way to do
18 it. I think it's useful to note on the record that the Joint
19 Petitioners would oppose any effort to supplement this record
20 with the submission of further testimony after the close of this
21 hearing. I think it's -- I think we should all know that we
22 believe that the evidentiary record should be closed at the end
23 of this process that you are holding here and that there should
24 be no need to provide additional rounds of testimony or

1 additional oral evidentiary hearings in this process.

2 JUDGE EPSTEIN: All right. Well, I don't
3 necessarily accede to that, but your point is noted for the
4 record. Mr. Prestemon.

5 MR. PRESTEMON: I think Mr. Schwartz' concession
6 answered most of what I was going to say, but I would add that we
7 all have an opportunity to cross-examine this panel and the
8 contents of this document now, and it probably would be more
9 fruitful to revisit this question after that is done to let
10 anyone who wants to do so indicate what they feel they have not
11 had a fair opportunity to question or respond to and don't have
12 sufficient information on.

13 I would hope at that point that any additional
14 sur-direct (sic) or whatever it might be called, would be
15 minimal. Our reading of the CPB of this document was that it was
16 not particularly argumentative, that it did not attempt to stake
17 out new positions or introduce new information not previously
18 available. It was an effort to cut off issues by taking a
19 position and agreeing to stand by it, and that, I thought, was
20 helpful to all of us.

21 JUDGE EPSTEIN: All right. I don't know whether
22 Staff will be prepared, at the end of the cross of this panel, I
23 don't know whether staff will be prepared to make a
24 representation that you were just calling for, Mr. Prestemon, but

1 we'll get to that when we get to it.

2 The immediate question of how to enter this
3 document, based on the discussion we have just had, this document
4 which is entitled, "Joint Petitioners' Partial Acceptance
5 Document," should go in the transcript as an additional piece of
6 prefiled testimony from this panel.

7 MR. VAN RYN: Your Honor, could we just -- just a
8 technical point. The last page is more in the nature of an
9 exhibit, and Staff would agree to mark that as an exhibit, and it
10 might help the record because it does look like an exhibit.

11 MR. SCHWARTZ: Your Honor, one comment. I don't
12 mean to interrupt this question that Mr. Van Ryn just raised.
13 One comment: You had mentioned that you would mark this as
14 testimony. I don't think we should try to confuse this. The
15 Joint Petitioners do not think that this would be an additional
16 round of testimony. To the extent that it's useful for your
17 Honor or for any other person to ask these witnesses whether they
18 agree and adopt this stipulation and have it marked as an exhibit
19 accordingly in this proceeding, I think would be appropriate. I
20 don't think in and of itself it reflects testimony, until such
21 time as somebody asks them whether, in fact, they agree to the
22 terms of this Joint Acceptance Document, which I believe that
23 they have already indicated that they would.

24 JUDGE EPSTEIN: Well, again, I'm just interested in

1 having it in the record in some manner that doesn't prejudice
2 Staff's argument. I don't want to prejudice the parties'
3 argument simply because we called something the wrong name. I
4 think the most neutral way of putting it into the record is as
5 testimony, subject to your observation that in some ways it's not
6 what you would ordinarily call testimony.

7 MR. BREW: Excuse me, your Honor, if I might --

8 JUDGE EPSTEIN: Mr. Brew.

9 MR. BREW: Actually, my suggestion would be to mark
10 it as an exhibit for identification. My reaction to it, since so
11 far I'm winning the pool on when the hearings will end, is that
12 -- I am -- is that I have some clarifying questions of my own in
13 terms of the document, as I suspect other parties do, to the
14 extent that it's clear from the questions that this is a
15 clarifying document as to concessions, which I view as sort of
16 what we commonly do in rate cases where you narrow exhibits that
17 are adjustments based on what was filed.

18 It strikes me as more straight forward to simply
19 mark it as an exhibit for identification, and then we can choose
20 to take it, and you can handle objections later.

21 MR. SCHWARTZ: The Joint Petitioners agree with the
22 way that Mr. Brew just laid that out, that it would be more
23 appropriate as an exhibit than as testimony.

24 MR. VAN RYN: Your Honor, we agree with your Honor.

1 We think it's more appropriate as testimony, with the last being
2 the exhibit, and also, there again, I don't want to foreclose the
3 Petitioners' right to oppose the filing of supplemental direct,
4 but I will agree to a process that will at least make it
5 efficient, and like I said, I'm not sure we're going to need to.
6 So I think that issue is best put off for a couple of days and
7 that we mark this, that we put this now in as testimony with an
8 exhibit, that Staff present oral direct when it puts its panel
9 on, and that the issue of what to do thereafter, we talk about
10 when the hearings are at an end.

11 JUDGE EPSTEIN: Mr. Mager, is probably going to have
12 the last word on this matter.

13 MR. MAGER: Well, I may never shut up, your Honor.
14 While I think it probably is more appropriate to mark it as an
15 exhibit than testimony, I'm okay either way. What I think is
16 important to note for the record, though, is that this was
17 circulated, I believe, late in the day on Friday or certainly on
18 Friday, the business day before the start of hearings. And while
19 I'm not objecting to its consideration here, and I think it does
20 serve a useful purpose in terms of potentially narrowing the gap,
21 I don't know that it gets rid of any issues, but it may narrow
22 the gap between parties on certain issues.

23 I fully support Staff's position that Staff and any
24 other party should have a reasonable opportunity to respond to

1 it, and so whether it's through, you know, oral supplemental
2 direct or otherwise, I think it's important that when an
3 unscheduled, and you know, unauthorized filing is made at the eve
4 of hearings, that parties are given a fair opportunity to respond
5 to it. Thank you.

6 MR. FOGEL: Your Honor, could I just make one quick
7 point, just procedurally? I realize Michael should have the last
8 word. It seems to me from Staff's prospective and from the
9 parties' prospective, I've always been of the view that testimony
10 is more weight than an exhibit, which you can mark for
11 identification with as much limitation as you want. And my view
12 would be, if we simply mark it for identification, leave it for
13 later, even if it would be incorporated into the record, it could
14 be rejected. It's a safer bet than making it testimony at this
15 point, and it takes on a life of its own, and then maybe you need
16 to rebut it or not.

17 I think from Staff's prospective, you're safer off
18 just marking it for identification with its limitation. If it's
19 necessary that something further, some counter exhibit should be
20 filed, it can be done that way, but it's a lot better than making
21 something testimony, which I've always viewed is of a higher
22 status and level than simply marking -- we can mark anything for
23 identification. We can mark this table for identification. But
24 the question is whether or not it gets incorporated in the record

1 and how we're going to relate to it.

2 MR. VAN RYN: The problem, Usher, is that I think it
3 deserves the weight of testimony. So I disagree with the
4 premise.

5 JUDGE EPSTEIN: Okay. I have changed my mind for
6 reasons that were not discussed here so far. It occurs to me
7 that testimony sometimes is subject to a preclusion motion
8 because it was not filed at a time that was appropriate to give
9 other parties an adequate opportunity to analyze it and react to
10 it before the hearing, and in substance, I believe this document
11 was distributed around 1:30 in the afternoon on Friday the 14th,
12 and I think I'm hearing some of the same concerns that would be
13 expressed on a preclusion motion.

14 So actually, I think the more appropriate treatment
15 of this would be to mark it as an exhibit, making clear that
16 we're doing that for the various reasons that were discussed here
17 today and not because we discounted in any way Staff's claim that
18 they have the right to go on to present their case by additional
19 means, such as supplemental direct. We're not reaching the
20 question or prejudging in any way the question whether Staff has
21 that right, but we're marking it as an exhibit because there is
22 some question as to whether it might properly be precluded if it
23 were testimony. So it will be marked. And Mr. FitzGerald, I may
24 have lost the trail here somewhere. There must be nine exhibits

1 by this time.

2 MR. FITZGERALD: Yes, your Honor, there are going to
3 be nine exhibits by this panel. What we could do would be, mark
4 the JPP-1 through 8 first, individually, then JPP-9 as its own
5 separate exhibit as well.

6 JUDGE EPSTEIN: Forty-two through fifty.

7 MR. FITZGERALD: That's correct, your Honor.

8 JUDGE EPSTEIN: Okay, individually.

9 MR. FITZGERALD: That's correct, your Honor.

10 JUDGE EPSTEIN: So that JPP-1 is 42.

11 (Exhibit Numbers 42 through 50 were marked for
12 identification.)

13 JUDGE EPSTEIN: Okay. And the witnesses are
14 available.

15 MR. FITZGERALD: Yes, your Honor. There will be two
16 attorneys defending the panel, Mr. Schwartz and myself.
17 And your Honor, the witnesses are now available for
18 cross-examination.

19 CROSS-EXAMINATION

20 BY MR. VAN RYN:

21 Q. Good morning, panel.

22 A. (Mr. Laurito) Good morning.

23 A. (Mr. Rude) Good morning.

24 A. (Mr. Azagra) Good morning.

1 Q. Is it correct that the State of Maine has approved
2 Iberdrola's acquisition of Energy East?

3 A. (Mr. Rude) Yes, that's correct.

4 MR. VAN RYN: Your Honor, I'd like to have marked as
5 an exhibit the Order approving Stipulation for the State of Maine
6 Public Utilities Commission addressing Iberdrola's acquisition of
7 Energy East.

8 JUDGE EPSTEIN: Fifty-one.

9 (Exhibit Number 51 was marked for identification.)

10 Q. And the procedure followed in Maine was that the
11 Commission approved a settlement among the parties that's
12 called Stipulation; is that correct?

13 A. (Mr. Rude) That's correct.

14 MR. VAN RYN: Your Honor, I'd like to have that
15 document marked as well.

16 JUDGE EPSTEIN: Fifty-two.

17 (Exhibit Number 52 was marked for identification.)

18 Q. And under Maine's procedures, there was a prior document
19 issued in the proceeding known as a Bench Analysis; is
20 that correct?

21 A. (Mr. Rude) That's correct.

22 MR. VAN RYN: Your Honor, I have selected pages from
23 the Bench Analysis that I would like to have marked as an
24 exhibit.

1 JUDGE EPSTEIN: Fifty-three.

2 (Exhibit Number 53 was marked for identification.)

3 MR. SCHWARTZ: Your Honor, I just wanted to note
4 that Exhibit 52 that Mr. Van Ryn had marked does not appear to be
5 a complete copy. I don't know yet what pages are missing, but it
6 seems that it ends on page 15 of the Stipulations, and I think we
7 just need to confirm and check that all the pages are here. We
8 would like to reserve the right to work with Mr. Van Ryn to make
9 sure that that's complete, and if not, we would supplement it to
10 make sure it's a complete copy.

11 MR. VAN RYN: Yes, your Honor. Wherever we've used
12 excerpts from documents, of course, we would -- if the company
13 has any objection, we will either provide the full document or
14 allow the company to do so.

15 JUDGE EPSTEIN: Okay.

16 Q. And if you could turn to page four of the Maine Order.
17 In there it describes the tests that must be met under Maine law
18 in order for a merger to receive approval. In your view, is it
19 correct to characterize that test as met if there is no harm to
20 ratepayers from the transaction?

21 MR. FITZGERALD: Your Honor, we're just going to
22 object again. It's calling for a legal conclusion.

23 MR. VAN RYN: Well, your Honor, these are expert
24 witnesses. I'm not asking for their legal opinion. I'm merely

1 asking for how they understand the Order. I fully understand
2 that, upon brief, the Petitioners will fully explain their view
3 of the law in Maine. I'm merely asking for the layman's
4 understanding of this panel?

5 JUDGE EPSTEIN: Okay. Mr. Van Ryn, I don't see the
6 discussion that you're referring to. Is it page 4 of the Order?
7 It may be there, but I'm just not picking up on it?

8 MR. FITZGERALD: Your Honor, it's Exhibit 51.

9 MR. SCHWARTZ: I think Mr. Van Ryn is referring to
10 the paragraph beginning with "Finally." Is that right, Mr. Van
11 Ryn.

12 MR. VAN RYN: Yes.

13 MR. SCHWARTZ: Your Honor, what Mr. FitzGerald had
14 stated, we would just like to reiterate, under Maine law like
15 under New York law, there are legal arguments as to what's needed
16 to meet the burden and that the language in the statute is not
17 entirely clear, and that, therefore, this really is legal
18 conclusion with respect to what is needed to meet the burden
19 under Maine law.

20 JUDGE EPSTEIN: Right. Okay. So, Mr. Van Ryn, are
21 you asking them -- are you just calling their attention to this
22 recital by the Maine Commission, or are you asking them to --

23 Q. Let's put it this way -- let's see if I ask this
24 question: Would you agree that the Maine Commission said they

1 would approve of the merger if the total benefits are equal to or
2 greater than the detriments or risks to ratepayers and
3 shareholders?

4 A. (Mr. Rude) That's what they concluded in this Order.

5 Q. And later on in the Order, it states that Maine
6 ratepayers will benefit because Energy East will not recover the
7 acquisition premium paid for Central Maine in future revenue
8 requirement calculations, and Central Maine will agree to
9 levelize the revenue requirements associated with its proposed
10 advanced metering infrastructure investment. Is that your
11 understanding of the Order?

12 A. (Mr. Rude) Those are two of the benefits that they cited,
13 yes.

14 Q. And is it correct that the metering infrastructure
15 investments carrying charge that was forgone was valued at about
16 \$86 million?

17 A. (Mr. Rude) Not by the company.

18 Q. Was it valued that way by the Commission?

19 MR. FITZGERALD: Mr. Van Ryn, do you have a
20 reference to that in the Order?

21 MR. VAN RYN: A moment, your Honor. I'll withdraw
22 that last question.

23 Q. Do you know what the company valued that adjustment at?

24 A. (Mr. Rude) We didn't put a monetary value on that,

1 because the AMI system, as to whether or not it will be
2 installed, is the subject of another proceeding.

3 Q. So you're saying that the value of that carrying charge
4 will be determined at a later time?

5 A. (Mr. Rude) I believe the levelization that we agreed to
6 was due positively, because it would have the effect of lowering
7 revenue requirement for that system if it went in at the
8 beginning, but again, all the details associated with that really
9 are part of another proceeding.

10 Q. So it's correct to say the monetary value will be
11 determined at a later time?

12 A. (Mr. Rude) Of that levelization concession as part of the
13 overall project, yes.

14 Q. And there's also a monetary value to the acquisition
15 premium that will not be recovered from Central Maine?

16 A. (Mr. Rude) The effect of that was to reduce the,
17 essentially reduce the cost of service requests in CMPs of
18 alternative rate plan filing for the first year, and an
19 adjustment to that revenue requirement was made by CMP after this
20 Order was issued.

21 Q. When Energy East initially requested approval of the
22 merger from the Maine Commission, did it at that time say that
23 there were no risks or costs to consumers in Maine?

24 A. (Mr. Rude) I would have to refresh my memory on that.

1 It's been quite a few years.

2 MR. VAN RYN: If you could do so, we'd make that a
3 transcript request.

4 Q. And also at the time it requested approval, did it
5 identify non-monetary public policy benefits to the State of
6 Maine from the merger?

7 MR. FITZGERALD: Mr. Van Ryn, just to clarify your
8 question, were you referring at the time we printed the
9 prior transaction? It wasn't clear to me which
10 transaction you were referring to.

11 MR. VAN RYN: No, Iberdrola's acquisition of Energy
12 East.

13 A. (Mr. Rude) Again, if I can have an opportunity to refresh
14 my memory in that.

15 MR. VAN RYN: I will make that a transcript request.

16 Q. Switching to another topic, if you could turn to page 73
17 of your testimony?

18 MR. FITZGERALD: Mr. Van Ryn, because of the page
19 number, I'm assuming you're referring to the Joint
20 Petitioners' Policy Rebuttal at this point; is that
21 correct?

22 MR. VAN RYN: Yes.

23 MR. FITZGERALD: Thank you.

24 Q. In there, to summarize your testimony, you were critical

1 of a Staff calculation that multiplies the year five benefit from
2 the prior RGS merger that led to the formation of Energy East,
3 and they take that year five benefit of approximately \$77 million
4 and multiply it by five years; is that correct?

5 A. (Mr. Rude) Yes, that's correct.

6 Q. Now, in the merger between NYSEG and RG&E that formed
7 Energy East, NYSEG was allowed to retain fifty percent of the net
8 synergies from the merger; is that correct?

9 A. (Mr. Rude) I think it would be more correct to say that
10 NYSEG rates reflected fifty percent of the synergies for the
11 customer on this appendix.

12 Q. And that was for a five-year period; is that correct?

13 A. (Mr. Rude) That's correct, for the period of the rate
14 plan.

15 Q. And at the end of that five-year period, the savings
16 would continue to flow through to ratepayers thereafter; is that
17 correct?

18 A. (Mr. Rude) The way the rate plan was designed, that
19 question was left open, but in NYSEG's last rate case, all of
20 those synergies went back to ratepayers.

21 Q. Including for the next five years; is that correct?

22 A. (Mr. Rude) Forever.

23 MR. VAN RYN: One moment, your Honor. Your Honor, I
24 have another document I would like to have marked as an exhibit.

1 Your Honor, this document is two pages from an Appendix to the
2 Bench Analysis submitted earlier. We're doing this for
3 convenience. Again, if there's anything else in the Bench
4 Analysis that the Petitioners would like to see in the record, we
5 will, of course, agree to put it in.

6 JUDGE EPSTEIN: Fifty-four.

7 (Exhibit Number 54 was marked for identification.)

8 MR. VAN RYN: I also need to apologize for the fact
9 the pages in this seem to be reversed. It should be pages 1 and
10 3. It's 3 first and 1 second.

11 MR. SCHWARTZ: Your Honor, I just wanted to ask Mr.
12 Van Ryn -- this is the Bench Analysis. Can you clarify what
13 document this is.

14 MR. VAN RYN: This is an Appendix to the Bench
15 Analysis that we submitted earlier.

16 MR. SCHWARTZ: Bench Analysis from --

17 MR. VAN RYN: -- the State of Maine.

18 JUDGE EPSTEIN: It's an Appendix to Exhibit 53?

19 MR. VAN RYN: Yes.

20 MR. FITZGERALD: Mr. Van Ryn, the handout that we
21 received said before, "The State of New York, Public Service
22 Commission," as a cover page.

23 MR. VAN RYN: Yes, that's the exhibit cover page.

24 MR. FITZGERALD: Right, and then the two pages that

1 follow are Appendix Merger Premiums, page 1, and Appendix Merger
2 Premiums, page 3. I just wanted to make sure they were stapled
3 backwards.

4 MR. VAN RYN: Yes.

5 MR. FITZGERALD: Thank you.

6 MR. SCHWARTZ: Your Honor, I think maybe this is in
7 the form of first a clarification of Mr. Van Ryn. Do you know
8 which Maine regulatory proceeding this is part of.

9 MR. VAN RYN: Yes, it's in the Maine Docket
10 2007-315.

11 MR. FITZGERALD: Your Honor, for clarity we would
12 ask that the full document be marked or substituted for these
13 pages at a later time just for clarification.

14 MR. SCHWARTZ: One other thing, I think the separate
15 matter is that this document may not be the merger proceeding.
16 This document may be the Bench Analysis for the different rate
17 proceeding that deals with what in Maine they call the "Arc," and
18 therefore, we would like to reserve rights to object to the
19 introduction of this as to whether it's relevant to this
20 proceeding.

21 MR. VAN RYN: He has correctly characterized the
22 document. As to relevance, let me ask the question, and we'll
23 see.

24 MR. SCHWARTZ: Just for purposes of clarification so

1 everyone knows, your Honor, what this document is, it's a --
2 there is a rate proceeding that was commensurate with the merger
3 proceeding that actually predated the start of the merger
4 proceeding, and this is a Bench Analysis from that rate
5 proceeding.

6 JUDGE EPSTEIN: Okay. So, Petitioners, you're
7 reserving your objections based on relevance.

8 MR. SCHWARTZ: Yes, your Honor.

9 MR. BREW: Excuse me, your Honor. Could I get a
10 clarification? Is Exhibit marked for identification 54 an
11 Appendix to Exhibit 53, or are they different bench memos.

12 MR. SCHWARTZ: I don't have a copy of 53 yet, so I
13 haven't seen that yet. I'm sorry. I do have that.

14 MR. VAN RYN: Just a moment, your Honor.

15 MR. SCHWARTZ: We would have to check, your Honor.
16 I think these are two separate proceedings.

17 MR. VAN RYN: Mr. Schwartz is correct. It's an
18 appendix to the separate bench memo in the rate proceeding that
19 he described.

20 MR. SCHWARTZ: With separate docket numbers, I
21 believe, Mr. Van Ryn.

22 MR. VAN RYN: Yes, that's correct.

23 MR. SCHWARTZ: Do you have the entirety of these
24 documents for the record.

1 MR. VAN RYN: Why don't we discuss afterwards what
2 you would like to see on the record, because these documents in
3 some cases are many hundreds of pages long and contain a lot of
4 extraneous material. So why don't we discuss that at some point
5 what you would like to see.

6 JUDGE EPSTEIN: Okay. That's good.

7 Q. And to get to the question, could you please refer to the
8 exhibit, page number 3. In there there's a chart labeled,
9 "Allocation to Premium to NYSEG." Is that correct.

10 A. (Mr. Rude) Yes.

11 Q. And as described in that chart, the total synergies were
12 120 million; is that correct?

13 A. (Mr. Rude) That's what the chart says, yes.

14 MR. VAN RYN: Turning to another topic, I'd like to
15 discuss with the panel Iberdrola's relationship with Gamesa
16 Energy, and I have two documents I would like marked for
17 identification. The first document is response Iber 203, and the
18 second is response Iber 227.

19 JUDGE EPSTEIN: Okay. That's 55 and 56.

20 (Exhibit Numbers 55 and 56 were marked for
21 identification.)

22 Q. Please turn to Iber 203.

23 MR. FITZGERALD: Your Honor, we haven't yet received
24 a copy of the materials. One moment. Thank you, your

1 Honor. We now have copies.

2 Q. In there it states that Iberdrola owns nearly 25 percent
3 of Gamesa; is that correct?

4 A. (Mr. Azagra) That is correct.

5 Q. And Gamesa is developing two wind projects in New York
6 State; is that correct?

7 A. (Mr. Azagra) That is correct.

8 Q. And even though Iberdrola owns a 25 percent interest, the
9 response states that Iberdrola does not have any access to
10 information of Gamesa's projects and activities by virtue of this
11 interest; is that correct?

12 A. (Mr. Azagra) You mind to repeat the question?

13 Q. Sure. If you could just -- the last line on the first
14 page of the IR response, the last sentence on the first page of
15 the IR response --

16 A. (Mr. Azagra) Yes.

17 Q. And if you return to --

18 MR. SCHWARTZ: Just to clarify the question, which
19 IR response are you referring to here?

20 MR. VAN RYN: Two zero three.

21 MR. SCHWARTZ: So it's the last line on that,
22 William Hieronymus response.

23 MR. VAN RYN: Yes.

24 Q. And if you turn to Iber 227, that describes the ownership

1 interest, Iberdrola's shares with Bank BBVA of a holding company
2 known as IBV, and it also states that through that holding
3 company, Iberdrola owns some interest in Gamesa?

4 A. (Mr. Azagra) It's my understanding not any longer,
5 because it was sold in the past, you know, in the past week.

6 Q. The interest in IBV or Gamesa?

7 A. (Mr. Azagra) No, IBV's interest in Gamesa.

8 Q. IBV's interest in Gamesa was sold?

9 A. (Mr. Azagra) Yes.

10 Q. To whom?

11 A. (Mr. Azagra) Partially to us and then to BBVA. I'm not
12 aware exactly, you know, what to BBVA and what BBVA did with
13 that, but we took a portion of that. So it's direct ownership
14 now by withdrawal.

15 Q. So your direct ownership interest now exceeds 25 percent?

16 A. (Mr. Azagra) I believe so. I think it's around 24
17 percent. It's a little bit less than 24 percent.

18 Q. During the time Iberdrola participated in the management
19 of IBV, it stated that its role is to collaborate with the other
20 owner of IBV with respect to new investments and to monitor the
21 performance of existing investments. Now, how did you acquire
22 the information on Gamesa necessary to perform the monitoring
23 function you described?

24 A. (Mr. Azagra) I'm not aware of that. I'll come back to

1 you with the information, if we have it.

2 Q. You also report in Iber 203 that an Iberdrola subsidiary
3 has purchased the interests of Gamesa's subsidiaries in proposed
4 wind farms located in Pennsylvania, Texas and Illinois; is that
5 correct?

6 A. (Mr. Azagra) That's correct.

7 Q. How did Iberdrola obtain information on those projects
8 that Gamesa owns sufficient to justify their acquisition of them?

9 A. (Mr. Azagra) Those projects, as I understand, you know,
10 it's part of the framework agreement between Iberdrola Renewables
11 and Gamesa for the purchase of some assets. So our knowledge of
12 that would come through Iberdrola Renewables, that it was closed
13 before Iberdrola Renewables was IPO'ed. It was, you know, at
14 that time, it was a hundred percent owned subsidiary.

15 Q. And would it be possible to enter into a similar
16 framework agreement concerning the New York projects if Iberdrola
17 or Gamesa so desired?

18 A. (Mr. Azagra) There is no reason. They could sign with
19 any other party.

20 MR. VAN RYN: A moment, your Honor. Your Honor, I
21 have another IR response I'd like marked for
22 identification. This is Iber-8-S.

23 JUDGE EPSTEIN: Fifty-seven.

24 (Exhibit Number 57 was marked for identification.)

1 Q. And in this IR response, Iberdrola reports that its
2 affiliates are planning to develop additional wind projects in
3 New York; is that correct?

4 A. (Mr. Azagra) That is correct.

5 Q. And that several of these projects are planned for
6 interconnection with the NYSEG transmission system; is that
7 correct?

8 A. (Mr. Azagra) The connection request has not been
9 requested yet, but they will be -- if they were to be, they would
10 be interconnected to that utility.

11 MR. VAN RYN: Turning to another topic, your Honor,
12 I would like marked for identification a document from
13 Market Watch authored by David Roman.

14 JUDGE EPSTEIN: Fifty-eight.

15 (Exhibit Number 58 was marked for identification.)

16 Q. In this news report -- excuse me. Strike that. This
17 news report discusses plans supposedly made by EDF, a large
18 French utility, to acquire Iberdrola. Does Iberdrola have any
19 comment on this news report?

20 MR. SCHWARTZ: Your Honor, just as a notation, we
21 would like to reserve objections to documents like this
22 that may not have proper foundation for introduction into
23 evidence, but with that reservation, we have no objection
24 for continuing this level of cross.

1 A. (Mr. Azagra) I think Iberdrola's communication policy
2 basically is very simple. We don't comment to market rumors, to
3 media rumors which are not real facts for the company to be
4 involved in.

5 MR. VAN RYN: Your Honor, to conclude my cross, I
6 have some questions I would like to ask on confidential responses
7 to Iber 361 through 363. So we need to make arrangements now to
8 create a confidential record.

9 MR. SCHWARTZ: As a procedural matter, your Honor, I
10 think that I would just like to know how you intend to do this.
11 Our only preference would be to do it efficiently. We have no
12 objection to proceeding in this fashion. It may make sense to
13 allow, just from an expeditious standpoint, to allow other people
14 to ask their questions before we turn on and off microphones, but
15 my only inquiry is as to timing.

16 JUDGE EPSTEIN: Yes, according to the estimates,
17 there are possibly a few more hours of cross for this panel. So
18 --

19 MR. VAN RYN: If the parties feel it's more
20 efficient for me to wait till the end, I'll happily do so.

21 JUDGE EPSTEIN: Okay. Mr. Brew.

22 MR. BREW: Your Honor, I expect my cross to be
23 substantially shorter than what was on the sheets, particularly
24 since I expect that some of my areas and Mr. Mager's are

1 overlapping.

2 JUDGE EPSTEIN: Yes.

3 MR. PRESTEMON: I'm notoriously bad at these
4 estimates but expect mine will be shorter than the one hour I put
5 down, too.

6 JUDGE EPSTEIN: Okay. I'm just thinking in terms of
7 this, that the planned break was around 11:00. So that if the
8 other parties completed their cross around sometime approaching
9 11:00, then at that point that might be a convenient time to the
10 confidential portion of the cross. Okay. So you're okay with
11 that, Staff.

12 MR. VAN RYN: Yes.

13 JUDGE EPSTEIN: Okay. So let's go on to the next
14 cross-examiner.

15 CROSS-EXAMINATION

16 BY MR. MAGER:

17 Q. Good morning, panel.

18 A. (Mr. Laurito) Good morning.

19 A. (Mr. Rude) Good morning.

20 A. (Mr. Azagra) Good morning.

21 Q. I have a number of questions regarding Exhibit 50, the
22 Joint Petitioners' Partial Acceptance Document. Could you please
23 get that handy. Do you have it? Let's start with some questions
24 regarding the section entitled, "Vertical Market Power,"

1 specifically, the Joint Petitioners' Acceptance. Can you
2 identify the location of the generating plants that the
3 Petitioners have offered to divest?

4 A. (Mr. Rude) Yes, the Russell Station, the Allegheny
5 Station, the Peaker Station 3 and Peaker Station 9, all in the
6 Rochester, New York area. The Carthage Peaking Unit, it is my
7 understanding that's in the, near the Watertown area or in that
8 Tug Hill Plateau area.

9 Q. Okay. And that's not part of the company's service
10 territory, correct?

11 A. (Mr. Rude) That's correct.

12 Q. And what are the approximate book values of those units?
13 Are they fully depreciated?

14 A. (Mr. Rude) Only Russell Station is fully depreciated and
15 is being readied for closure. We would have to provide the other
16 book values, but they are relatively small.

17 MR. MAGER: Okay. Can I make a request to have
18 entered into the record the book values of the other generating
19 units?

20 MR. FITZGERALD: We'll take that under transcript
21 requests.

22 MR. MAGER: Thank you.

23 Q. You stated in the paragraph, Joint Petitioners'
24 Acceptance, that "The above commitments are subject to reasonable

1 protocols determined by the Commission which should provide that
2 such assets would not be sold below book value." Do you see
3 that?

4 A. (Mr. Rude) Yes.

5 Q. Does that agreement not to sell the units below book
6 value apply to the units individually or in the aggregate?

7 A. (Mr. Rude) I believe that would be worked out in the
8 determination of the protocols.

9 Q. So at this point the company doesn't have a specific
10 proposal that it's advancing on that?

11 A. (Mr. Rude) That's correct.

12 Q. And would these reasonable protocols be decided in this
13 proceeding?

14 A. (Mr. Rude) Subsequent to this proceeding.

15 Q. Now, to the extent a single purchaser was to acquire all
16 of those generating units, at least the ones within the RG&E
17 service territory, would there be any market power concerns?

18 A. (Mr. Rude) I don't think I'm equipped to respond to that.

19 Q. Okay. Who would pay the costs associated with auctioning
20 the units under your proposal?

21 A. (Mr. Rude) Again, that would be subject to the protocols.
22 What typically happens is the transactions costs are netted
23 against the proceeds.

24 Q. Is the company making a specific proposal in this

1 proceeding on how the costs would be treated?

2 A. No, we are not.

3 Q. How would the auction proceeds be treated?

4 A. (Mr. Rude) This Acceptance Document doesn't speak to
5 that.

6 Q. So the company is not making any proposals in this
7 proceeding as to who would get the money if the plants are sold?

8 A. (Mr. Rude) That's correct.

9 Q. Would you agree that customers paid -- withdrawn. With
10 the exception of the Carthage Peaking Unit that's owned by Cayuga
11 Energy, would you agree that customers paid for the construction,
12 operation and maintenance of the other generating units through
13 rates?

14 A. (Mr. Rude) Yes.

15 Q. What is the estimated value of those units should they be
16 divested?

17 A. (Mr. Rude) We haven't done that study, Mr. Mager, to
18 determine what that value would be.

19 Q. And so my understanding is that if this merger was to be
20 approved, this part of your Partial Acceptance Document would not
21 produce any financial benefits to customers?

22 A. (Mr. Rude) It would really be our opinion, or I could say
23 my opinion, that I believe it would. I believe that given the
24 relatively low book values here and flexibility in how the

1 auction was conducted could, in fact, produce value. To the
2 extent the Commission determined that that value should go back
3 to customers, then that would be a substantial value in this
4 proceeding.

5 Q. And so would you agree that the more, the larger
6 percentage of auction proceeds that went to customers, the larger
7 the potential financial benefits would be?

8 A. (Mr. Azagra) I think, you know, the potential is that
9 there are more. I think there are. So I think, you know, a part
10 of those gains, you know, go to customers. That's what I figure.
11 In our opinion the question is, you know, if there are more, then
12 it could have been just by, you know, going to the customers,
13 part of that, you know, there would be a benefit.

14 Q. Well, there would also be a potential cost, would there
15 not, in terms of the customers would lose the benefit of that
16 generation; isn't that true? Let me ask the question again. Do
17 customers currently receive any benefit from RG&E owning those
18 generating units?

19 A. (Mr. Rude) The market value of that generation is
20 returned to customers.

21 Q. And so that benefit would be lost if the plants are sold?

22 A. (Mr. Rude) Not necessarily. It depends on how that sale
23 was structured and if there was a contract associated with that
24 and how rates were set. I mean, those details are to be worked

1 out. I would not conclude that it would be a detriment to
2 customers.

3 Q. But sitting here today, you don't know whether the
4 benefits to customers in the form of failed proceeds would
5 outweigh the benefits to customers of retained ownership?

6 A. (Mr. Rude) No, but this concession is made to resolve the
7 vertical market power issue. So if there is one dollar of
8 financial benefit, beyond that, then it's a bonus.

9 Q. And so for purposes of this proceeding, the company is
10 not assigning any dollar value benefit to customers with respect
11 to this acceptance; is that fair?

12 A. (Mr. Rude) That's correct.

13 Q. Okay. Would the company commit in this proceeding that
14 100 percent of the auction proceeds be allocated to customers?

15 A. (Mr. Rude) Are we negotiating?

16 Q. I'm asking if the company would accept that.

17 MR. SCHWARTZ: Can I ask a clarifying question? Mr.
18 Mager, are you referring to footnote 3 on the Partial Acceptance
19 Document?

20 MR. MAGER: No.

21 A. (Mr. Rude) I'm not comfortable making those types of
22 commitments in a vacuum. I'm sorry.

23 Q. Let's turn to the section of your document entitled,
24 "Positive Benefit Adjustments." Do you see that?

1 A. (Mr. Rude) Yes.

2 Q. And in that section of the document, the Joint
3 Petitioners are agreeing to provide customers with 201.642
4 million in PBAs; is that correct?

5 A. (Mr. Rude) That's correct.

6 Q. How was that number chosen?

7 A. (Mr. Rude) Carefully.

8 Q. Please elaborate.

9 A. (Mr. Rude) We really have a variety of factors that went
10 into it. We started with the Staff recommendations, and we
11 looked at, frankly, what we thought we could live with and then
12 tried to select items among that list that might make some sense
13 and produce the most benefit.

14 Q. When you say you tried to select what in Staff's list you
15 could live with, are you referring to the total dollar value, or
16 are you referring to the specific, the substance of the specific
17 adjustments?

18 A. (Mr. Rude) Both really, but principally the total dollar
19 value.

20 Q. Why did you choose these specific adjustments to get to
21 the roughly \$200 million figure as opposed to other adjustments?

22 A. (Mr. Rude) There wasn't one theme that connected all of
23 these. Again, it was an approach that tried to select something
24 that we thought would make the most sense and, again, would have

1 the most impact. For example, the loss on re-acquired debt
2 affected all the companies involved here. So it spread that
3 benefit among all the companies. The flood regulatory asset and
4 the environmental reserve, again, it had an environmental theme
5 that we thought was important here and important for customers.
6 And then the Nine Mile, the two Nine Mile regulatory assets
7 because of their size, provided substantial value for customers,
8 if they were recovered rapidly in this case. So it was really a
9 combination of those, those items and that thinking that led to
10 the selection.

11 Q. Would you agree that those type of considerations could
12 also justify other adjustments identified by Staff?

13 A. (Mr. Rude) It's possible or other considerations.

14 Q. What went into the thinking in terms of allocating the
15 PBAs between RG&E and NYSEG?

16 A. Other than the loss on re-acquired debt, it pretty much
17 fell out this way. The environmental reserve at NYSEG, they had
18 more of the environmental sites to clean up. So it made sense
19 for that to be a NYSEG item. So again, it wasn't so much between
20 the two companies as to really how it fell out, given our other
21 thinking.

22 Q. Were you trying to strike any sort of balance between
23 allocations to RG&E and NYSEG, and if so, what?

24 A. (Mr. Rude) No, we didn't.

1 Q. Did you try to strike any type of balance between
2 allocations to electric operations and gas operations?

3 A. (Mr. Rude) No, with the exception of, as I mentioned, the
4 loss on re-acquired debt which did touch all of the companies.

5 Q. For instance, just let me draw your attention -- it seems
6 like for NYSEG, the electric benefits are roughly three times the
7 gas benefits, whereas, for RG&E the electric benefits are maybe
8 seventy or eighty times the amount of gas benefits. Was that
9 intentional?

10 A. (Mr. Rude) I think that's just purely a function of the
11 size of the Nine Mile reg. assets.

12 Q. Now, looking at attachment one to Exhibit 50 where you
13 identify these specific PBAs, you have -- the bottom line of that
14 chart is "Total PBAs Pretaxed." Do you see that?

15 A. (Mr. Rude) Yes.

16 Q. How would the tax treatment work for these adjustments,
17 and what would be the approximate value after taxes?

18 A. (Mr. Rude) There would be -- there's deferred taxes on
19 these items. I would have to get that information for you and
20 read it into the record.

21 MR. MAGER: Okay. I would like to make a transcript
22 request for the post tax value of the PBAs.

23 MR. FITZGERALD: We can provide that.

24 Q. Would the post tax value to customers be higher or lower

1 than what's shown as the pretax?

2 A. (Mr. Rude) Well, the value is the same. It's just one is
3 pre and one is post tax, and then determining how it was returned
4 to customers, that's also a factor.

5 Q. Well, let's discuss that. What would be the rate impacts
6 on customers if these adjustments were adopted and the merger was
7 approved and these adjustments took effect July 1, 2008, as you
8 propose?

9 A. (Mr. Rude) One second, please. The determination on
10 this, as we have put in here that we would -- certainly, the
11 Commission would be able to determine how that benefit would be
12 flowed through the customers, but if it was done in terms of a
13 rate reduction simultaneously with or very close to when the
14 write-offs occurred, then we estimate that that would be about
15 \$50 million.

16 Q. Okay. So all of the PBAs listed on attachment one
17 collectively would amount to a \$50 million rate decrease for
18 customers?

19 A. (Mr. Rude) Approximately, yes.

20 Q. And that's combined NYSEG and RG&E?

21 A. (Mr. Rude) That's correct.

22 Q. Do you have a breakdown for both, for each?

23 A. (Mr. Rude) I could provide an approximation.

24 MR. MAGER: Could I make an on-the-record request

1 for that as well?

2 MR. FITZGERALD: Yes. To the extent the witness
3 said he could provide an approximation, we will.

4 MR. MAGER: Okay.

5 Q. What are the approximate combined delivery revenues for
6 NYSEG and RG&E electric and gas?

7 A. (Mr. Rude) Again, if I could just take that and make sure
8 I don't make a mistake.

9 MR. MAGER: I would like that as well.

10 MR. FITZGERALD: Could you clarify what year you're
11 speaking of and what revenues particularly?

12 MR. MAGER: I'll take any recent 12-month period.
13 I'm looking for the total delivery revenues for electric
14 and gas for both NYSEG and RG&E.

15 Q. Sitting here today, do you have any idea what percentage
16 rate decrease \$50 million would be on the combined NYSEG and RG&E
17 operations?

18 A. (Mr. Rude) I'll provide that when I provide the
19 approximation.

20 Q. Okay. Now, with respect to the PBAs, am I correct that
21 the company has not proposed any type of stay-out with respect to
22 future rate cases?

23 A. (Mr. Rude) Not within this document, but the company has
24 proposed in a separate filing that the RG&E electric and gas rate

1 plans continue.

2 Q. Until when?

3 A. (Mr. Rude) Just continue. There's no term to the
4 request. The provisions are designed to continue, subject to
5 review by the Commission.

6 Q. So -- well, let's just take an example. Let's say the
7 merger is approved and is consummated July 1st, 2008. Am I
8 correct that on July 2nd, RG&E can file a new electric rate case
9 under your proposal?

10 A. (Mr. Rude) No, no. The rate plan continues through the
11 end of '08.

12 Q. And the company is precluded from filing for new rates
13 through the end of '08? Isn't it true that the rates, that the
14 company is entitled to file a rate case at any time?

15 A. (Mr. Rude) I believe we would violate that rate plan if
16 we filed -- we could file -- I beg your pardon. We could file a
17 rate case for rates that were effective after '08. That's
18 correct.

19 Q. So under your proposal, on July 2nd, RG&E could file a
20 new electric rate case, correct?

21 A. (Mr. Rude) But that's not what we've done. We filed a
22 proposal to continue the current rate plan.

23 Q. But even under that proposal, you would still be
24 permitted to file a new rate case on July 2nd?

1 A. (Mr. Rude) I believe the Commission would have to act on
2 our continuation filing first.

3 Q. Under what provision of the rate plan do you believe
4 you're precluded from filing a new rate case?

5 A. (Mr. Rude) Not precluded, but we've made the decision to
6 request that the rate plan continue. To file a rate case while
7 that's pending wouldn't be the correct thing to do.

8 Q. So if the Commission never rules on your request to
9 extend the rate plan, you essentially can file new rate cases?

10 A. (Mr. Rude) The company would continue the rate. If they
11 didn't rule, the company would continue the rate plan as it is at
12 the current rates.

13 Q. For how long?

14 A. (Mr. Rude) Until either the Commission asks us to file a
15 case or we decide to file a case.

16 Q. And can you decide to file a case on July 2nd, 2008?

17 A. (Mr. Rude) I just think that would be -- that's not what
18 the company would do, because the company has already made it
19 known that we want the current rate plan to continue in '09. So
20 I think that would be disingenuous.

21 Q. Again, I just want to be very clear in my question. I'm
22 not asking what the company intends to do or may not do. What
23 I'm interested in is, what would the utility be allowed to do if
24 it's Partial Acceptance Document is accepted?

1 A. (Mr. Rude) I don't want to try to provide some legal
2 opinion, but it seems to me that the fact that we have a filing
3 pending with the Commission to continue the current rates, that
4 it would be improper, if not illegal, to file a rate case while
5 that continuation filing is pending.

6 Q. Okay. Same question with respect to NYSEG. Under this
7 Partial Acceptance Document, NYSEG could file for new electric
8 and gas rates on July 2nd, 2008, correct?

9 A. (Mr. Rude) That's correct.

10 Q. So it's possible the day after the merger closes, the
11 company could seek relief in excess of the PBAs given to
12 customers under Exhibit 50?

13 A. (Mr. Rude) There's a number of possibilities. That is
14 not the company's plan.

15 Q. Did the company consider agreeing to stay-outs for RG&E
16 and NYSEG as part of this Partial Acceptance Document?

17 A. (Mr. Rude) We did not consider it. What we considered
18 was returning these benefits to customers as soon as possible.

19 Q. Would the agreement to refrain from seeking rate
20 increases, following the merger for some period of time, be a
21 benefit to customers?

22 A. (Mr. Rude) Well, I don't know if it would be a benefit to
23 customers. I mean, there were others that would have to
24 determine that, but it does fit with the company's plans. As I

1 told you, we filed a continuation filing for Rochester. It is
2 the company's intention to continue the NYSEG gas plan. That
3 plan is permitted to continue without a filing, and we have no
4 plans to file a NYSEG electric case. So in that scenario, those
5 stay-outs are planned.

6 Q. So to the extent the Commission directed NYSEG and RG&E
7 to stay out of filing rate cases for some period of time
8 following the merger, that would not be inconsistent with any of
9 the company's current plans?

10 A. (Mr. Rude) It would depend on the nature of that order
11 but generally consistent, yes.

12 Q. Now, let's turn to section three, the renewable
13 commitment section. Specifically, I want to direct your
14 attention to the paragraph that starts "Joint Petitioners
15 Acceptance." Do you see that?

16 A. (Mr. Azagra) Yes.

17 Q. And specifically, I want to first draw your attention to
18 the beginning of that where it says, "So long as the Commission
19 does not impose any limitations on the ability of Iberdrola
20 Renewables to develop renewable generation in New York State as a
21 result of this proceeding," what do you mean by that language?

22 A. (Mr. Azagra) Basically, to have the certainty that
23 Iberdrola Renewables may continue to develop any renewable
24 opportunity in the State of New York.

1 Q. Now, if the Commission were to rule that no wind could be
2 developed within the NYSEG and RG&E service territories,
3 Iberdrola would still be allowed to build new wind projects
4 elsewhere in the state; would it not?

5 A. (Mr. Azagra) I guess, legally, we don't refer to service
6 territory for these purposes. We refer it, you know, to whether
7 some assets are interconnected to our company or another one, you
8 know, transmission owner, transmission assets. So we tend not to
9 service territories for these purposes. But what you said, you
10 know, it could be like that if that's what the Commission -- we
11 will not agree with that -- but that's what the Commission could
12 rule.

13 Q. And right now, Iberdrola owns existing wind projects, but
14 none of them are in the NYSEG and RG&E service territories; is
15 that correct?

16 A. (Mr. Azagra) That is correct.

17 Q. And it has some projects that are identified that are in
18 the New York ISO for development; is that correct?

19 A. That is correct.

20 Q. And those are also not in the RG&E and NYSEG territories?

21 A. (Mr. Azagra) That is my understanding.

22 Q. Okay. And then --

23 A. (Mr. Azagra) Again, I would like to refer to be or not be
24 interconnected to the company. To talk about the service

1 territory we think is different.

2 Q. Okay. And turning to Exhibit 57, which I believe you
3 still have up there, the company is now proposing to develop at
4 least three wind projects that would be interconnected to NYSEG;
5 is that understanding correct?

6 MR. SCHWARTZ: Just as clarification, which document
7 are you referring to?

8 MR. MAGER: Exhibit 57, which is Iberdrola response
9 0008-S.

10 MR. SCHWARTZ: Thank you.

11 A. (Mr. Azagra) That is correct, but as I mentioned before,
12 they haven't asked for interconnection yet. You know, this is
13 very customary in the wind development business. There are many
14 projects, you know, different pipelines, you know, different
15 degree of certainty into the pipelines of companies, continues to
16 plan development which basically, you know, you have the
17 certainties which are real and start operation, you know,
18 construction and have certainty when you will start the
19 construction and have certainty when it comes in operation, and
20 there are many, you know, many other assets, you know. You know,
21 we have Iberdrola, about 47,000 megawatts of pipeline. I think
22 in Iberdrola's idea, we made it very clear, we will make three
23 different categories, instead of probability of the pipeline
24 becoming real. And I think, you know, in the Iberdrola

1 Renewables, they continue to identify potential assets which are,
2 you know, very far from becoming real. Let's make it clear. You
3 know, we will support Iberdrola Renewables, you know, to promote
4 and develop as much wind as possible in the State of New York, as
5 we do everywhere else.

6 Q. One thing I'm interested in Exhibit 57 is a revised or
7 supplemented response, and the initial response did not list any
8 projects that would be interconnected to NYSEG.

9 A. (Mr. Azagra) Correct.

10 Q. And so I'm just curious as to, at some point during the
11 merger proceeding, after the merger was already announced,
12 Iberdrola then decided it would want to develop three additional,
13 three new generation projects that would have to be
14 interconnected to NYSEG.

15 A. (Mr. Azagra) Let me explain, again, you know, how
16 renewables development works. Internally, and again, you know,
17 now Iberdrola Renewables is an independent company. So I think,
18 you know, we need to think about that as well, you know, in terms
19 we are an eighty percent shareholder of the company. The way,
20 you know, we do the renewables' review every X number of months
21 for review of the pipeline, and that -- you know, the pipeline,
22 you know, there are megawatts coming in, and there are megawatts
23 coming out. That happens all the time. If you just review the
24 overall pipeline, you know, which is different from the

1 development plan, which is, you know, what we have said to the
2 investors we're going to be doing in the next, you know, one or
3 two or three years, you know, especially with names, specific
4 assets becoming real, and that's, you know, what Iberdrola
5 Renewables has been explaining to the markets. The other ones,
6 you know, it is unknown to me what's the different probabilities.
7 So there are many megawatts coming in all the time and coming
8 out. If you see the pipeline of Iberdrola Renewables, you know,
9 in the last three to five years, that number has continuously
10 grown. So it's not a surprise, you know, when that review is
11 done, there is no megawatts here or there, and you know, two
12 months later, you know, there is, you know, some introduction
13 coming into that, you know, assessment of megawatts. I think
14 it's just, you know, our ongoing review that we do internally,
15 and it will continue to be that. As soon as that information,
16 you know, puts on the table certain priorities, even though there
17 is no permit requested yet for this, you know, yet, even though
18 there is no interconnection requested, so on, so forth, you know,
19 once you become aware of that, for whatever reason, it has become
20 part of the pipeline, then we just put it on the table. That's
21 an ongoing process with it all the time.

22 Q. Well, as part of that process, when you decide to put
23 these new projects on the table, do you consider things like the
24 Public Service Commission's vertical market policy or other

1 restrictions that may impact Iberdrola's ability to construct new
2 wind projects that are interconnected to a transmission and
3 distribution utility it's attempting to purchase?

4 A. (Mr. Azagra) I think that's a different question.
5 Iberdrola, you know, there is in the company, they will always
6 comply with policies or legislation in every single state,
7 country, market, industry in which we do business. I think I
8 will refer to the witnesses that we have, you know, that they
9 will explain better what's the policy. It's my understanding,
10 you know, based on the work we have done that, you know, the
11 current policy will not stop us from doing this type of business.
12 Again, I will refer to the witness, you know, to explain that in
13 detail. And I think, you know, of course, we take into account,
14 and we will continue to do so, every policy and legislation in
15 every country or state in which we do business. Absolutely.

16 Q. But --

17 A. (Mr. Azagra) But the same legislation and policies change
18 as well, and that's why, you know, to have pipeline is -- you
19 know, this is a business that to develop parts takes three to
20 five years. So I think, you know, in three to five years from
21 now all things may change. So that's why, you know, what is more
22 credible, you know, than other things will be decided over time.
23 We cannot, you know, run the risk of perhaps things being
24 different in some countries five years from now from a tax point

1 of view, like what happens in Europe many times, and just, you
2 know, saying, we're not going to focus there, because, you know,
3 you cannot do certain things right now. No, we need to be there.
4 You know, we need to continue to push for legislation, you know,
5 to be different, you know, to develop the promotion of renewable
6 energy. Within the United States, you know, we have a clear
7 vision by the government and, you know, also in the other
8 previous government, you know, supporting renewables in the
9 States, and we like that.

10 Q. You mentioned in response to, not my last question but
11 the one before it, that Iberdrola Renewables is an independent
12 company. Iberdrola owns eighty percent of Iberdrola Renewables;
13 does it not?

14 A. (Mr. Azagra) Correct.

15 Q. And is it fair to say that Iberdrola controls Iberdrola
16 Renewables?

17 A. With an eighty percent stake, there are certain decisions
18 that, you know, basically, we would have the majority taken.

19 Q. Iberdrola is not going to be out voted, right?

20 A. (Mr. Azagra) It sounds, sounds not. Additional review of
21 the corporate government's, you know, documents we have put on
22 the table in relation with the company.

23 Q. Going to the next part of that first sentence under the
24 Joint Petitioners' Acceptance, it says, "Iberdrola will support

1 and encourage investments by Iberdrola Renewables." Does the
2 language "support and encourage" mean anything different than
3 making sure that those investments happen?

4 A. (Mr. Azagra) Supporting means, you know, approving favor
5 of developing of certain investments in certain regions, which is
6 the case, as that is the case.

7 Q. And what projects did -- withdrawn. If you look at
8 Exhibit 57 again, the first five projects listed were projects
9 that Iberdrola was planning to develop before the merger was
10 announced, correct?

11 A. (Mr. Azagra) The words "planning to develop," you know,
12 with the understanding that they are in the pipeline with
13 attention to try to develop them, yes. That is correct.

14 Q. What would be the investment for those projects if they
15 actually were built? What would their cost be?

16 A. A rough number investment for megawatt in the U.S., you
17 should think about probably around \$2 million per megawatt,
18 roughly. It could be 1.8, around that. I'm talking about, you
19 know, the market consensus.

20 Q. So if these five projects end added up to 434 megawatts,
21 roughly, the cost to developing them would be roughly \$868
22 million by your number. Does that sound right?

23 A. (Mr. Azagra) Yes.

24 Q. So when the Joint Petitioners say that they will support

1 and encourage investments of a \$100 million, that's a level
2 that's less than an eighth of what was already under
3 consideration before the merger even was announced, right?

4 A. (Mr. Azagra) Before or during? It depends, you know,
5 when the price becomes known. I think that 100 million, I think
6 is, you know, a number basically to address, and we have reviewed
7 it, you know, and I think I should refer to the witness that we
8 have, you know, in relation to the past practice of how, you
9 know, first interconnections have been approved. I think this is
10 a specific commitment which, you know, we have decided to put it
11 in this Partial Acceptance Document just to show Iberdrola's
12 commitment, you know, to the state, and you know, share the
13 views. Keep in mind that, you know, for example, if the tax
14 credits were to be removed, or sorry, were not to be extended,
15 you know, by your Congress and Senate by another year, we believe
16 the number of megawatts to be built next year will be zero in the
17 U.S. So, you know, as you can imagine, you know, Iberdrola,
18 which has a track record of basically putting in targets and
19 trying to comply with them, they have been very transparent, you
20 know, and even when we say this is a commitment, we take it very
21 seriously because we put our credit in delivering. And remember
22 that, you know, this amount of megawatts are competing with other
23 megawatts in other parts of the U.S. as well, but the final
24 decision where to invest, you know, is not just whether these are

1 the only assets. There are many other opportunities.

2 Q. I guess, one of the points I wanted to make is that the
3 projects that could easily satisfy this \$100 million commitment,
4 there's plenty of projects outside of NYSEG and RG&E service
5 territories that could be built that would still satisfy that
6 \$100 million commitment.

7 A. That's typical to say in wind business development. I
8 think if you see the track record of projects becoming real, it's
9 not so easy.

10 Q. Okay. I'll move on. So if the production tax credits
11 are not renewed, this \$100 million commitment in Exhibit 50 would
12 go away.

13 A. (Mr. Azagra) Not necessarily. I think, you know, that's
14 why you need to probably review Iberdrola's track record of
15 complying, you know, with what they tell the markets or
16 regulators, and basically, you know, we will make sure, you know,
17 that we continue to comply with these proposals.

18 Q. So let's go through that part of the proposal again,
19 because maybe I didn't understand it. It says that you'll make
20 "investments in excess of \$100 million in the development of wind
21 generation in New York State within the next three years, subject
22 to all necessary development permits and authorizations and
23 provided that there is no material adverse change to existing
24 fundamental economics of wind generation development in New York

1 State, e.g., values associated with PTCs, RPS and NYSEG market
2 pricing." Do you see that?

3 A. Yes.

4 Q. Now, I interpreted that to mean that Iberdrola would not
5 be bound by the \$100 million commitment if the value of
6 production tax credits changed; is that correct?

7 A. Legally speaking, that's correct.

8 Q. Okay. And so if -- and with respect to RPS, you're
9 referring to the subsidy payments to wind developers?

10 A. (Mr. Azagra) Yes.

11 Q. So if the value of the subsidy payments under the RPS
12 proceeding changed, Iberdrola would not be bound to the \$100
13 million commitment.

14 A. (Mr. Azagra) That's correct. I was explaining that, you
15 know, Iberdrola has a track record, you know, laying out capital
16 expenditure and commitments in front of the markets and in front
17 of regulators and governments, and I think, you know, here there
18 is two different ways of looking into this. One is
19 contractually. You know, we have to write it down that way. A
20 different one is, you know, Iberdrola will intend to commit to
21 the \$100 million investment. Either through this way or another
22 way, I think Iberdrola tries to belabor its, you know,
23 announcements.

24 Q. Now, let's turn to your rebuttal testimony. Now, on

1 pages three and four, you discuss, on the bottom of three to the
2 top of four, you discuss some of the benefits of the proposed
3 transaction. Do you see that?

4 A. (Mr. Azagra) Yes.

5 Q. Now, in discussing the financial strength, am I correct
6 that the current Standard & Poor's credit ratings for Iberdrola
7 is A minus and Energy East is triple B plus?

8 A. (Mr. Azagra) That is correct.

9 Q. And that's a one-notch difference, correct?

10 A. (Mr. Azagra) Yes.

11 Q. And approximately what's the spread between, the interest
12 rate spread between A minus and triple B plus then?

13 A. (Mr. Azagra) Do you mean the spread on the debt?

14 Q. Yes.

15 A. On the finance, I mean, you know, it changes every
16 minute. With the current market situation, you know, it has
17 widened a lot, you know, a category spread versus a three B
18 category. I cannot tell you right now which is the spread, but
19 you know, I think probably you can think about, you know, tens of
20 basis points of difference, you know, widening range in the
21 spread, you know, between triple B category and A category in the
22 recent, you know, period.

23 Q. And over the next say year, how much savings would be
24 realized as a result of having a higher credit rating?

1 A. (Mr. Azagra) I think, you know, I would need some time to
2 discuss that. You know, because first of all, I think this
3 depends on the markets. I think, you know, the current
4 expectation for the market I think is probably one of the basic
5 examples for why we think, you know, a better rated company, you
6 know, buying a worsely rated company is a benefit, a strong
7 benefit. I think, you know, we have seen other cases in which,
8 because of the contrary happening, I think, you know, there were
9 some protections being put on the table. You know, the way we
10 have it in the final deal, we believe it's a bench mark, you
11 know, to have raised all equity for paying for the equity for
12 this other company, you know, four and a half billion, you know,
13 cash in equity. That's a huge difference in how to approach the
14 matter. Going forward in terms of what you asked, very simple, I
15 think, you know, the currency situations in the markets is not
16 only a question of costs. It's a question of whether you get the
17 money. I think, you know, there are many companies right now
18 that they are going through troubled situations from a financial
19 point of view simply because they cannot refinance their existing
20 debt.

21 Q. Are you aware of any instances where Energy East has had
22 trouble accessing the financial markets?

23 A. (Mr. Azagra) I'm not aware of that.

24 Q. Okay. So to the extent there are savings as a result of

1 Iberdrola's higher rating compared to Energy East, what is the
2 approximate value of those savings for the next year or so?

3 A. (Mr. Azagra) Well, the way we work is, you know, that
4 some of the agencies, they have a consolidated approach, so
5 basically in the way they will do the rating of the books. Any
6 subsidiary, they keep in mind those are ratings of the parent
7 company. So I think, you know, that will be an enhancement to be
8 taken into account. Every time there will be a bond of, you
9 know, basically being refinanced or a loan, you know, should
10 there be as well. You know, that will be the timing which you
11 will benefit from enhancement. So it's not something that you
12 can determine right now. It's something that -- you know, if you
13 prepare right now to extend the bonds, probably there are some of
14 them that are fixed rates, you will incur huge penalties. So it
15 just goes as long as, you know, those bonds and loans have to be
16 terminated. You know, what will be the enhancement, the spread
17 differential that you will gain from basically being owned by a
18 better rated company than you had before? That will be
19 determined -- can we expect -- can we determine that right now?
20 No, I cannot. You can make an assumption. You know, does the
21 current spread increase? Well, you know, if you assume the
22 agencies will treat this in a different way and the markets will
23 see that, you know, you should be at the upper level of a rating
24 rather than, you know, on the lower level of a rating from a

1 spread point of view, that will be the differential you will get.
2 That will be factored in over time.

3 Q. So if the savings are the spread between an A minus and a
4 triple B plus rating company for either refinancings or new debt,
5 would customers realize those savings before rates are reset?

6 A. (Mr. Azagra) It's not that it will have an A level
7 spread, you know. The rating of the companies will probably
8 remain as it is themselves. However, you know, the markets will
9 take into account, because the agencies will have factored it in
10 because they have already commented on that, and that's why there
11 should be a mechanism in the spread. I think, you know, in terms
12 of the other customers who would benefit from that, I would
13 refer, you know, to how that's done in the rates and so on.

14 Q. Okay, before they address value. So what you're saying
15 is your expectation is that Energy East or NYSEG and RG&E's
16 ratings will not change as a result.

17 A. Could change, but I can't say it will change, could
18 change, but definitely the spread, you know, is customary
19 practice, and it can be, you know, analyzing debt. You know,
20 we'll benefit from that.

21 Q. Okay. And so just picking numbers out, if we're talking
22 tens of basis points, if debt is refinanced on July 1st, 2008,
23 when would customers realize that benefit?

24 A. (Mr. Rude) When rates are reset and new cost of capital

1 is developed for each company.

2 Q. So to the extent the company is able to save some money
3 as a result of the merger through refinancings, isn't that kind
4 of what's called a synergy savings?

5 A. (Mr. Azagra) Synergy is something you can, you know,
6 justify right now with a number, if you have certainty of that.
7 In the case of financing, there is no way we can guarantee
8 something right now. It's impossible. Let's think about, you
9 know, in a scenario since, you know, sometimes one of the parties
10 refer to a worse case scenario, let's think about, you know, the
11 other way around, a best case scenario. You know, the economy
12 does look like it's going to get better. You know, employment is
13 going to get better. Population is going to increase, you know,
14 in the state, you know, everywhere. I think of them that it will
15 not be a basically synergy or anything like that related to the
16 transaction itself. You know, the spread will get better simply
17 because the economy is getting better and everything is getting
18 better. So there is not certainty right now you can put a number
19 on that. It's a benefit that will come over time, assuming
20 always, you know, several parties' approach, which is everything
21 remains as it is right now.

22 Q. But let's take a different assumption. Say that there's
23 a big spread in interest rates, and after the merger closes, the
24 company is able to refinance a lot of debt. That would be

1 savings as a result of the merger that would not go to customers
2 until rates were reset. Isn't that the testimony of the panel?

3 A. (Mr. Azagra) If it works like that, that's correct.

4 A. (Mr. Rude) I think it -- and again, it depends on the
5 company. You know, there's -- if in that scenario, which I'm not
6 accepting necessarily because it's holding everything else equal,
7 which I think was your question, you know, there are already
8 sharing provisions for three of the companies that could capture
9 that.

10 Q. Is the company over earning, NYSEG electric gas, RG&E
11 electric and gas that the earnings sharing is already kicking in?

12 A. (Mr. Rude) The company doesn't, in our opinion, the
13 company doesn't over earn. It earns, and then it shares what it
14 earns if it achieves a certain structure.

15 Q. Let me be more precise, Mr. Rude. Has the earnings
16 sharings mechanisms already kicked in for NYSEG electric gas and
17 RG&E electric and gas?

18 A. (Mr. Rude) NYSEG electric does not have earnings sharing
19 mechanism. NYSEG gas does, but it is not in a sharing -- the
20 company is not sharing. Its earnings have not reached that
21 level. That's in the rate plan. And RG&E electric has been in a
22 sharing mode. It's in the process of completing its compliance
23 files for '07 now. They'll be submitted later this month, and I
24 would have to, I would have to refresh my memory on RG&E gas, but

1 I do not believe it's been in the sharing mode.

2 Q. Okay. So if we put RG&E electric aside, RG&E gas,
3 subject to you're checking, and NYSEG gas, you have not yet hit
4 the point of earnings sharing, and NYSEG electric, there would be
5 no earnings sharing.

6 A. (Mr. Rude) That's correct.

7 Q. Did the company study how much savings it could realize
8 through refinancings as a result of the merger?

9 A. (Mr. Azagra) No.

10 Q. Has the -- has Iberdrola made any commitment to higher
11 performance standards for electric reliability if the merger is
12 approved?

13 A. (Mr. Azagra) Say that again.

14 Q. Is there any commitment of Iberdrola to more stringent
15 electric reliability standards if the merger is approved?

16 A. (Mr. Rude) No, there is no commitment to that higher
17 standards.

18 Q. Is there any commitment for higher performance standards
19 for service quality if the merger is approved?

20 A. (Mr. Rude) Nothing specific, no.

21 Q. Is there any agreement for higher or more stringent
22 performance standards for gas safety or reliability if the merger
23 is approved?

24 A. (Mr. Rude) No proposal.

1 Q. On page 4 of your testimony, line 11, you mention -- as
2 mentioned, one of the benefits is maintaining existing utility
3 jobs. Do you see that? Has Iberdrola agreed to maintain
4 existing manpower levels at NYSEG and RG&E if the merger is
5 approved?

6 A. (Mr. Azagra) Should I go ahead? What we have agreed
7 contractually is that, you know, as a result of the merger, there
8 will not be any change. I think, you know, basically as a
9 policy, you know, we want to make sure that also the current
10 standard, I believe, you know, certain quality, so forth, so on
11 will remain there. You know, so from that point of view, you
12 know, I think it will be that the management of the companies,
13 they want to decide whether what you said is something that
14 should be done or not, as they are doing right now. So there
15 will be no change, you know, with past practice, and it will be a
16 decision taken by the management of the company.

17 Q. So the management could decide to have layoffs following
18 the merger?

19 A. (Mr. Azagra) You know, if you call that in the scenario,
20 that's basically, you know, something we don't have basis right
21 now. You know, we don't have any reason to envision that at all,
22 and I would have to refer, you know, to whether the company on
23 its own right now that, you know, they will basically see that's
24 in the scenario going forward. Iberdrola has no reason to

1 believe that's the case, you know, based on the information we
2 have. And again, you know, I think that's unrelated to the
3 transaction at all.

4 Q. No, but you're stating in your testimony that the
5 proposed transaction supports economic development by maintaining
6 existing utility jobs in Upstate New York. So what I'm asking
7 is, is that a commitment by Iberdrola to maintain existing
8 employment levels at NYSEG and RG&E?

9 A. (Mr. Azagra) The commitment we have here in writing is
10 quite simple. Many mergers, you know, are based on layoffs, when
11 they announce, you know, layoff problems before the deal is
12 closed. Whether to get synergies or to get savings or even value
13 to shareholders, whatever the reason you want, we concluded,
14 based on previous cases and based on the current
15 micro-environment you have in the state and, you know, in the
16 U.S. as well, you know, that's not a positive thing in terms of
17 announcing the construction. So that's why we agreed to what we
18 agreed, which is because of the transaction, there is going to
19 be, you know, no employment at all. You know, so we have agreed
20 with that. No. If you're asking me, are we going to in the
21 ordinary course of business, you know, the decision, I don't
22 think Iberdrola is in a position to answer that right now. I
23 think, you know, the current management should explain to you,
24 you know, that whether Iberdrola is an owner or not of the

1 company, the answer should be the same one. It's unrelated
2 whether we become or not the shareholder, you know, the owner of
3 the company.

4 Q. So two months after the merger closes, Iberdrola could
5 decide to reduce manpower by ten percent. I know that's not your
6 expectations, but you're not making any commitments that would
7 stop you from doing that; is that correct?

8 A. (Mr. Azagra) That's correct. You know, the persons that
9 will be taking those positions in terms of running the businesses
10 are the management of the companies. So I think when you refer
11 to Iberdrola, it should be, you know, more the utilities
12 themselves, the ones taking the positions in the managements of
13 those companies. I think, you know, we are committing to
14 basically a lot of things here. So our expectation, you know, on
15 information we have right now has nothing to do with that
16 scenario you are describing there.

17 Q. Well, if that's the case, why doesn't the company just
18 make a commitment right now to maintain existing manpower levels?

19 A. (Mr. Azagra) I think we're making, you know, several
20 commitments to the State of New York, to the companies and to
21 many other people, and this commitment of non-layoffs we believe
22 is a bench mark at the announcement of the construction as
23 compared to most, if not all, most of the construction going on
24 in the State of New York and also in other states in the U.S. So

1 I think that's a huge benefit, in our opinion.

2 Q. And that's what I'm trying to explore, the extent of
3 that, of what you call a huge benefit. You're saying no layoffs
4 as a result of the merger, but the day after the merger or some
5 period afterwards, you could have layoffs for some other stated
6 corporate reason, correct?

7 A. (Mr. Azagra) Let's remember this is a first mover
8 transaction, which, you know, it's very important to remember
9 that. I think when, you know, you don't have any other utility
10 operations in the state, in the region or in the U.S., and the
11 only presence we have in the U.S. is through a separate company,
12 which has been IPO'ed, so it's, you know, probably a situated
13 company. You know, there is no merger there that is a vehicle,
14 which we have agreed is going to a specific business. That's it.
15 So basically, you know, the only platform, the only head we are
16 going to have in the U.S., you know, is going to be Energy East
17 should the deal be approved. So from that point of view, I think
18 it's quite easy to see that, you know. I don't think the
19 scenario you are describing is what is customary with respect to
20 this type of first movers into an across boarder, Trans-Atlantic
21 transaction.

22 Q. Let me ask the question this way, and then I'll move on,
23 I guess. To the extent that Iberdrola decides sometime after the
24 merger to reduce employment levels by some amount, isn't it true

1 that customers would receive no costs savings related to that
2 until rates are reset?

3 A. (Mr. Azagra) Again, I will make sure that it's not
4 Iberdrola. It will be the management of the utilities taking the
5 ordinary course of business decisions in terms of, you know, the
6 question.

7 A. (Mr. Rude) Mr. Mager, I think you can read this
8 commitment as that the transaction is, unlike other transactions
9 perhaps, the transaction itself will not result in job losses,
10 and that's the commitment, and that's Energy East's understanding
11 of Iberdrola's commitment, and that's what's being communicated
12 to employees. There could be circumstances that could arise in
13 the future that neither of us can identify that might result in
14 the change of employment levels, but that change could be
15 upwards. So I think the commitment is that the transaction in
16 and of itself will not change job levels, and that's a
17 substantial commitment compared to other transactions.

18 A. (Mr. Azagra) I think, you know, remember Iberdrola's
19 track record everywhere we go. You know, I think our track
20 record is to do as much business as we can, and right after we go
21 into any market, any state, any country, I think, you know,
22 three, four, six months after we start, you know, having
23 operations there, we just really come back with a strategic plan.
24 Capital expenditure, you know, is key for us, opportunities to

1 invest. I think, you know, that's the track record we have. You
2 can review that in Mexico. You can review that in the UK. You
3 can review that in Spain and just, you know, go country by
4 country. So I think from that point of view, I think Iberdrola's
5 approach to this transaction basically to acquire, you know, this
6 company and just optimize it as much as you could, no. You know,
7 this is the platform in which we want to do much more business in
8 the state, of course, and in other parts of the U.S. if possible.
9 But definitely, you know, that is the approach we need to
10 concentrate on that is proper. We do need to do more.

11 Q. Okay. Can you just explain to me how these decisions are
12 going to be made, because two questions ago when we were talking
13 about employment levels after the merger, you were saying, you
14 know, it's not up to Iberdrola. It's up to existing management.
15 And now, you're saying this is the way Iberdrola does things.
16 Aren't all these decisions ultimately -- aren't we talking the
17 same thing? After the merger isn't existing management part of
18 Iberdrola?

19 A. Absolutely. I mean, it would be -- you know, I think the
20 way I think it sounds to me, you refer kind of like Iberdrola is
21 separating that from Energy East or management or new management
22 in the future, you know, running the company. Absolutely not.
23 The local management, that's the approach we have to run the
24 companies and take care of the decisions. I think, you know,

1 whatever part of the company, we support decisions being taken by
2 the management. We think, you know, they are fair by any
3 management of any, you know, subsidiary we have within the group,
4 whether it's in Spain, in the UK, in Greece or in Mexico or in
5 the U.S. I think from that point of view it's important, you
6 know, basically, the culture that we have. In the terms of
7 investments that I mention right now, that's a different thing.
8 I think, you know, the location of resources within the group --
9 that's taking, you know, the holding company. So from that point
10 of view, you know, it will not increase investments in any
11 region. That has to be a group decision, and that was what I was
12 referring to in my previous concept.

13 Q. When you talk about being a first mover, what exactly do
14 you mean by that?

15 A. I think it's how many other constructions have been
16 approved. In New York, you know, we don't have any existing
17 utilities in New York. So we are not merging to existing
18 companies in New York. You know, we are just doing a straight
19 purchase of shares of a company which is a utility in New York or
20 in the region. That's it. We're not merging existing utilities
21 either in New York or in the states around New York.

22 Q. And Iberdrola didn't have any existing utilities in
23 Scotland, right, or England or in any of those areas?

24 A. (Mr. Azagra) No, it did not.

1 Q. Was the Scottish Power acquisition a first mover?

2 A. (Mr. Azagra) Yes.

3 Q. And in that case, not only were there synergy savings,
4 but I believe Staff stated in its testimony on page 58 that the
5 synergy savings were double of what was originally estimated. Do
6 you question that?

7 A. (Mr. Azagra) It is not a statement that we have committed
8 to achieving. You know, that's an estimate, but that's what it
9 is right now.

10 Q. So synergy savings still can be realized through first
11 mover transactions?

12 A. (Mr. Azagra) Initial review, you know, the disclosure of
13 those synergies within the different businesses for Scottish
14 Power, you will find, you know, we're talking about three
15 million, only three million in the T&D businesses. I think, you
16 know, if you review the IT, you will see they have SAP, which is
17 the main driver of those synergies. So I would encourage you to
18 review the detail of those synergies.

19 Q. Did Iberdrola ever perform studies to identify and
20 quantify possible synergy savings with respect to this merger?

21 A. (Mr. Azagra) Scottish Power or --

22 Q. No, Energy East.

23 A. No, we did not.

24 Q. Why did it decide not to even conduct any studies to see

1 if synergy savings were possible? Wouldn't that be something of
2 importance to consider?

3 A. (Mr. Azagra) I think, you know, the way this transaction
4 has been presented to the market, as we always try to do, is a
5 very transparent move. I think, you know, we have been
6 criticized, you know, by some experts, some analysts, Why are you
7 doing this contractually? You know, there are no up-front
8 synergies that you can explain to people. Well, that's the case
9 for many mergers going around the world. I think, you know, it's
10 not strange to say this is, you know, the first move, and then,
11 you know, we get familiar how the regulatory frameworks work in
12 the U.S. from a political point of view, and we'll go from there.
13 You know, that's how we moved into Brazil. We went first into
14 regulated business, and then, you know, when we were comfortable,
15 you know, with overall regulation within the country, then we
16 started doing other businesses. So I think that's very, you
17 know, clearly explained and not strange.

18 Q. So what you're saying is, there may, in fact, be synergy
19 savings, lots of synergy savings. You just don't know them now.

20 A. (Mr. Azagra) I would not refer to synergy savings. I
21 would refer, you know, to best practices at most.

22 Q. Well, you're saying you don't want refer to synergy
23 savings but --

24 A. (Mr. Azagra) No. If we were of the thought that, you

1 know, this is a deal, you know, we could have thought about
2 synergy savings, we would have put that on the table, absolutely.

3 Q. Wouldn't it have made sense in considering the deal to
4 investigate whether there were synergy savings?

5 A. (Mr. Azagra) Well, I think, you know, when you have
6 experience of doing this business for more than a hundred years,
7 when you've got, you know, construction in Europe with -- we go
8 over \$30 billion in the UK. It's over a \$30 billion amount
9 involving the transaction, and the synergies that we analyzed in
10 that company, you know, in the regulated business are three
11 million, you know, I think, you know, probably it's kind of
12 strange that our investors would agree with us that this is not a
13 synergy driven transaction action, as many other cases in New
14 York has been treated like that and acknowledged by, you know,
15 what I understand -- I will refer you to our experts on that and
16 the witness, but that's something that has been acknowledged with
17 other transactions, in different transactions.

18 Q. What is your understanding of how New York treats synergy
19 savings in merger cases?

20 A. (Mr. Rude) Well, again, in our, you know, limited
21 experience, you know, it can vary, but generally, there's been a
22 sharing, but usually the burden is on the company to find them.
23 So there's generally an up-front realization of the synergies
24 before they are achieved.

1 Q. And wouldn't you agree with me that the Petitioners have
2 an incentive, financial incentive to minimize any identified
3 synergy savings prior to the transaction?

4 A. (Mr. Rude) Well, I can say in support of Mr. Azagra, it
5 was not a focus of the transaction. The synergy savings and
6 potential that I'm familiar with is associated with duplicative
7 functions, redundant functions between companies where you're
8 doing a combination, and that wasn't the case here.

9 Q. Now, with respect to the merger, is there a possibility
10 that Iberdrola will realize certain benefits from production tax
11 credits?

12 JUDGE EPSTEIN: I'm sorry. If we're going onto a
13 somewhat different subject, let's have a discussion about
14 scheduling off the record.

15 (A brief recess was taken.)

16 JUDGE EPSTEIN: We're back on the non-confidential
17 record, and in between closing the confidential record
18 and opening this one, we had an off-the-record discussion
19 about the confidentiality portions of the confidential
20 record and that discussion resolved those issues. So I
21 would assume that what we would like to do at this point
22 is to continue with Mr. Mager's cross.

23 MR. MAGER: Thank you, your Honor.

24 Q. Can you please turn to page 66 of your rebuttal

1 testimony. On that page the panel discusses the Rochester
2 transmission project or RTP. Do you see that?

3 A. (Mr. Rude) Yes.

4 Q. Now, what was the justification for the RTP?

5 A. (Mr. Rude) Shut down the Russell Station. Excuse me.

6 Q. And explain why the RTP was needed if Russell Station was
7 shut down.

8 A. (Mr. Rude) I believe that's covered in some detail in
9 some interrogatory responses, but it's really not having that
10 generating source, actually a multi-unit generating source in the
11 load center, required the T&D infrastructure in that area to be
12 reinforced in the event of a shutdown, that contingency.

13 Q. When was the RTP approved approximately?

14 A. (Mr. Rude) Fall of 2004, subject to check.

15 Q. And when did construction start on the project?

16 A. (Mr. Rude) Soon thereafter.

17 Q. And is it your testimony now that the RTP project does
18 not satisfy the reliability need that it was justified?

19 A. (Mr. Rude) No, just the opposite. Russell Station is
20 scheduled to be shut down shortly, and the area would not have
21 sufficient reliability without the RTP project. So, in fact,
22 it's essential once Russell shuts down.

23 Q. And does the RTP satisfy any reliability needs for that
24 region of the service territory?

1 A. (Mr. Rude) Yes, the shut down of Russell Station.

2 Q. Okay. Can you please explain to me the sentence starting
3 on line 13 of page 66 where you state, "The Rochester system has
4 experienced additional growth since that time, and RG&E has
5 identified a localized reliability need within the system that
6 cannot and was not designed to be met by the RTP."

7 A. (Mr. Rude) Yes, that's looking out into the future beyond
8 the shutdown of Russell Station, and also the ISO has identified
9 in Zone B the need for more reinforcement in about a five- to
10 six-year time frame.

11 Q. And how much growth has the company experienced since
12 approval of the RTP in that region?

13 A. (Mr. Laurito) Yeah, I don't think we can speak to that
14 type period specifically, Mike, but we can say that the peak load
15 growth since 1999 approaches 30 percent.

16 Q. How much has peak load growth -- how much has peak load
17 grown since the RTP project was approved, and how much has it
18 grown above what the company projected at that time?

19 A. (Mr. Laurito) Don't know.

20 Q. Is the RTP project complete?

21 A. (Mr. Laurito) No.

22 Q. When will it be completed?

23 A. (Mr. Laurito) In May of 2007 or May of 2008, excuse me.

24 Q. And is it on budget or above budget?

1 A. (Mr. Laurito) It is on track with the contracted price
2 that was established.

3 Q. Was the contacted price that was established the same as
4 the price estimates at the time the regulatory approval was
5 sought for the project?

6 A. (Mr. Laurito) I'm not sure. I'd have to double check. I
7 don't have that with me.

8 MR. MAGER: Okay. I'd like to make an on record
9 request for the projected cost of the RTP project when it
10 was proposed to the Commission and the projected cost of
11 the RTP project now according to the company's best
12 estimate.

13 MR. FITZGERALD: To the extent that doesn't call for
14 any study, we'll provide that data.

15 MR. MAGER: Thank you.

16 MR. VAN RYN: Your Honor, I believe that there is
17 projected costs right in the Order approving the RTP
18 project.

19 Q. Is that the cost that the company still believes is
20 accurate?

21 A. (Mr. Laurito) I'm not sure what costs you're talking
22 about.

23 MR. VAN RYN: It was in the RTP Order approving the
24 project. There are estimated costs of what it's going to

1 cost, a dollar-for-dollar figure. Now, it could have
2 changed. I suppose you could state that it changed
3 later, but that is a projected cost that was in a
4 Commission Order.

5 JUDGE EPSTEIN: So, Mr. Mager, are you requesting
6 something that might be different from that?

7 MR. MAGER: No, I'll keep with my original request,
8 and I can always look up the Order if I need to.

9 Q. Let me just change gears now. I think we just have one
10 or two more topics and I'm done. Production tax credits
11 or PTCs, is it Iberdrola's position that it will not
12 realize any financial benefit as a result of the merger
13 with respect to PTCs?

14 A. (Mr. Azagra) Are you referring to a specific line or --

15 Q. Sure. Let me direct you. I believe starting on page 28
16 and continuing through page 36.

17 A. (Mr. Azagra) Tax credits is in making the same to enhance
18 renewable energy being developed. As you know, it has been
19 provided by the federal government in taxable income credits or
20 exemptions or whatever the right word, you know, has to be. So
21 it's totally unrelated to the transaction itself, you know,
22 whether there was to be the construction, that we be there. It
23 is part of those mechanisms that allow basically the economics of
24 wind development to be there. So should those, you know,

1 enhancements not be there, you know, there would be no wind being
2 developed.

3 Q. The production tax credits are used to offset income; are
4 they not?

5 A. (Mr. Azagra) For people that have income, they can
6 benefit from that.

7 Q. Is it possible that Iberdrola would use income realized,
8 income earned by Energy East to maximize the tax benefit of a
9 production tax credit?

10 A. (Mr. Azagra) Any income you were to have in the U.S., is
11 not a specific of this transaction with this company. You know,
12 subject to the tax credits being there, which, as you know, still
13 have not been renewed for next year and basically relate to the
14 transaction, so it's a condition in parenting to the economics of
15 those projects, otherwise they will not be developed.

16 Q. And you believe that the opportunity to utilize
17 production tax credits are unrelated to this merger?

18 A. (Mr. Azagra) It's not unrelated. You know, I think, you
19 know, any potential income that you were to have would allow you
20 to benefit for whatever the federal government has decided to do
21 in order to enhance the type related to any, you know, issue with
22 ratepayers or anything like that. I think, you know, however,
23 from our point of view, when you move into evaluation of Energy
24 East, we did not and we do not take that into account, because it

1 is not certain. There is no certainty that it will be there.

2 Q. And if it was there, that would be a synergy savings;
3 would it not?

4 A. (Mr. Azagra) No, it would not.

5 Q. It would be a benefit realized by Iberdrola as a result
6 of the merger?

7 A. (Mr. Azagra) I would not define it as a benefit. It's
8 something that, you know, the federal government has decided
9 which is not related to the public formation or the rates being
10 set up or anything like that.

11 Q. Let me ask it this way: Wasn't the ability to utilize
12 production tax credits one of the motivations to acquire Energy
13 East?

14 A. (Mr. Azagra) It's one of the items that was addressed,
15 you know, that it had to be analyzed, and subsequently, when it
16 was analyzed, basically we came to the conclusion there is no
17 certainty that will be there, and that's why it didn't become a
18 driver for us, you know, going forward. It was one of the
19 initial items that was identified that should be analyzed by us
20 in order to be put in the position of this investment in the
21 transaction and the development of wind energy in the U.S.

22 Q. And do you agree that in presentations concerning the
23 merger, Iberdrola cited the production tax credits as one of the
24 benefits and motivations for the merger?

1 A. (Mr. Azagra) In the initial presentations, yes, we did.

2 Q. And when you say there's no guarantee or certainty that
3 the benefits will be there, would you also agree there's no
4 certainty that the benefits would not be there?

5 A. (Mr. Azagra) Again, I would not define it as a benefit,
6 you know, related to the transaction, you know, in relation to
7 the Public Commission, rates being paid by the ratepayers or
8 anything like that. I think it's, you know, it's basically a
9 mechanism at the federal income level. So any distraction from
10 that objective basically will result in not building it.

11 Q. Well, let's assume that the production tax credits are
12 renewed. What is the maximum financial benefit that Iberdrola
13 could realize from those credits along with its acquisition of
14 Energy East?

15 A. (Mr. Azagra) We have not done anything on that analysis.
16 I think it's related, you know, to the tax credits being there,
17 which is not the case right now since they have not been renewed.
18 Second, you know, Iberdrola Renewables as a separate entity has
19 been using tax equity investors till right now. So from that
20 point of view, should Iberdrola have taxable income, they will
21 have to process, you know, also to be the tax equity investor.

22 Q. What are the -- what are the Spanish tax benefits that
23 you address in your testimony? Can you explain what those
24 benefits are?

1 A. (Mr. Azagra) We don't address any benefits, you know.

2 Q. Your position is that there are no benefits, but what I'm
3 asking is, what are the potential Spanish tax laws that could be
4 taken advantage of as a result of the merger?

5 A. (Mr. Azagra) I think it's very similar, you know, to the
6 tax credits. I think, you know, we believe, you know, any
7 transaction that we could do, you know, if there is no federal
8 government, in this case the Spanish government, that they want
9 their taxpayers basically to produce, to provide some type of
10 extension on some items. You know, it's unrelated to this
11 transaction or any other that we are doing anywhere. However, if
12 the tax mechanism that you refer to is related to amortization of
13 the financial good will, related to the purchase in relation to
14 investments of Spain --

15 Q. Like Energy East.

16 A. (Mr. Azagra) I was going to go into that.

17 Q. Okay.

18 A. (Mr. Azagra) I think, you know, there are two important
19 things there. The first one is a tax deferral. So basically,
20 you know, it's something whenever you were to sell those assets,
21 you will incur payments and you will have to pay for that. So
22 it's not forever an exemption. The second one will be, you know,
23 from a cash point of view, it's there. So we just put aside the
24 money. So it's not something, you know, from a cash point of

1 view that we enjoy, and also important is based on the rulings
2 that, you know, the government has done, and again, it is
3 something that the taxpayers in Spain are happy to do, but you
4 know, it's the case, you know, analyzed under the rules of the
5 tax authorities in Spain that you will not enjoy these if you
6 were to acquire a holding company. It's done with intent when
7 you acquire assets, when you acquire businesses but not when you
8 acquire holding company. So that's why also from an evaluation
9 point of view, there's a difference from, you know, Scottish
10 Power, as an example. We came to the conclusion that that was
11 not going to be, you know, the case, and we didn't take that into
12 account in the evaluation of the company.

13 Q. Let me direct your to page 36 of your testimony, line 16.
14 You state that, "There is no certainty that Iberdrola will ever
15 be able to obtain any tax offset or good will amortization
16 associated with the proposed transaction under Spanish law." Do
17 you see that?

18 A. (Mr. Azagra) Yep.

19 Q. Now, is there a certainty that Iberdrola will not be able
20 to obtain any tax offset or good will amortization?

21 A. (Mr. Azagra) Our belief is that according to the current
22 case reviews that they have done, by acquiring a holding company,
23 we will not be able to benefit from that.

24 Q. But at this point you're not sure yet?

1 A. (Mr. Azagra) I cannot be sure, you know, because it's
2 something that the tax authorities have to rule when there is
3 something on the table. So until the transaction is not closed,
4 there is no certainty for us at all, and even in the transaction
5 they have to review that.

6 Q. So what would happen would be after the transaction is
7 closed, Iberdrola would make some sort of filing with the tax
8 authority?

9 A. (Mr. Azagra) What historically has been the case with
10 investments is we file our requests for them to understand
11 whether, you know, we fall within the category or not, and then
12 you know the taxpayers are happy basically to defer this tax
13 issue, but you know, their rules are there.

14 Q. And if Iberdrola was to make such a filing, it would seek
15 favorable tax treatment?

16 A. (Mr. Azagra) Absolutely.

17 Q. And if favorable tax treatment was granted, would any of
18 that flow to the customers of NYSEG and RG&E?

19 A. (Mr. Azagra) We think, you know, in that scenario that is
20 not fair, you know, basically to move what taxpayers are happy to
21 do because of the government in another country, you know, to
22 unrelated rates being set up in another business, we think are
23 totally unrelated matters.

24 Q. So you're saying U.S. customers cannot take advantage of

1 Spanish tax laws, but Spanish companies can take advantage of the
2 United States' production tax credit?

3 A. (Mr. Azagra) When you invest, when you invest and then
4 produce energy, then you benefit from that. So I think your
5 comment is totally unrelated.

6 Q. Isn't the Spanish tax law specifically for investments?

7 A. (Mr. Azagra) For any company?

8 Q. In other countries.

9 A. (Mr. Azagra) For any company based in Spain, not a
10 Spanish company, any company based in Spain, and again, it's a
11 tax deferral. So don't call it tax benefit.

12 MR. MAGER: I have nothing further. Thank you, you
13 panel.

14 JUDGE EPSTEIN: Okay. Other cross?

15 MR. BREW: Yes, your Honor. Since Mr. Mager has
16 covered everything that I pretty much planned to get to,
17 this will be very brief.

18 CROSS-EXAMINATION

19 BY MR. BREW:

20 Q. In your rebuttal testimony on page 9 under the heading,
21 "Economic Development and Jobs," you state that the proposed
22 transaction will reinforce ongoing efforts to maintain and
23 revitalize the economy of Upstate New York." Do you see that?

24 A. (Mr. Azagra) Yes.

1 Q. "Ongoing efforts," does that refer to ongoing efforts by
2 the Energy East companies or some other efforts?

3 A. (Mr. Azagra) We could expand that to some other efforts.

4 Q. Would it include efforts by the Energy East companies?

5 A. (Mr. Azagra) If there are specific projects, absolutely.

6 Q. On page 16 of your testimony at line 16, you indicated
7 that, "Finally, the Joint Petitioners wish to emphasize that
8 reliability, safety and customer service will remain top
9 priorities for both NYSEG and RG&E after the consummation of the
10 proposed transaction." Do you see that?

11 A. (Mr. Rude) Yes.

12 Q. Is support for efforts to maintain and revitalize the
13 Upstate economy also a top priority for the Energy East
14 companies, and if so, would remain so after consummation of the
15 transaction?

16 A. (Mr. Azagra) I mean, we are not a government. So, you
17 know, we are not the people that set up policy and basically
18 focus in one region or another one. I think, you know, what we
19 have a track record of is of investing, and I think the type of
20 investments that Iberdrola has done in the past -- and I want you
21 to make sure that people understand the track record -- coincides
22 with the type of investments you need in a specific region of the
23 state. So we think, you know, we are the right player to come
24 into New York, and that's basically the reason why we are very

1 comfortable focusing on New York when compared to going something
2 else.

3 Q. My question was, do the Energy East companies have a role
4 now in helping to support economic development in Upstate?

5 A. (Mr. Rude) Through our rate structure, we certainly do,
6 both to retain or to provide alternatives to contested load and
7 also to provide incentives for companies willing to invest and
8 grow their businesses and load in the service territory.

9 Q. Okay. Thank you. And you've got multiple references to
10 the importance of economic development in your testimony,
11 specifically, on pages 4, 9 and here on 16. So my question is,
12 following the consummation of the proposed transaction, will the
13 Energy East companies remain committed to supporting economic
14 development as a priority?

15 A. (Mr. Rude) Yes, in the manner I just spoke about.

16 MR. BREW: Thank you. That's all I have.

17 JUDGE EPSTEIN: We'll have a discussion of
18 scheduling off the record.

19 MR. DUTHIE: Your Honor, I have cross-examination,
20 too.

21 JUDGE EPSTEIN: That's fine. That's what I want to
22 talk about. You have -- I'd like to get us out for lunch
23 around 1:30. So can you please say you've got more than
24 15 minutes worth? I'm just wondering whether to break

1 for lunch now. And Mr. Prestemon.

2 MR. PRESTEMON: As with Mr. Brew, Mr. Mager asked
3 most of the questions I wanted to ask, but I might have
4 15 or 20 minutes at the most, and I do not want to have
5 the pressure of being the one that's holding up lunch.

6 MR. DUTHIE: And your Honor, as a result of Mike's
7 questioning, I have a couple of follow-ups.

8 JUDGE EPSTEIN: All right. So what do you say it's
9 lunchtime now?

10 MR. PRESTEMON: Yes, sounds good.

11 JUDGE EPSTEIN: Okay. We'll be back in one hour.

12 (Discussion off the record.)

13 JUDGE EPSTEIN: Back on the record, we just had a
14 discussion such that we are adjourning for one hour.

15 (A luncheon recess was taken.)

16 JUDGE EPSTEIN: Other parties have cross for this
17 panel.

18 MR. PRESTEMON: I do, Your Honor.

19 JUDGE EPSTEIN: Sir?

20 BY MR. PRESTEMON:

21 Q. As I said earlier, Mr. Mager covered most of the
22 questions so I have a few follow-ups to his questions and just a
23 few more.

24 First of all, on your discussion of your commitment

1 to sell the fossil fuel generation in RG&E's territory, as I
2 understand the partial acceptance, you are imposing only two
3 conditions on that sale: That only the proceeds in excess of
4 book value be shared with rate payers; and that all the proceeds
5 from the sale of the Carthage peaking unit go to shareholders; is
6 that correct?

7 A. (Rude) Gains or losses.

8 Q. Gains or losses. Those are the only two conditions and
9 otherwise you say that you will accept reasonable protocols
10 established by the Commission, correct?

11 A. (Rude) That is correct.

12 Q. So --

13 A. (Rude) As well as a determination of where the proceeds
14 go.

15 Q. You are committing now to abide by -- subject to those
16 conditions -- to abide by the determination of the Commission on
17 the protocols in all other respects; is that correct?

18 A. (Rude) That is correct.

19 Q. If either or both of those conditions is not incorporated
20 in the decision by the Commission in this case, would you
21 consider that fatal to proceeding with this transaction -- I
22 guess this would be a question more for Pedro -- or merely a
23 negative factor?

24 MR. FITZGERALD: Can you repeat the question again?

1 BY MR. PRESTEMON:

2 Q. I am asking: If the two conditions that you are asking
3 for on the sale of the fossil fuel-fired units are -- either one
4 or both is not incorporated in an order in this case by the
5 Commission as accepted conditions, would you consider that fatal
6 to your decision to proceed with the transaction, or merely a
7 negative factor that you would weigh against all other provisions
8 of the order?

9 A. (Rude) I think we'd wait to see whatever changes were
10 made before we made any kind of decision like that. However,
11 it's hard for us to imagine that the Commission wouldn't accept
12 these two conditions.

13 Q. That's fine.

14 I would like to explore a little more the limitation
15 that you have on your commitment to renewables. I'm just trying
16 to determine to what extent this is a binary condition -- on or
17 off -- or whether there is some nuance to it.

18 You state that, if the Commission imposes
19 restrictions on your ability to develop renewables, that might
20 cause you to withdraw this commitment. If a decision by the
21 Commission imposes some sort of restrictions that inhibits you in
22 some areas or maybe makes certain projects infeasible but leaves
23 most of the others available for you to develop, would you still
24 consider your commitment to have been withdrawn?

1 A. (Azagra) I think one of the reasons why we are here is
2 because of the development of energy and wind energy in New York.
3 So if there was to be any restrictions to that, I think that
4 would apply to this concept.

5 Q. So, if the Commission determined that Iberdrola should
6 not develop wind power that interconnects with the facilities of
7 NYSEG or RG&E, then you would consider this commitment to be
8 withdrawn; is that correct?

9 A. (Azagra) Absolutely.

10 Q. And if there were a change in the RPS program or the
11 federal tax credits or any other economic factor governing the
12 development of wind power such that some of the projects in
13 New York would not be as attractive -- let's say not unprofitable
14 but not as an attractive as additional wind projects on the north
15 coast of Scotland or Bolivia -- would you consider that to have
16 caused this commitment to be withdrawn?

17 A. (Azagra) It could be one of the reasons as well.

18 Q. Are you aware that the -- I think it's been mentioned a
19 few times -- that then-Lieutenant Governor, now Governor of the
20 state headed a task force that investigated the development of
21 renewable energy in the state?

22 A. (Azagra) Partially aware.

23 Q. In his report, he suggested that the State of New York,
24 in addition to the development of wind power itself, needs help

1 with education and training of personnel to operate and construct
2 these facilities and also needs investment in the manufacturing
3 of equipment for the generation of wind power.

4 Would Iberdrola be willing to make a commitment to
5 expenditures in areas such as that?

6 A. (Azagra) I think, as part of economic development that we
7 do with wind development, that we have done in many countries --
8 especially the first part of your comments, the one referring to
9 training people and using local sources to develop facilities to
10 be able to construct and so on -- that's the case. That's
11 something, you know, that has been done. It's done. So that's
12 one of the basically reasons why we are local because that's
13 something that brings wind development with it, that specific
14 comments that you said.

15 Q. Are you willing to make a commitment to those types of
16 expenditures, now, in this case?

17 A. (Azagra) I think that comes with wind development. I
18 think there are companies and there is a queue of potential
19 development. I think we've seen that queue in many countries and
20 in the States. I think Iberdrola brings reality to projects and
21 commitment in developing them. Once we come to the conclusion
22 that New York is there, probably the experience of Spain, where
23 we took care of more than 50 percent of the renewable targets
24 when Europe and the UK being the No. 1 development of wind and

1 you're looking to the US No. 2 -- here No. 1 in the world --
2 seems to us that's the best credentials for the type of companies
3 you want to do business in New York. We don't go into states not
4 to do anything.

5 Q. So, effectively, if conditions occur that cause you to
6 withdraw your commitment with respect to the construction of wind
7 power generation, that would also withdraw any commitment you
8 might have to training, education, or construction?

9 A. (Azagra) Everything is linked and we are happy to share
10 our experience in all the other countries where we are either the
11 No. 1 or No. 2 operator and developer at the same time.

12 Q. And now just a couple follow up questions --

13 A. (Azagra) You can find even public pieces, public news,
14 where it has been described the importance of wind and the
15 economic development behind wind. In many countries, that has
16 happened already. That's something that is findable, not just
17 theory. It has been proven already, so that's quite an
18 interesting area, the one you are raising.

19 Q. Couple follow-up questions to Mr. Mager's question on
20 jobs.

21 If I understood what you said in response to some of
22 Mr. Mager's questions, Iberdrola currently has no plans
23 associated with the consummation of this transaction to make any
24 major reductions in staffing at any of the regulated utilities in

1 New York State; is that correct?

2 A. (Azagra) Not major. None at all.

3 Q. Even better.

4 I think you also said that day-to-day,
5 month-to-month, year-to-year decisions concerning staffing, it
6 was Iberdrola's intention to leave that to the management in
7 place at Energy East?

8 A. (Azagra) Affirmative.

9 Q. Okay, so, then moving to Energy East -- I said I'd ask
10 Energy East: Do you have any plans currently to make any major
11 reductions in staffing as a result of the consummation of this
12 transaction?

13 A. (Rude) No. None at all.

14 Q. Have you done any studies or analyses to indicate that
15 any such reductions might be possible?

16 A. (Rude) I certainly can ask Jim to comment more on that,
17 but we know what our staffing is and where it was, and as we have
18 provided in this proceeding that's come down over time for some
19 reasons related to the synergies between the two companies and
20 also the formation of service companies where employees left the
21 utility companies but came to the service companies.

22 We think we reached a point where that's got to head
23 in the other direction, frankly, and particularly to meet the
24 capital program needs that we have and just to maintain service

1 quality in the territory. The comment I would add to that, Dave,
2 is no, we haven't done any studies.

3 Q. Given that, is there any reason why the companies
4 Iberdrola and Energy East could not make a commitment now that no
5 such major reductions are going to take place in the next three
6 years?

7 A. (Azagra) I think, as to Iberdrola, the basic approach we
8 have to the businesses is: Businesses change over time for the
9 good and for the bad, and regulations change, and governments
10 change. And there are many things you can not guarantee that
11 would be out there right now in the future.

12 One angle that is important is the track record of
13 Iberdrola in relation to human resources and labor relationships.
14 We provided information about the trade unions representation and
15 collective agreements that we have in Spain. How that approach
16 is also done in the UK. That's probably the track record we
17 have, one of the things that we feel very comfortable, which is a
18 very long track record, a complete agreement. Many steps are
19 taken in the companies from an HR point of view with the workers'
20 representatives.

21 There have been no unilateral decisions being taken
22 by the management in the Company, at least as long as I can
23 remember since I joined. That's probably the best example and
24 demonstration of the culture that we bring, which is basically

1 everything being done through agreements.

2 Q. Now, in an effort to save some time here, if I were to
3 ask you that same series of questions I just asked about
4 staffing, with respect to reductions in staffing, if I were to
5 ask you that concerning relocations of utility personnel out of
6 the State of New York, would your answers currently be the same?
7 That is, if Iberdrola has no immediate plans, Energy East has no
8 immediate plans?

9 A. (Azagra) I think, as Iberdrola, we committed in writing,
10 again, some transactions happening in the US which involved
11 different states, different companies headquartered in different
12 states, and the headquarters being a big issue for the regulators
13 and Commission approving the details. We committed to
14 maintaining the headquarters where they were. That's another
15 tool for making sure people understand we want to remain local.
16 That's something we have put in writing in the merger agreement.

17 (Rude) The changes in location for utility employees
18 was really related to the service companies. I mean, we haven't
19 moved NYSEG and RG&E utility employees to Pennsylvania. You
20 wouldn't do that. So, that service company development and
21 transfer, that's already occurred. That won't happen again.

22 Q. And finally, with respect to the location of facilities
23 in New York State, are your answers essentially the same: There
24 are no plans to make any major changes?

1 A. (Rude) No, there is no plans other than the capital
2 additions that we proposed.

3 Q. I am sorry to be jumping around, I missed one back on the
4 renewables commitment.

5 You were asked about the meaning of the undertaking
6 to support and encourage development of renewables. I believe
7 Mr. Mager brought out the fact you own 80 percent of the stock in
8 Iberdrola Renewables.

9 Is there any reason why Iberdrola, the parent
10 company, can not direct its subsidiaries to undertake these
11 investment?

12 A. (Azagra) Would you mind to repeat the question?

13 Q. I am just asking: Given your control of the stock of
14 Iberdrola Renewables, is there any reason why, in furtherance of
15 your commitment in your partial acceptance, you can not direct
16 the development of renewable energy projects, rather than merely
17 support and encourage them?

18 A. (Azagra) We have in the agreement signed between
19 Iberdrola Renewables and Iberdrola parent company. Iberdrola
20 Renewables has become the exclusive vehicle for any renewable
21 development within the group. So no other part of Iberdrola can
22 develop -- any development of wind or other renewable source of
23 generation will be done through Iberdrola Renewables. Legally
24 speaking, since NYSEG's a publicly traded company, we can

1 support. Being the 80 percent majority shareholder, that
2 explains how comfortable we are that that would be done. We need
3 to say it in that way.

4 Q. So, in effect, you can direct Iberdrola Renewables to go
5 forward with these commitments?

6 MR. SCHWARTZ: Objection, Your Honor, Mr. Prestemon
7 is asking a question that he's already asked. While I have no
8 objection to the quality of the question, it seems like he's
9 looking for a legal determination with respect to the corporate
10 structure powers that Iberdrola has over Iberdrola Renewables. I
11 believe that, as a witness, non-lawyer in this proceeding, that
12 Mr. Azagra has already answered that.

13 JUDGE EPSTEIN: I didn't quite understand the
14 witness' answer. I couldn't hear.

15 You were saying that there is a publicly held
16 company. You are referring to Renewables, not -- you weren't
17 talking about Iberdrola?

18 A. (Azagra) No. We placed in the market, through a capital
19 increase, 20 percent of the Company back in November.

20 JUDGE EPSTEIN: And so was your answer that, because
21 of the 20 percent, Renewables is an autonomous company and
22 Iberdrola cannot direct it to take certain actions?

23 A. (Azagra) Taking into account the legal obligation, I
24 would refer to lawyers for that. I think the word "support"

1 means we can vote and we can basically, through our vote in the
2 Company, promote the direction of investments and other things
3 that we would have to vote for. That's why we were using the
4 word "vote" or "support."

5 BY MR. PRESTEMON:

6 Q. All right, is the meaning of your commitment as set forth
7 in your partial acceptance that you will encourage and support
8 the development of these renewables through the exercise of your
9 upstream voting power? Is the meaning of that commitment that
10 you will vote your shares to have Iberdrola Renewables carry out
11 this commitment?

12 A. (Azagra) What the legal means that we would have to put
13 in place in order to comply with this commitment.

14 Q. I hesitate to ask this because I don't know if this is a
15 legal question either, but: Do you know of any reason why
16 Iberdrola could not have this matter considered by Iberdrola
17 Renewables so that you could vote on that?

18 All right. What I am trying to get at is: Do you
19 have the power to make this happen? Or do we need Iberdrola
20 Renewables in the room here to assure ourselves that something is
21 going to happen?

22 A. (Azagra) I think we are putting here because Iberdrola is
23 taking the obligation to comply with this. We are running the
24 risk of complying or not complying with that.

1 Q. And if, for any reason, Iberdrola does not comply with
2 this commitment, what will be the recourse of those of us --
3 parties who have supported the inclusion of this commitment -- in
4 the decision of the Commission?

5 A. (Azagra) I don't think that's a scenario we envisage.

6 Q. I know, unfortunately. I don't want to envision it
7 but --

8 A. (Azagra) I think if you review our strategic plan in
9 which we highlight, as Iberdrola, which are the targets from our
10 renewable point of view, the vehicle to implement those targets
11 is Iberdrola Renewables. But I think we have our target as a
12 group and the vehicle is Iberdrola Renewables. This obligation,
13 as the targets for Iberdrola, are part of Iberdrola's strategic
14 plan. That's why we have the targets and the vehicle is
15 Iberdrola Renewables.

16 Q. Let me ask a couple of questions on the vertical market
17 power issue.

18 At pages 20 and 21 of your rebuttal testimony, I
19 believe you state there that it is your opinion that the
20 testimony of Dr. Hieronymus demonstrated vertical market power
21 should not be an issue with respect to wind power development by
22 Iberdrola; is that correct?

23 A. (Azagra) That is my opinion. I will refer to other
24 witnesses to explain in that detail, but that's my understanding.

1 Q. But are you familiar with your witness' testimony because
2 you've cited it there?

3 A. (Azagra) Yes.

4 Q. Is it your understanding that the wind power development
5 by Iberdrola should not be considered to raise vertical market
6 power concerns either because this type of development would not
7 give you the power -- would not enable you to exercise such power
8 or that reasonable mitigating conditions could be imposed to
9 assure that vertical market power could not be exercised?

10 A. (Azagra) I think I should refer to our local counsel or
11 the experts that we are bringing. They know the market power
12 policy of the state. As Iberdrola, we do not believe that there
13 is any market power with wind development anywhere. Not only in
14 New York, but anywhere else where we're doing business.

15 That's our own opinion. It's a very firm opinion.
16 We don't think any limitations to that. We don't think there is
17 any mitigations that should be required. That's our clear
18 opinion for that.

19 Q. Are you familiar with the vertical market power policy
20 statement of the Commission in the state?

21 A. (Azagra) I would refer to our counsel or experts in
22 detail for that.

23 Q. So, you do not understand, yourself, what that policy
24 would require?

1 A. (Azagra) It's our understanding that there is no market
2 power issue in the development of wind in New York by Iberdrola's
3 subsidiary Iberdrola Renewables should we acquire these
4 utilities.

5 Q. I understand what your position is, but I am just asking
6 if -- maybe I have asked it already.

7 You are not familiar with the terms of the
8 Commission's policy statement?

9 A. (Azagra) I will say it again: My understanding is that
10 there is no conflict with any market power in the state of New
11 York by developing wind.

12 Q. Does anybody else on the panel have a familiarity with
13 the terms of the policy statement?

14 A. (Rude) I have familiarity with the terms.

15 Q. Mr. Rude, do you understand that the policy statement
16 says that there is a rebuttable presumption that vertical market
17 power could be exercised by a transmission owner that also owns
18 generation facilities?

19 A. (Rude) Yes.

20 Q. And that presumption can be rebutted by a showing either
21 that vertical market power cannot, in fact, be exercised by the
22 owner, or that reasonable conditions can be imposed that would
23 mitigate the exercise of that power?

24 A. (Rude) I think that's a fair paraphrasing.

1 Q. As I understand it, the witnesses for the companies in
2 this case have said that their opinion is that it is the case
3 that -- either with wind power development by Iberdrola, that
4 either no market power could be exercised or that reasonable
5 conditions should be imposed that would mitigate against the
6 exercise of that power, correct? And you have cited that in your
7 testimony?

8 A. (Rude) That is correct. I think we are also encouraged
9 by FERC's ruling on this in approving the transaction.

10 Q. Given that, is there any reason why the Company cannot
11 now commit that they are willing to be bound by the Commission's
12 policy statement as that policy statement may change from time to
13 time?

14 A. (Azagra) Iberdrola would comply with an existing or
15 future policy ruled by the Commission as we comply with any
16 legislation rule by any state or country in which we do business.
17 We will continue to do that as we always do.

18 MR. PRESTEMON: Thank you, I have no further
19 questions.

20 JUDGE EPSTEIN: Mr. Prestemon, I am concerned that
21 you asked a question that didn't bring a direct response and I
22 don't want to misstate anything that was said here. So let me
23 just see if I can reconstruct this.

24 Did you ask the panel what recourse there would be

1 if Iberdrola did not carry through on the commitment to support
2 and encourage investments by Renewables? Was that your question?

3 MR. PRESTEMON: Yes, I did ask that.

4 JUDGE EPSTEIN: Panel, I think your answer was that
5 that scenario was not realistic, that the commitment was firm, or
6 something of that nature? Was that your answer?

7 Q. (Azagra) I remember two different things. One is whether
8 we envisage the development of this wind investment not happening
9 because of any issues with Iberdrola Renewables, and we do not
10 envisage that scenario, which is also different from who is
11 taking the guarantee of this commitment, which is the parent
12 company, Iberdrola. So I think the last recourse is Iberdrola
13 taking the commitment, the highest or most important one you can
14 get from our group.

15 JUDGE EPSTEIN: Looking at the acceptance, the
16 Exhibit 50, it's very carefully written. It seems to put all the
17 necessary qualifications in there. Says that if the conditions
18 of the wind generation industry in New York change or all the
19 necessary permits are granted and so on.

20 So it's written as if some kind of enforceable
21 agreement, but is it an enforceable agreement? Or is it simply
22 that Iberdrola is saying now: This is our commitment and one has
23 to accept that at face value?

24 A. (Azagra) If the current drivers of the economics of these

1 projects that we have right now were to remain here within the
2 next three years, we could comply with this.

3 JUDGE EPSTEIN: Right. But it's written in such a
4 way that it seems to be setting a framework for debate down the
5 road as to whether Iberdrola actually complied with this letter
6 or not.

7 And where would that debate occur? Would you expect
8 to come back to the Commission to have to explain if Iberdrola
9 had not been supporting the development of wind generation?

10 A. (Azagra) I am not familiar with the ways in which you
11 need later after approval of a deal, basically to come back and
12 show how you have complied with that. Our intention is very
13 clear here: Let tax credits remain there. I think, with
14 economics being there, we will make sure this amount is invested
15 in wind development in New York in the next three years. Simply
16 of that. We will come back with approval that these are the
17 projects in which we have invested.

18 MR. SCHWARTZ: Your Honor, if part of the question
19 goes to legal enforceability of this document --

20 JUDGE EPSTEIN: Maybe it does.

21 MR. SCHWARTZ -- maybe that's not a question for a
22 panel. On behalf of the Joint Petitioners, I would be happy to
23 discuss it. I know that's not a standard way to go about this.
24 This is intended to be a legally binding commitment that, if

1 adopted, could be incorporated as a condition to the transaction
2 and could be enforceable with all the Commission's powers for
3 enforcement of conditions to merger orders. In other words, a
4 violation would be a violation of a merger condition.

5 JUDGE EPSTEIN: And then what might happen?

6 MR. SCHWARTZ: Just like with the violation of any
7 other merger condition, the Commission has enforcement authority
8 to pursue any remedies that are under its enforceability.

9 In this instance, if Mr. Azagra is saying certain
10 preconditions are met there is \$100 million renewable investment
11 goal, and if those conditions were met and the merging parties,
12 the Joint Petitioners, failed to fulfill them, the
13 Joint Petitioners' view is that the Commission would have all of
14 its enforcement powers available to it, just as if any other
15 merger conditions failed to be fulfilled.

16 MR. PRESTEMON: Could I ask then, based on the way
17 the commitment is worded, if on the third anniversary of the
18 order in this case a report by Iberdrola to the Commission showed
19 that the Company had not expended \$100 million on renewables, you
20 would deem it to be in violation of a Commission order and
21 subject to penalties under Section 25 of the Public Service Law?

22 MR. SCHWARTZ: To the extent that these conditions
23 were met -- in other words, to the extent the conditions that Mr.
24 Azagra laid out -- were met but the \$100 million were failed to

1 have been invested and to the extent that Iberdrola -- Mr. Azagra
2 has already laid out that all it can do is exercise its upstream
3 voting control. So when it exercises its upstream voting control
4 and those conditions or preconditions are met and Iberdrola
5 exercises its upstream voting control to invest in the \$100
6 million, it will have met the conditions.

7 If it failed to do those things after those
8 preconditions are met that are laid out in this section, the
9 answer is: Yes, it would be violating a merger condition and the
10 Joint Petitioners would be subject to enforcement authority by
11 the Commission.

12 MR. PRESTEMON: Based on that, could I also make an
13 on-the-record request that if there are any impediments to
14 Iberdrola, the parent company, exercising its control over
15 Iberdrola Renewables through its voting share to make these
16 developments happen. Could you send us a description of that or
17 a statement that they don't exist? The way you said it was,
18 Well, maybe Iberdrola votes 80 percent and Iberdrola Renewables
19 thumbs its nose at the parent.

20 MR. SCHWARTZ: This is a legal stipulation
21 discussion, but the language of the corporate structuring
22 document requires that we cannot say that we are -- that
23 Iberdrola is one and the same with Iberdrola Renewables. The way
24 you put it was the right way to put it. An upstream voting

1 interest.

2 There is a 20 percent interest that is outside of
3 the Iberdrola group. So in light of that, the answer -- I think
4 that some of these concerns are a little misplaced, and what I
5 think Mr. Azagra was trying to explain was that all they can do
6 is exercise upstream interest.

7 On the record, Iberdrola can say that, We know of no
8 restrictions that prevents Iberdrola from exercising all of its
9 80 percent interest in favor of the pursuit of this renewable
10 commitment.

11 A. (Azagra) I think I wanted to make it clear about
12 something. You need to review Iberdrola's strategic plan and,
13 with that, the renewable targets that we have.

14 Many of the companies don't make any strategic
15 plans. They don't announce anything. We have made it clear we
16 want 1000 megawatts in the US a year in the next three years.
17 That's roughly 1.52 billion investment a year. That's our
18 target. If we're trying to do more business in New York and in
19 the region, I think that makes it very clear what our intentions
20 are, which is to focus as much as we can in specific territories.
21 That's a target which is there. 1000 megawatts is almost 2
22 billion a year. Just keep that in mind.

23 JUDGE EPSTEIN: Okay.

24 MR. DUTHIE: If I could follow up on that.

1 BY MR. DUTHIE:

2 Q. Mr. Azagra, all of your wind projects are
3 project-financed; is that correct? Most of them?

4 A. (Azagra) No. I would need to come back to you on that.

5 Q. In other words, resources to the project, not back to
6 Iberdrola?

7 A. (Azagra) Not necessarily, no.

8 Q. Let me ask the question another way then:

9 The 100 million is the minimum commitment that you
10 are making?

11 A. (Azagra) Correct.

12 Q. Would that commitment be in the form of equity?

13 A. (Azagra) This is a continuous investment. How it's
14 financed is not purpose of commitment.

15 Q. The 100 million, if it were total project, would only
16 yield 50 megawatts. The 100 million, if it were 80/20
17 debt-financed, it would yield 250 megawatts. So, if someone were
18 looking for results and not just money, maybe the 250 might be a
19 better place to commit to than the 50?

20 A. (Azagra) I never thought anybody was going to rephrase it
21 that way. What we are taking here is what commitment we want to
22 put on the table in renewables, at least in New York for the next
23 three years. That's investment.

24 Where the money comes from, it doesn't matter. It's

1 at least 100 million will be investing here. I think, from
2 public interest point of view, the important thing is how much
3 money comes into the state in investments. That's 100 million.
4 That's what we are committing to.

5 Q. The 100 million could be a combination of debt and
6 equity?

7 A. (Azagra) What's the difference?

8 Q. The difference in my mind is the leverage that one
9 attains. \$100 million as an equity investment in a project can
10 generate a heck of lot more than just \$100 million total
11 investment.

12 A. (Azagra) Same way I could tell you that Iberdrola has no
13 debt right now because we wanted to position the Company in the
14 market with no debt. From that point of view, it's all equity.
15 Any investment since they have no debt right now could be all
16 equity. I don't agree with that. I could explain that that way
17 but I don't think that's important.

18 Q. This is a question that goes back to the revenue
19 requirement effects of the PBAs -- and I believe that Mr. Rude
20 had established this with Mr. Mager -- that approximately \$200
21 million PBA, or positive benefits adjustment -- I have to
22 acknowledge, I believe that term was invented by John Benedict --
23 would produce a \$50 million revenue requirement reduction. Is
24 that approximately correct?

1 A. (Rude) With one clarification. The \$200 million made up
2 the way we made it, based on our proposal in attachment 1, that
3 would produce \$50 million. It's not any 200 million.

4 Q. These PBAs are also all associated with the Company's
5 balance sheets; is that correct?

6 A. (Rude) No. Yes. But the effects aren't limited to that.

7 Q. The so-called PBA itself, the \$200 million, is basically
8 not a revenue requirement but rate base adjustment, to use that
9 word?

10 A. (Rude) The PBAs are, if you will, write-offs or increased
11 reserves.

12 Q. To the extent that there were \$400 million of PBAs of a
13 similar type, one would double the revenue requirement effect --
14 i.e., if it were a \$400 million write-off, it would be \$100
15 million of reduced revenue requirement?

16 A. (Rude) Not necessarily. Not dollar-for-dollar.

17 Q. Have you analyzed the Staff's position in terms of what
18 effect it would have on NYSEG's and RG&E's revenue requirements?

19 A. (Rude) I believe that's in our rate adjustment panel's
20 testimony.

21 Q. Do you recall approximately what the numbers look like?

22 A. (Rude) I don't have them right here. They were already
23 cross-examined. Staff would probably have a better answer for
24 you than I could give you.

1 Q. From a shareholder perspective, is it better for the
2 Companies to have -- all things being equal with the equivalent
3 revenue requirement impact -- a definite PBA adjustment or a
4 synergy savings implementation?

5 A. (Rude) Is there a third alternative?

6 MR. FITZGERALD: I want to object.

7 MR. DUTHIE: You are supposed to say the PBA is
8 better.

9 MR. FITZGERALD: Compound question, break it down so
10 the witness can respond.

11 Q. All things being equal so that it's either a PBA
12 adjustment or a synergy savings implication, from a shareholder
13 perspective, which is better?

14 A. (Rude) Let me take a shot, Pedro, and you can correct it.

15 I think our answer is in the unilateral acceptance
16 document. So if you could use that as a proxy for answering that
17 question and primarily because, as we testified, this is not a
18 transaction that produces synergies. So, therefore, a synergy
19 implementation is purely funded by the shareholder.

20 MR. DUTHIE: Okay. That's it.

21 JUDGE EPSTEIN: Okay, Mr. Johnson?

22 BY MR. DAVID JOHNSON:

23 Q. Good afternoon. Mr. Prestemon just asked you whether
24 Iberdrola would make a commitment to comply with the Commission's

1 vertical market power policy statement. You just said the answer
2 is yes; is that correct?

3 A. (Azagra) I said we'd comply with any policy or any
4 legislation that the Commission, the State, or any country where
5 doing business this. That's what I said.

6 Q. If the Commission were to approve the transaction and
7 allow the Company -- and not require as a condition the
8 provisions that IPPNY and Staff are seeking, which would prohibit
9 the Company from seeking to build the generation within the
10 service territory of NYSEG and RG&E -- how would you comply with
11 the vertical market power policy statement on a going-forward
12 basis? What exactly would the Company do?

13 MR. SCHWARTZ: Objection. Seems to ask for legal
14 interpretation.

15 MR. DAVID JOHNSON: He said they would comply with
16 whatever Commission orders and Commission policy statements.

17 MR. SCHWARTZ: Yes, but then when you're asking,
18 "Would you be complying with this legal requirement," I am
19 objecting to the follow-up because he's just making a general
20 corporate statement as opposed to a specific legal compliance
21 question.

22 You are asking a legal question, "How would you be
23 complying with this specific event or this specific thing," and
24 that's asking for a legal conclusion.

1 JUDGE EPSTEIN: Mr. Johnson, you seem to be
2 asking -- I am not sure whether your question presumed that the
3 transaction would be disapproved if the Commission were upholding
4 its policy on vertical market power?

5 MR. DAVID JOHNSON: I think what Mr. Prestemon was
6 getting at was a case-by-case determination on whether a
7 particular project would violate the Commission's vertical market
8 power policy statement, rather than having a blanket prohibition
9 in the Commission's order, and I was just curious about how,
10 going forward on a project-by-project basis, they would seek the
11 Commission's blessing to develop a project which would be in
12 compliance with the vertical market power policy statement.

13 JUDGE EPSTEIN: And I think that's more of a
14 management problem than an attorney's problem.

15 MR. SCHWARTZ: I think the question, Your Honor,
16 is -- and I don't mind having Mr. Azagra answer the question. I
17 think the question is: As this discussion continues, if it looks
18 like there is a legal interpretation of what -- if it looks like
19 we are asking, Is the vertical market power policy statement a
20 legal requirement now? That's legal question 1.

21 Legal question 2 is: If you do X, would it be in
22 violation of it?

23 Then I think we are headed towards legal
24 interpretation areas.

1 MR. DAVID JOHNSON: I was asking is the mechanism
2 about how the initial determination would be made. His position
3 now is that they can build any wind projects in the state without
4 violating the policy. I think what Mr. Prestemon was implying
5 was that, potentially, there would be a case-by-case
6 determination for each project as they build it.

7 JUDGE EPSTEIN: I mean, for the panel, if you were
8 faced with a Commission decision that said, We will look at every
9 proposed project from the standpoint of vertical market power,
10 what would you do? What would you do? Would you propose certain
11 projects and not others or what would the Company do?

12 A. (Azagra) I think our intention is to do as many projects
13 as we can in New York. We believe that's in compliance with any
14 market power policy or any assessment of whether there is market
15 power or not. I think, from that point of view, we will try to
16 do as much development as we can in the wind business. There is
17 no question about that.

18 In terms of how we'll develop each specific asset, I
19 am not an expert or operational expert on the different steps you
20 need to do in order to develop an asset and what permits are
21 required. I will refer to the experts on that.

22 If there are specific requests that you need to do
23 to the PSC or need to go to other regulatory bodies in the state,
24 we will comply with that. Absolutely.

1 BY MR. DAVID JOHNSON:

2 Q. Would the Company consider making a commitment for
3 seeking Commission approval for each particular project that
4 there was in the NYSEG and RG&E service territory with respect to
5 vertical market power?

6 A. (Mr. Azagra) if that is something that is not required by
7 any policy right now, no, we'd not commit to that.

8 MR. DAVID JOHNSON: I would like to mark for
9 identification IBER-0228.

10 JUDGE EPSTEIN: 60.

11 (Exhibit 60 marked for identification.)

12 BY MR. DAVID JOHNSON:

13 Q. Can you turn to page 65 of the Joint Petitioners' policy
14 panel rebuttal testimony, please.

15 A. (Rude) Yes.

16 Q. Lines 4 through 6, the panel states that, The Commission
17 has ordered RG&E to auction off the station after completion of
18 the Rochester transmission project and that there are certain
19 facts that have changed since the Commission's determination on
20 the issue, and RG&E believes it is important for the Commission
21 to be aware of these changes.

22 On page 66 of the testimony, lines 14 through 16,
23 the panel states that, RG&E has identified a localized
24 reliability need within the system that cannot be designed to be

1 met by the RGP. Based on a preliminary analysis, RG&E agrees it
2 can meet the reliability needs to the repowering of Russell
3 station at its current site."

4 IBER-0228, which is Exhibit 56 -- 60, excuse me --
5 includes the Rochester area 1900 megawatts source study which was
6 completed in the spring of 2006. Is this the preliminary
7 analysis that RG&E bases its support on the need for repowering
8 Russell?

9 A. (Rude) I would have to check on that to make sure this is
10 complete or there wasn't something in addition.

11 Q. So, you are saying there may be other studies and
12 analysis?

13 A. (Rude) We also submitted information to the ISO. I want
14 to make certain of that.

15 MR. DAVID JOHNSON: I would like to mark for
16 identification the April 27, 2007, letter from Mr. James P.
17 Laurito to Honorable Jaclyn Brilling.

18 JUDGE EPSTEIN: 61.

19 (Exhibit 61 marked for identification.)

20 BY MR. DAVID JOHNSON:

21 Q. Mr. Laurito, are you familiar with that letter?

22 A. (Laurito) Yes.

23 Q. The letter states on page 2 that, "Redeveloping the
24 Russell station will address an identified reliability concern of

1 the NYISO in the most recent reliability needs assessment."

2 Isn't it true that the ISO's reliability needs
3 assessment does not address RG&E's localized reliability needs
4 within its system?

5 A. (Laurito) I don't think that is true, no.

6 Q. So you are saying the ISO's reliability needs assessment
7 looks at localized reliability needs in determining whether a
8 project is needed?

9 A. (Laurito) I would have to double check that with our
10 technical folks because I think, as the RNA was initially
11 released, we saw some cause for concern. And then there has been
12 some discourse back and forth between our technical folks and the
13 ISO subsequent to their initial release of that RNA about that
14 localized reliability need. The facts and circumstances and our
15 understanding of the RNA may have changed since the date of this
16 letter, but I can't really speak to that in detail.

17 Q. Does the April 27 letter say anything about a localized
18 reliability need?

19 A. (Laurito) I don't know.

20 Q. Do you want to quickly review it?

21 A. (Laurito) Sure.

22 It looks to speak to an identified reliability
23 concern of the New York ISO in their most recent RNA. So it
24 doesn't go into detail as to whether it's local or not.

1 Q. You don't know whether or not the 2006 1900 megawatts
2 source study was provided to the New York ISO?

3 A. (Laurito) I don't.

4 Q. Is that something you could check on?

5 A. (Laurito) Sure.

6 Q. Turning to the Joint Petitioners' partial acceptance
7 document, it states that -- on page 1, it states that,
8 "Petitioners will competitively bid and auction Russell station
9 and the other fossil units."

10 Lines 21 through 23 of the policy panel testimony
11 states that, "Any --

12 MR. SCHWARTZ: What page, Dave?

13 MR. DAVID JOHNSON: Excuse me. That's page 65.

14 MR. FITZGERALD: What were the line references
15 again?

16 MR. DAVID JOHNSON: 21 to 23, last three lines.

17 BY MR. DAVID JOHNSON:

18 Q. Says that, "Any auction of Russell station should not
19 commence until the Commission has a chance to review and rule on
20 RG&E's repowering proposal."

21 Given the discussion today about your intended
22 purpose for the acceptance document, can you please confirm that
23 this aspect of your rebuttal testimony has been supplanted by the
24 acceptance document?

1 A. (Rude) It has been supplanted assuming the transaction is
2 approved and closes. We will continue to work on this until
3 then.

4 Q. Would the Petitioners commit to filing the auction
5 protocols within one month of the Commission order approving the
6 proposed transaction?

7 A. (Rude) If that was included in the Commission approval,
8 we probably wouldn't view it as "fatal," to use a term that was
9 used earlier.

10 Q. Given the alleged local reliability issues you identified
11 in Exhibit 60, would it be unreasonable for the Commission to
12 require the sale of the plants within nine months of the
13 Commission's order approving the protocols?

14 A. (Rude) I think that could be set as a goal and probably
15 is not an unreasonable goal, but there has to be caveats for
16 market conditions and time for adequate review by the parties on
17 the protocols and all those details. But in my experience,
18 that's not an unreasonable time frame.

19 Q. Turn to page 67, please, of the rebuttal testimony.

20 I think earlier today in response to questioning you
21 said that the sale of the fossil plants would not be a detriment
22 to rate payers because you could structure a contract. Why
23 couldn't you do that with the hydro plants?

24 A. (Rude) I am not sure we are saying that here. I think we

1 are saying these are--renewable resources are valuable. They
2 have never been challenged, to my knowledge, before, as being a
3 problem for T&D ownership. These are very low-cost sources of
4 power, and before this transaction, I was not aware that there
5 was any opposition to T&D ownership of these assets. So, we
6 really haven't thought about and considered a contract back.

7 Q. But if you sold them, they would remain renewable
8 projects. They would still have the benefit of a renewable
9 project. That aspect of the project wouldn't disappear if sold
10 to a third party.

11 A. (Rude) If they sold higher than book value, that would
12 mean that a development must view that the market value is
13 greater. The only way they would get that is to charge
14 above-utility profits. In our revenue stream, that would give
15 them more than utility profits, so I don't see how that would
16 benefit customers.

17 Q. Couldn't it be a benefit if the utility that bought them
18 redeveloped them or enlarged them?

19 A. (Rude) As part of the utility portfolio of assets, we are
20 always looking at the betterment of the facilities, particularly
21 given that they are renewable.

22 Q. Isn't it true that the New York ISO has no authority or
23 ability to direct where and how a transmission owner maintains
24 its transmission system?

1 A. (Rude) I think we answered that in one of the IRs. I
2 think that's almost a direct quote from one of your IRs. So I
3 would answer it in the same way we answered it in the data
4 request.

5 Q. The way you answered it, it is up to FERC to interpret
6 the language in the ISO tariffs?

7 A. (Rude) I think we went further than that.

8 Q. "The New York ISO coordinates all requests for
9 transmission outages based on the potential impact on system
10 reliability."

11 MR. FITZGERALD: Could you identify the IR you are
12 referring to.

13 MR. DAVID JOHNSON: IBER-0083.

14 A. (Rude) I accept that answer.

15 BY MR. DAVID JOHNSON:

16 Q. Has the New York ISO ever asked RG&E or NYSEG to perform
17 maintenance on its transmission lines?

18 A. (Laurito) I don't know the answer to that question. It's
19 a 150-year-old company.

20 Q. The ISO's only been around since 1998.

21 A. (Rude) We are not aware of that.

22 Q. Turning to Exhibit 57, which is IBER-0008-S.

23 Can you tell us about these five additional projects
24 which were identified on March 14? Are these projects that

1 Iberdrola has acquired from another company?

2 MR. SCHWARTZ: Your Honor and Dave, could we just
3 wait to make sure the witnesses pull this data request in front
4 of them.

5 MR. AZAGRA: Would you like to repeat your question.

6 BY MR. DAVID JOHNSON:

7 Q. The five projects which were identified for the first
8 time in this information response, beginning with the 46 megawatt
9 Sangerfield projects, were those projects acquired from another
10 developer by Iberdrola?

11 A. (Azagra) I don't know the answer. We could come back to
12 you if you need. We could get that answer to you.

13 Q. Earlier this afternoon, you were talking about projects
14 that are in the pipeline and projects that are planned. How long
15 have these projects been in the pipeline, as you described
16 earlier today?

17 A. (Azagra) If these names are not here, it's because they
18 have joined the pipeline. Not every potential project basically
19 is raised by the development people into the pipeline until they
20 reach a minimum set of criteria. These projects could have been
21 there with an option perhaps but not with the substance of
22 putting in what we call pipeline. So the reason they are here
23 right now is because, for whatever reason, they comply with two
24 out of the 30 items they need to comply with, six out of the 40

1 criteria they have to comply with.

2 Once they comply with six, become pipeline. Low
3 probability would be at the very end of the pipeline but not what
4 we call pipeline. That's the reason we are here. Otherwise,
5 they not known by any management at all within the firm.

6 Q. The projects which were identified in No. 1, those
7 projects have been in the pipeline, and at the time those
8 projects were identified, the five new projects were not in the
9 pipeline?

10 A. (Azagra) In what we define as pipeline? Yes, that's
11 correct.

12 Q. How long has the Company known about these new five
13 projects? Was it March 14 that it first identified these
14 projects?

15 A. (Azagra) I don't know. We check regularly with them.
16 When we became aware of the projects, we made them public to you.

17 Q. Are there any other projects which Iberdrola has in any
18 phase of the planning process that haven't been disclosed on this
19 list?

20 A. (Azagra) If they were part of the pipeline, they would be
21 here. I think many other companies call pipeline what we don't
22 call pipeline.

23 I would encourage you to review our IPO materials
24 where you will see what we define as pipeline as compared to many

1 other companies that they call pipeline things that would never
2 be real. I think the delivery ratio that we have or the track
3 record of bring megawatts into operation prove that not every
4 megawatt that people say is a real megawatt. We call pipeline
5 according to specific criteria. Otherwise, we don't believe
6 those are even potential projects.

7 MR. DAVID JOHNSON: That's all the questions I have.

8 MR. FOGEL: Your Honor, I had not planned on asking
9 any questions. I just had some clarification questions on the
10 partial acceptance document filed on Friday.

11 BY MR. FOGEL:

12 Q. Good afternoon, panel.

13 I'd like to direct your attention to the first page
14 of Exhibit 50, which is the partial acceptance document. When
15 you have it give me a signal.

16 Dealing with the vertical market power, you indicate
17 that you would make the commitment to competitive bid in auction
18 the Russell Station, the Allegheny Station, Peaker Station 3 and
19 Peaker Station 9; is that correct?

20 A. (Rude) Yes.

21 Q. I believe in response to a piercing question from Mr.
22 Mager, you had indicated that basically these were older
23 facilities paid for by ratepayers, correct?

24 A. (Rude) I don't recall the piercing nature of the

1 question, but I believe I answered yes to that.

2 Q. Would you also agree that the potential exists that if
3 there is an auction as a result of that, or maybe a subsequent
4 step, there may be some sort of buy back purchase power agreement
5 between you and whoever purchases the facility?

6 A. (Rude) That's a possibility. It wouldn't be for Russell
7 because it's a closed plant.

8 Q. For other ones, that could happen?

9 A. (Rude) It's possible. It seems very unlikely given their
10 size.

11 Q. In the event that would happen, would the Company be
12 willing to give a commitment that the manner in which that power
13 was reflected in rates would be done in such a manner that would
14 be competitively neutral -- strike that.

15 Would you agree that, in the event of a purchase
16 power arrangement, that the manner in which the cost of the power
17 was reflected in utility rates would be accomplished so that it
18 was competitively neutral vis-a-vis customers taking commodity
19 supply from the Company and those taken from independent
20 supplier?

21 A. (Rude) I believe that's the way we operate today. I
22 wouldn't believe it would be any different in the future.

23 MR. FOGEL: Thank you.

24 JUDGE EPSTEIN: I have maybe a couple of questions

1 in two areas.

2 First of all, as far as the Russell Station is
3 concerned, I don't have a good general understanding of what the
4 status of that facility is, and maybe it's in the testimony
5 somewhere and I missed it. But it's my understanding that Energy
6 East, last month, entered into a settlement of some litigation
7 that was brought by the State of New York -- I assume the
8 Attorney General -- and that the settlement involved a commitment
9 to shut down the plant. And it involved certain commitments in
10 the event of construction of a new facility. That if an
11 application were filed, I assume, for a permit to build a new
12 facility, that proposal would involve state-of-the-art gas
13 combustion.

14 I don't know whether that's the same thing as
15 repowering. That's part of my problem. Part of the problem is I
16 have Exhibit 50, the acceptance document, where the
17 Joint Petitioners would undertake to auction the facility, and I
18 don't understand whether that's independent of any possible plans
19 to apply for a permit to build a new state-of-the-art facility.
20 In other words, when you commit to auction the facility, does
21 that refer only to the existing Russell Station that's due to be
22 shut down under this settlement?

23 And I think that's the extent of my question.

24 A. (Rude) As I responded previously, if this condition were

1 accepted and the Commission approved the transaction, the Company
2 would abandon its repowering efforts.

3 JUDGE EPSTEIN: The repowering, that's the
4 state-of-the-art gas combustion, that's the subject of the
5 settlement of the litigation?

6 A. (Rude) I don't have the settlement in front of me, but
7 the way I interpret the settlement is: If RG&E repowers Russell,
8 then it must be a natural gas combined cycle. I don't
9 necessarily -- although it would be a legal interpretation, which
10 my colleagues from time to time say I try to make -- but I would
11 think that if there was a new owner of that site, it's not
12 necessarily restricted to them on what they do with that site.
13 But if RG&E were to repower, then it must use natural gas.

14 JUDGE EPSTEIN: Okay, so, there was a question and
15 answer before about the fact that the Petitioners were
16 withdrawing -- or they were, let's say, discarding that part of
17 their rebuttal testimony that said that any further Commission
18 action on the Russell Station should await the disposition of the
19 RTP. That's all gone by the board now, assuming if the
20 transaction were approved?

21 A. (Rude) There is really two steps. The RTP must be
22 completed before Russell can be fully shut down. That's
23 anticipated to happen in about six weeks. So that's the first
24 step.

1 Our efforts to develop a plan to repower and a
2 filing with the Commission that we said we would make in June of
3 this year, we would abandon those efforts. They would be
4 supplanted by this partial acceptance if it was included in a
5 condition approving this merger.

6 JUDGE EPSTEIN: And my other area of questions --
7 this is because it's something that was raised rather often by
8 people that made statements or talked to me while I was touring
9 the service territory on public statement hearings -- and that is
10 about employee benefits and particularly pensions and medical
11 benefits.

12 So just as a matter of -- first of all, just as a
13 matter of literal interpretation, on page 27 of the rebuttal at
14 line 9, it says, "Iberdrola has committed that existing employee
15 compensation and benefits..."

16 First of all, that doesn't mean -- that is not
17 limited to compensation and benefits for existing employees but
18 rather it means existing compensation and benefits and pensions
19 and other post-employment benefits; is that what that sentence
20 means?

21 A. (Rude) I believe that's a correct interpretation of the
22 merger agreement, yes.

23 JUDGE EPSTEIN: And then, all the types of benefits
24 I just referred to -- namely pensions and -- let me back up.

1 OPEBs includes medical benefits?

2 A. (Rude) Medical benefits, yes.

3 JUDGE EPSTEIN: So that pensions and medical
4 benefits are subject to that 18-month limitation?

5 A. (Rude) Yes. I don't know if I would use the word
6 "subject to." I would say "included in."

7 JUDGE EPSTEIN: Is it possible for you to expand on
8 that statement by differentiating between pensions and medical
9 benefits? Would you say, for example, Well, one of those things
10 is probably going to last a lot longer than the other, or
11 something like that.

12 Can you make a more refined statement about that or
13 is that pretty much the extent of how you would describe
14 Iberdrola's commitment?

15 A. (Azagra) I think probably my answer would go to the past
16 practice, how we run with these matters within the group. I
17 think any major change in how those matters that you are raising
18 is addressed or is dealt with in the future, it's always done on
19 an agreement basis with workers' representatives. So I think
20 that's how we approach things.

21 We did major changes in pension systems in
22 Iberdrola, I think, in 1996. That was done through agreement
23 with all the unions and all the workers' representatives. There
24 was no problem with that. It was agreed so from that point of

1 view. I think the reason why we say things like "substantially"
2 is, because of a merger taking place, we cannot maintain certain
3 ways of people being paid. Perhaps we do it in different way and
4 prefer other ways. The items you are raising, pensions and
5 health systems, I think we would never take any decision without
6 agreement with trade unions and other workers' representatives.
7 That's the approach we follow everywhere.

8 JUDGE EPSTEIN: Earlier, when we were talking about
9 I think it was employee levels and whether they would be
10 increased, decreased, or stable, I understood you to be putting
11 forth kind of two competing descriptions of Iberdrola's track
12 record.

13 One was that, if I understood it correctly, that
14 Iberdrola really defers to the management of the subsidiaries,
15 such as Energy East, on questions about how the operation can
16 best be managed, questions that might have an impact on
17 employees.

18 And on the other hand, Iberdrola itself has a track
19 record of working smoothly with labor representatives.

20 So I am a little unclear about whether a question
21 such as the medical benefits or the pensions, whether that would
22 be more an Iberdrola judgment or an Energy East judgment.

23 A. (Azagra) It will be a local management issue to be
24 addressed because they are the ones who know the details of these

1 matters at the operating companies. However, there were old
2 policies in the firm on labor matters. No issues. No problems.
3 No strikes. No conflicts. That's something we will make sure --
4 I don't know the track record of Energy East, but that will be
5 taken into account also going forward. I think the basics of the
6 overall culture, how to address certain issues, will extend to
7 the new companies joining the group.

8 JUDGE EPSTEIN: Thank you. Other cross for this
9 panel? Redirect?

10 MR. SCHWARTZ: Your Honor, could we have a few
11 minutes with the witnesses? Is it appropriate to take a little
12 break and come back?

13 JUDGE EPSTEIN: I was planning on a 15-minute break
14 at 4:00.

15 MR. SCHWARTZ: That would be preferable to us.

16 (Recess taken.)

17 MR. BREW: Your Honor, we are presenting testimony
18 of Frank R. Radigan.

19 FRANK R. RADIGAN, after first having been duly
20 sworn, was examined and testified as follows:

21 DIRECT EXAMINATION

22 BY MR. BREW:

23 Q. Mr. Radigan, please state your full name and address.

24 A. Name is Frank Radigan, 120 Washington Avenue, Albany, New

1 York 12201.

2 Q. Mr. Radigan, did you prepare direct testimony in this
3 case?

4 A. I did.

5 Q. Do you have before you a typewritten document consisting
6 of a cover page and 11 pages of questions and answers entitled
7 direct testimony of Frank R. Radigan on behalf of Nucor Steel
8 Auburn?

9 A. I do.

10 Q. Was that the testimony you prepared for this docket?

11 A. It was.

12 Q. Do you have any corrections to make to that testimony?

13 A. I do not.

14 Q. If I were to ask you the questions contained therein
15 would your answers be the same today?

16 A. It would.

17 MR. BREW: I ask the direct testimony of Mr. Radigan
18 be copied into the record.

19 JUDGE EPSTEIN: Good.

20 (The following is the prefiled testimony of Frank
21 Radigan:)

22

23

24

1

2 **Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS?**

3 A. My name is Frank W. Radigan. I am a principal in the Hudson River Energy
4 Group, a consulting firm providing services regarding the electric utility industry
5 and specializing in the fields of rates, planning and utility economics. My office
6 address is 120 Washington Avenue, Albany, New York 12210.

7 **Q. WOULD YOU PLEASE SUMMARIZE YOUR EDUCATION AND**
8 **BUSINESS EXPERIENCE?**

9 A. I received a Bachelor of Science degree in Chemical Engineering from Clarkson
10 College of Technology in Potsdam, New York (now Clarkson University) in 1981.
11 I received a Certificate in Regulatory Economics from the State University of New
12 York at Albany in 1990. From 1981 through February 1997, I served on the Staff
13 of the New York State Department of Public Service ("DPS") in the Rates and
14 System Planning sections of the Power Division. My responsibilities included
15 resource planning and the analysis of rates, depreciation rates and tariffs of electric,
16 gas, water and steam utilities in the State and encompassed rate design and
17 performing embedded and marginal cost of service studies as well as depreciation
18 studies.

19 Before leaving the DPS, I was responsible for directing all engineering staff during
20 major rate proceedings including those relating to integrated resource planning and
21 environmental impact studies. In February 1997, I left the DPS and joined a firm
22 called Louis Berger & Associates as a Senior Energy Consultant. In December
23 1998, I formed my own Company. In my 27 years of experience, I have testified as

1 an expert witness in utility rate proceedings on more than 60 occasions before
2 various utility regulatory bodies, including this Commission, the Nevada Public
3 Utility Commission, the New York State Department of Taxation and Finance, the
4 Connecticut Department of Utility Control, the Rhode Island Public Utilities
5 Commission, the Michigan Public Service Commission and the Federal Energy
6 Regulatory Commission.

7 **Q. ON WHOSE BEHALF ARE YOU TESTIFYING IN THIS PROCEEDING?**

8 A. I am submitting this testimony on behalf of Nucor Steel Auburn, Inc. ("Nucor"),
9 which operates an electric arc furnace-based steel manufacturing facility
10 located in Auburn, New York. Nucor employs approximately 300 people at
11 this steel "mini-mill" facility, where scrap steel is recycled and molten steel is
12 recast into a variety of steel products, such as rebar, that are then sold in the highly
13 competitive steel commodity markets. Nucor recycles approximately
14 500,000 tons of steel scrap annually and is the largest single point
15 electric load on the New York State Electric & Gas Corporation
16 ("NYSEG") system. Since acquiring this operation from Auburn Steel in 2001,
17 Nucor has invested over \$30 million in modernizing the facility. As an energy
18 intensive manufacturing facility, reliable and cost-competitive electric service is
19 critical to Nucor's operation.

20 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

21 A. I will address the need for the Commission to establish specific commitments from
22 the petitioners regarding economic development initiatives and support for local
23 communities.

1 Q. PLEASE EXPLAIN.

2 A. I share the concerns expressed by the Maine PUC advisory staff in its review of the
3 proposed merger that the acquisition of Energy East by a large, multi-national
4 entity, such as Iberdrola, creates new risks and concerns for consumers that must be
5 considered and addressed. In a November 6, 2007 bench memo, the Maine PUC
6 Advisory Staff wrote:

7 CMP's executive management resides in Maine. Energy East's headquarters
8 are in Maine. In contrast, Iberdrola's executive management and
9 headquarters are in Spain. Although the Petitioners and Iberdrola have
10 indicated that the Energy East and CMP executive and management
11 structures will not be changed if the acquisition is approved, this is not
12 guaranteed in perpetuity, or, for that matter, at all.

13 More importantly, even if Energy East's and CMP's executive and
14 management structures never change, it is likely that ultimate decision-
15 making authority will reside with officials at Iberdrola's headquarters in
16 Spain.

17 Iberdrola's physical and language separation from Maine creates the
18 potential that decisions affecting CMP may be removed from the local
19 concerns of Maine's citizenry and government. Iberdrola's management is
20 unlikely to be as familiar with Maine-specific issues and concerns, yet they
21 may be the ultimate decision-makers about CMP's investments and
22 operations, as well as its positions and actions with respect to regional and
23 policy issues of importance to Maine.

24 This is not a theoretical concern. Maine has experience with other utility
25 acquisitions, and has observed the tendencies of large companies to treat as
26 unimportant problems of an affiliate located in a relatively small and remote
27 state. In particular, we note Maine's less than positive experiences in
28 telephone and natural gas, where Maine utilities have been acquired by
29 large, distant holding companies, followed by degradation of service quality
30 and diminished sensitivity and responsiveness to Maine regulatory concerns
31 and issues.

32 We do not mean to suggest that this acquisition would lead to a similar
33 result. However, it is clearly a risk.¹

¹ [Footnote omitted].

1 I believe that the Maine PUC advisory staff accurately noted that ultimate decision-
2 making in many, or most, aspects of Iberdrola's U.S. utility operations and
3 investments will be made in Spain.

4 With respect to New York utility operations, there is a risk that Iberdrola will not
5 share New York State and Commission concerns with regard to economic
6 development initiatives and infrastructure investment, among other matters, when it
7 comes to the conglomerate's actually investing in the NYSEG and RG&E service
8 territories. These are, however, vital concerns for reining in New York's high cost of
9 living and doing business in New York, as the Governor emphasized in his January
10 9, 2008 State of the State address. The appropriate remedy to address this risk is
11 for the Commission to establish specific commitment requirements as part of any
12 merger approval order. I expect that the DPS Trial Staff and other parties will
13 address the need for positive consumer benefits in a number of areas. I confine this
14 testimony to the need for specific commitments regarding economic development
15 initiatives.

16 **Q. PLEASE DISCUSS THE IMPORTANCE OF MANUFACTURING JOB**
17 **RETENTION AND ATTRACTION.**

18 A. Support for manufacturing is essential for Upstate economic development efforts to
19 be successful. Manufacturing industries contribute more to any local, regional or
20 national economy than any other sector. The Manufactures Association of Central
21 New York ("MACNY") reports that manufacturing employs over 550,000 New
22 Yorkers and contributes \$61 billion annually to New York State's GDP. Compared
23 to other sectors of the economy, manufacturers pay higher wages, generate better

1 benefits, and stimulate more high technology growth through research and
2 development and productivity improvements.

3 MACNY reports that manufacturing jobs pay on average 20 percent more than
4 other sectors of the economy. In fact, MACNY also reports that manufacturing
5 jobs pay salaries on average of over \$48,000 a year. Service sector employees earn
6 about 60 percent of that, and retail workers earn about 40 percent of the wages
7 paid to manufacturers. Manufacturing accounts for over 70 percent of private
8 sector research and development in the United States. Every manufacturing job
9 creates more than 2.5 related jobs in other sectors, and every dollar spent generates
10 an additional \$1.37 in economic activity. Simply put, manufacturing is the wealth
11 generating sector of the New York economy.

12 It is no secret that Upstate New York, and particularly the areas served by NYSEG
13 and RG&E, has been losing the battle to retain and attract quality jobs. The US
14 Bureau of Labor Statistics reports that between March 1990 and March 2007
15 manufacturing jobs in New York have dropped 55%. On January 5, 2008, the
16 Albany Times Union reported that manufacturing jobs in New York dropped
17 almost 29% between 1996 and 2006, a bigger decline than all states except North
18 Carolina and Rhode Island. In the same article, the Times Union also reported that
19 the cost of doing business in New York is second only to the cost of doing business
20 in Hawaii, and is 30.7% above the national average.

21 **Q. PLEASE CONTINUE.**

22 **A.** The cost of electricity is a very large part of this cost disparity. The Albany Times
23 Union reports that the average price of electricity for 2007 in New York State was

1 14.54 cents per kWh, the fourth highest in the nation and 66 percent above the
2 national average of 8.77 cents. An October 2007 report prepared by Power in the
3 Public Interest (“PPI”) suggested that New York’s retail deregulation policies are
4 responsible for some of this disparity. (See Exh. FWR-1). PPI reported that retail
5 electricity prices in deregulated states averaged 2.0 cents per kWh higher than rates
6 in traditionally regulated states in 2000, and that, by 2007, this rate disparity had
7 grown to more than 4.0 cents per kwh.

8 PPI also reported that in 2000, the average electric rate for all customers in New
9 York was 10.6 cents/kwh, while the comparable figure for the collective regulated
10 states was 6.0 cents/kwh—or a difference of 4.6 cents. According to PPI, as of June
11 2007, the difference had widened to 6.8 cents (14.5 cents/kwh for New York and
12 7.7 cents/kwh for the regulated states). For the 12 months ending June 2007, New
13 Yorkers paid \$22 billion for their electricity. The same amount of electricity at the
14 regulated states’ average rate would have cost \$11.6 billion—a difference (or
15 comparative purchasing-power disadvantage to New Yorkers) of \$10.4 billion for a
16 12-month period.

17 I recognize that there is considerable controversy regarding the claimed success or
18 failure of competitive retail power markets. There is little doubt, however, that on
19 the ultimate question of cost competitiveness New York has continued to lose
20 ground on the electric rates charged to homes and businesses.

21 **Q. WHAT PROGRAMS EXIST IN NEW YORK TO REDUCE ELECTRICITY**
22 **COSTS FOR NEW YORK MANUFACTURING LOADS?**

1 A. Historically, the State has administered a series of economic development programs
2 that streamed low cost hydro power and excess nuclear capacity through the New
3 York Power Authority (“NYPA”), and the Commission also approved and provided
4 oversight to a variety of utility administered economic development initiatives.
5 NYSEG and RG&E historically offered bundled, and more recently, unbundled,
6 job retention and attraction (“flex rate”) service agreements. NYSEG also has a
7 specific budget for various consolidated economic development programs that was
8 established in its last delivery rate case.²

9 **Q. ARE THESE EFFORTS WORKING?**

10 A. The historic NYPA, bundled flex rate and Economic Development Zone Incentive
11 (“EDZI”) discounted rate programs have been highly successful, as indicated by the
12 number of manufacturing loads that continue to take service under one or more of
13 these programs. The same cannot be said of the current programs, which offer
14 limited benefits or availability, as is evidenced by the continued erosion of
15 manufacturing jobs noted above.

16 **Q. PLEASE DISCUSS THE PETITIONERS’ PROPOSAL REGARDING**
17 **ECONOMIC DEVELOPMENT INITIATIVES.**

18 A. The petitioners correctly listed a commitment to local communities and economic
19 development initiatives as an important component of the acquisition assurances to
20 the State. The vague representation in the petition that Iberdrola will not further

² Case No. 05-E-1222, Order Adopting Recommended Decision with Modifications, dated August 23, 2006; Order on Rehearing, dated December 15, 2006.

1 degrade current programs that are ineffectual, however, is not a satisfactory
2 response to one of New York's most compelling challenges.

3 In the recently completed merger of KeySpan and National Grid, the Commission
4 determined that utility merger terms must be shown to be in the public interest
5 within the borders of New York, both in the short- and long-term. The
6 Commission further noted that the burden of proof with respect to all the merger
7 and revenue requirement issues rests with the petitioners. In Nucor's view, to
8 satisfy the Public Service law requirement the petitioners must demonstrate that
9 there will be positive and tangible benefits to New York consumers.

10 **Q. PLEASE DISCUSS THE NEED FOR COMMITMENTS REGARDING**
11 **ENHANCED ECONOMIC DEVELOPMENT INITIATIVES.**

12 **A.** It is well established that uncompetitively high energy costs are a leading barrier to
13 the retention of quality manufacturing jobs in the Upstate areas served by NYSEG
14 and RG&E. On January 9, 2008, Governor Spitzer's State of the State address
15 discussed the urgent need to take the initiative to stem the tide of Upstate job
16 losses. The Governor quoted Franklin Delano Roosevelt's comment that "It is
17 common sense to take a method and try it; if it fails, admit it frankly and try
18 another. But above all, try something." This observation clearly applies to the need
19 for more innovative approaches to stemming the impact of high energy costs on
20 Upstate manufacturing. Effective utility rate economic development initiatives are
21 a key feature of successful job retention and attraction efforts, and revitalizing
22 those initiatives should be a Commission focus in this docket. The "no adverse

1 impact” approach proposed by the Petitioners in this docket is altogether
2 inadequate.

3 **Q. WHAT DOES NUCOR RECOMMEND?**

4 **A.** Much more needs to be done to establish competitive power rates for
5 manufacturing businesses that are investing in facilities and will retain or create
6 quality jobs in New York. The delivery portion of a utility bill is a relatively small
7 component of the total bill, and economic development discounts to the delivery
8 component alone cannot be expected to be effective. Nucor recommends that the
9 Commission require Iberdrola to expand the range of economic development
10 program options and that it encourage the utility to develop innovative approaches.
11 This could include exempting flex rate and other qualified manufacturing loads
12 from various surcharges (SBC, RPS, EPS, etc.) or streaming lower cost sources of
13 supply or hedged positions to those qualifying loads. For example, NYSEG has
14 hydroelectric units and the cost of power from certain remaining contracts with
15 Independent Power Producers that are forecast to be well under market prices.
16 Streaming low cost power sources to retain and attract manufacturing jobs is not a
17 new concept in New York. It has been done in Jamestown, NY (Case 02-E-1335)
18 and Massena, NY (Alcoa) to stream low cost hydro power to customers in order to
19 retain or attract jobs. In any event, in view of current uncompetitively high energy
20 costs and the State imperative to revitalize the Upstate economy, the Commission
21 should require Iberdrola to develop and file an aggressive and innovative job
22 retention and attraction program.

23 **Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

1 A. Yes it does.

1 BY MR. BREW:

2 Q. Secondly, Mr. Radigan, did you prepare an exhibit to your
3 testimony?

4 A. I did.

5 Q. Do you have in front of you an exhibit labeled FWR-1,
6 which is an article dated October 9, 2007 entitled Electricity
7 trends in New York compared to trends in price regulated states?

8 A. Yes.

9 Q. Do you wish to sponsor that article as an exhibit?

10 A. I do.

11 MR. BREW: I ask the item be marked for
12 identification. I believe the number is 61.

13 JUDGE EPSTEIN: 62.

14 (Exhibit 62 marked for identification.)

15 MR. BREW: Mr. Radigan is available for
16 cross-examination. I understand none of the parties have
17 questions for him.

18 JUDGE EPSTEIN: You are excused. Thank you very
19 much.

20 (Witness excused.)

21 (Recess taken.)

22 JUDGE EPSTEIN: We are back on the record with the
23 redirect of the panel.

24 REDIRECT EXAMINATION

1 BY MR. FITZGERALD:

2 Q. Good afternoon, panel. Do you recall an Exhibit 54 from
3 Staff? It was entitled, on the very top, "Pending Merger
4 Premium." First sentence was, "How much of the premium should be
5 assigned to the PMP?"

6 A. (Rude) Yes. Yes, I believe it came from the Maine bench
7 analysis in the ARP proceeding.

8 MR. FITZGERALD: Excuse me, Your Honor. Staff
9 counsel doesn't seem to be here at the moment.

10 (Off the record.)

11 JUDGE EPSTEIN: Mr. Fitzpatrick, if you would start
12 over with that question you were asking.

13 MR. FITZGERALD: Sure, Your Honor. Be happy to.

14 Q. Mr. Rude, do you recall an Exhibit 54 from Staff that
15 they presented earlier today?

16 A. (Rude) Yes, I do.

17 Q. Could you turn to page 3 of that exhibit. On page --

18 A. (Rude) Yes. It's the first page.

19 Q. -- on page 3 it references a data response IBER 0157 as a
20 source of certain data. Is that response important to understand
21 the identified allocation of premium set forth later on the page?

22 A. (Rude) Yes, I think it would be very important for that
23 data response to be attached as part of this exhibit as, I
24 believe, Staff counsel offered to make sure it was complete. I

1 think that's very important that was the case.

2 MR. FITZGERALD: Your Honor, we'd like to take Staff
3 counsel up on its offer earlier today and request that the full
4 document be marked as Exhibit 54 from which there's excerpted
5 certain pages. And also we'd like to reserve the exhibit number
6 for the IBER 0157 response, which is referenced therein.

7 JUDGE EPSTEIN: Is one of these the same exhibit
8 that's where Staff counsel was saying, You'd better have some
9 consultation because you are dealing with hundreds and hundreds
10 of pages?

11 MR. FITZGERALD: I don't believe so, Your Honor.

12 JUDGE EPSTEIN: So, we will reserve number 63.

13 (Exhibit 63 marked for identification.)

14 MR. VAN RYN: And what is 63 being reserved for?

15 MR. FITZGERALD: For IBER 0157, the data responses
16 referenced in the exhibit, and also where we've made the request
17 to have the full document included as part of Exhibit 54 from
18 which it was currently exempted.

19 MR. VAN RYN: We will look into it.

20 MR. FITZGERALD: Your Honor, is that a statement by
21 Staff counsel that he will include it in the record?

22 MR. VAN RYN: I think the judge was saying it might
23 be hundreds of pages long. I need to look at the whole thing,
24 so --

1 JUDGE EPSTEIN: All right. Well --

2 MR. VAN RYN: You are asking me about a document I
3 don't have in front of me. So I have to look at it, see exactly
4 how it...

5 MR. FITZGERALD: Your Honor, one other thing, too.
6 It would be much more efficient if we have the full document in
7 the exhibit in case we need to refer to other sections of it to
8 put it in context. Our witness has already indicated that it
9 would be very important to have the full context for this
10 document.

11 JUDGE EPSTEIN: Okay. Well, would it be --

12 MR. VAN RYN: The alternative here is that he seems
13 to have more familiarity with the whole document than I do. This
14 is, I believe, in an Energy East proceeding in Maine. Might be
15 better if -- petitioners might have easier access to it than I
16 do.

17 A. (Rude) If I could make a suggestion, what I had proposed
18 is that just IBER 0157 could be attached to these two pages or
19 that just the appendix, not the entire bench analysis with IBER
20 0157.

21 MR. VAN RYN: You are offering to put in the whole
22 information request and you have access to it?

23 A. (Rude) Yes.

24 MR. VAN RYN: All right. That would be fine.

1 MR. SCHWARTZ: Your Honor, I have a few redirect
2 questions, as well.

3 JUDGE EPSTEIN: That goes to Exhibit 63, the IBER
4 0157, but what about the other question regarding 54 -- revising
5 Exhibit 54 to include more than what we have in there now?

6 MR. FITZGERALD: Your Honor, Staff took an excerpt
7 from it under the presumption they would have the full document
8 and be provided a copy of that exhibit in its entirety.

9 JUDGE EPSTEIN: And --

10 MR. FITZGERALD: If they can not, Your Honor, we
11 certainly can provide it ourselves for inclusion in that exhibit.

12 JUDGE EPSTEIN: Now, is that something we have to
13 examine --

14 MR. VAN RYN: Yeah, I would think so. We are
15 talking about an attachment to a Maine bench decision --

16 JUDGE EPSTEIN: Yeah, well --

17 MR. VAN RYN: -- which is very lengthy, but if they
18 want to provide the whole bench decision for the record, that's
19 fine with me.

20 JUDGE EPSTEIN: I also don't want to put in a lot of
21 extraneous material if we are talking about a lot.

22 MR. VAN RYN: It's a bench decision so sort of a
23 like a recommended decision, hundreds of pages.

24 JUDGE EPSTEIN: I guess what I am not understanding

1 is whether this has to be resolved while the witnesses are here
2 --

3 MR. VAN RYN: That's fine, Your Honor.

4 JUDGE EPSTEIN: -- because if it doesn't maybe we
5 should take this off line and resolve it sometime in the next day
6 or two.

7 MR. FITZGERALD: That's fine, Your Honor. What we
8 will do is we will provide the IBER 0157 the new exhibit numbers
9 you just identified.

10 And I will work with Mr. Van Ryn regarding any
11 additional pages that are necessary for Exhibit 54 with the idea
12 of keeping them as limited as possible.

13 JUDGE EPSTEIN: Okay.

14 MR. SCHWARTZ: Your Honor, I have a few redirect
15 questions, as well.

16 BY MR. SCHWARTZ:

17 Q. Panel, Mr. Mager asked a number of questions about
18 goodwill tax amortization. And I think Mr. Azagra answered those
19 questions from Mr. Mager.

20 What is the financial goodwill
21 attributable to?

22 A. (Azagra) The financial goodwill is -- it has not been
23 determined and cannot be determined before closing the
24 transaction until it has been reviewed by the auditor. He

1 basically comes up with the valuation of the goodwill and it's
2 allocation to financial goodwill, intangible or potential update
3 on value of the assets, as we have explained in the rebuttal and
4 some of the questions and answers.

5 I think it's important that that financial goodwill
6 is a portion which basically we have committed that it would not
7 be sent into rates or anything like that. So from that point of
8 view whether there are any potential tax treatment back in Spain,
9 I think, you know, we are making sure that the rate payers in New
10 York, they have no impact with financial goodwill.

11 Q. Mr. Azagra, who pays for the costs of that financial
12 goodwill?

13 A. (Azagra) The taxpayers will not pay for that. It's our
14 shareholders, the ones, you know, that they are paying for that.
15 We have committed basically to keep it at the parent Company.

16 Q. Thank you.

17 Mr. Mager also asked the panel whether there would
18 be any commitments for higher or more stringent reliability
19 standards, service quality standards and gas safety standards. I
20 think Mr. Rude answered those questions.

21 Mr. Rude, do you have an opinion about whether any
22 such higher standards would be necessary or required as part of
23 this transaction?

24 A. (Rude) Yes, I have an opinion. No, I think the current

1 standards are operating fine for all of these companies and all
2 the companies have had a very good record.

3 However, as we testified, we are hoping over time
4 that the sharing of best practices will allow us to further
5 improve the delivery of service. We're always looking for ways
6 to do that. And, again, we're hopeful of joining forces with
7 this large global utility, that that will be possible.

8 Q. Thank you.

9 There were a few questions asked, I believe also by
10 Mr. Mager, about Standard & Poor's rating and the difference
11 between the Iberdrola rating and Energy East rating. And I
12 believe Mr. Azagra answered those questions.

13 Mr. Azagra, have you examined the comparison of
14 ratings from other rating agencies other than Standard & Poor's?

15 A. (Azagra) Standard & Poor's, there is one notch difference
16 between Iberdrola and Energy East's rate rating. Moody's has two
17 notches. You know, we are an A3 versus BAA2 for Energy East.

18 And if you look into Fitch IBCA, that's another
19 major rating agency. There is a two-notch difference between the
20 two companies, Iberdrola being an A-rated company and Energy East
21 being triple B-rated company.

22 Q. Mr. Azagra, just to clarify, how many notches is that on
23 Fitch?

24 A. (Azagra) Two notches -- sorry, three notches. Sorry

1 about that.

2 Q. Thank you.

3 Panel, you were asked a few questions about the
4 Gamesa issues and Gamesa projects in New York.

5 Mr. Azagra, you answered those questions, I believe,
6 raised by Mr. Mager. How did you obtain information about Gamesa
7 projects in New York?

8 A. (Azagra) That was asked by Mr. Van Ryn and I've been
9 informed that's a publicly available information.

10 Q. Thank you.

11 There were a few questions Mr. Mager asked about
12 PTCs. And the questions went to the utilization of those
13 production tax credits.

14 Mr. Azagra, you addressed those questions from Mr.
15 Mager. Right now prior to the acquisition do you have a view as
16 to whether Iberdrola Renewables projects currently utilized
17 production tax credits?

18 A. (Azagra) As has been explained in the Iberdrola
19 Renewables IPO, Iberdrola Renewables has been using, uses, and we
20 estimate that we continue to use equity investors. That's a very
21 liquid market right now in the US. And they have not been able
22 to achieve right now 100 percent of the tax equity investment
23 needed in all of the projects.

24 And that's the estimate going forward we have

1 without the need of the transaction or any other transaction by
2 Iberdrola.

3 Q. Thank you.

4 We heard some -- quite a bit of discussion including
5 questions from Mr. Prestemon about the \$100 million renewable
6 commitment in the partial acceptance document.

7 And with that back and forth, Mr. Azagra, there may
8 have been some ambiguity about committed levels of renewable
9 development and goals or targets for renewable development.
10 Would you like to elaborate and clarify any misunderstanding on
11 that?

12 A. (Azagra) As stated in our strategy plan and stated in
13 the Iberdrola Renewables strategy plan, when the IPO took place
14 the intention in the US market is to develop and start operation
15 of 1,000 megawatts a year for the next three years. That is
16 roughly 1.5 to over \$2 billion investment per year.

17 Within that context what we are doing here is
18 committing to at least 100 million in New York State for wind
19 development, but it's important to highlight our much more
20 ambitious and compromised investment in the US.

21 MR. SCHWARTZ: Thank you. I have no further
22 redirect.

23 JUDGE EPSTEIN: Recross.

24 MR. VAN RYN: Yes, Your Honor.

1 RE CROSS EXAMINATION

2 BY MR. VAN RYN:

3 Q. On the Gamesa projects we discussed your role in -- I
4 believe it was with Bank BBVA and investing in Gamesa.

5 Do you remember that?

6 A. (Azagra) If you can elaborate a little bit more. What
7 exactly --

8 Q. You and this bank formed a holding company and that
9 holding company invested in Gamesa; is that correct?

10 A. (Azagra) Correct, IBV.

11 Q. When you were performing those investments you used only
12 publicly available information in deciding whether -- in
13 monitoring Gamesa and deciding whether to invest in Gamesa?

14 MR. SCHWARTZ: Objection, Your Honor. This goes
15 beyond the scope of redirect.

16 MR. VAN RYN: Your Honor, I believe he asked and the
17 witness said he relied only on publicly available information.

18 MR. SCHWARTZ: That's not true, Your Honor. The
19 witness said that with respect to the Gamesa projects in the
20 United States that he identified and were asked about that, that
21 information was obtained from publicly available data, not the
22 subject matter Mr. Van Ryn has requested.

23 MR. VAN RYN: Then we'll move on to the Gamesa
24 project.

1 Q. When you investigated the purchase of the Gamesa projects
2 in states other than New York, you relied only on publicly
3 available information in performing your investigation?

4 A. (Azagra) Those are two different matters. One is
5 agreements that we may reach with Gamesa or other developers in
6 which we agree we will buy some assets from those companies when
7 those assets become in operation.

8 So basically that's a negotiated agreement between
9 Iberdrola Renewables and Gamesa and are here in this case or any
10 other Company. That's a bilateral negotiation by which the two
11 companies reach an agreement in order to have a share purchase
12 agreement of assets or a company or whatever -- they reach an
13 agreement with.

14 That's, I think, different from the other public
15 available information of two of specific periods that are
16 happening. That's why in those negotiations, you know, that
17 agreement they will share information as needed in order to reach
18 that agreement.

19 MR. VAN RYN: Thank you for the clarification.

20 JUDGE EPSTEIN: Anything else?

21 BY MR. MAGER:

22 Q. Mr. Rude, a couple of quick follow-up, what are intended
23 to be "yes" or "no" questions on electric reliability, service
24 quality and gas safety and reliability.

1 Has the Company proposed any commitments to improve
2 performance in areas of electric reliability, service quality or
3 gas safety and reliability as a result of the merger?

4 A. (Rude) That has to be "yes" or "no"?

5 Q. Yes.

6 MR. FITZGERALD: Your Honor, I am going to object to
7 this. I think the question also goes beyond the scope of the
8 redirect asked by Mr. Schwartz.

9 MR. MAGER: I don't believe so, Your Honor. Mr.
10 Schwartz asked questions specifically about electric reliability,
11 service quality and gas safety and reliability in terms of what
12 may or may not happen going forward, or at least that's what the
13 witness testified to.

14 MR. SCHWARTZ: Mr. Mager, I asked Mr. Rude
15 specifically whether he had an opinion about whether any
16 improvements were needed in those specific areas -- in those
17 specific areas. And he provided that opinion. If you want to
18 ask recross on his opinion, then I think that would be
19 appropriate scope.

20 Q. In your opinion, has the Company made any commitments to
21 improve electric reliability, service quality or gas safety and
22 reliability?

23 MR. FITZGERALD: Your Honor, we are still going to
24 just renew our objection to the question regardless of how it's

1 reformulated.

2 MR. MAGER: Your Honor --

3 JUDGE EPSTEIN: I think it's a fair question. It
4 may be relevant to whether there will be improvements.

5 Go ahead, Mr. Mager.

6 BY MR. MAGER:

7 Q. Has the Company made any commitments to improve its
8 performance in electric reliability, service quality or gas
9 safety and reliability as a result of the merger?

10 A. (Rude) Yes. In the unilateral acceptance documents for
11 the document for the cooperatives in the Village of Sherburne, to
12 the extent the task force that is developed resolves the concerns
13 of those entities.

14 Q. When I was -- withdrawn.

15 Let me be more specific to the performance standards
16 upon which the Company currently is measured quantitatively. Has
17 the Company proposed any commitments to improve its performance
18 in those areas in terms of electric reliability, service quality
19 and gas safety and reliability as a result of the merger?

20 A. (Rude) Since this transaction does not affect those
21 items, no.

22 Q. Has the Company proposed any commitments to prevent any
23 deterioration or backsliding of its performance in those areas as
24 a result of the merger?

1 A. (Rude) Indirectly through the -- through the commitment
2 to maintain the same compensation and benefit levels and to not
3 affect the employment levels.

4 Q. The Company has not agreed to any changes in terms of the
5 specific performance standards themselves or the financial
6 adjustments related to those standards, has it?

7 A. (Rude) No. They would continue to operate under the
8 current ones.

9 Q. There was a question about Iberdrola's bond ratings
10 versus that of Energy East. Do you recall that question on
11 redirect?

12 And you indicated that as compared to Standard &
13 Poor's when there is a one notch difference, Moody's and Fitch,
14 the current difference is either two notches or three notches.

15 Do you recall that?

16 A. (Azagra) Yes.

17 Q. The -- to the extent the difference between Iberdrola and
18 Energy East is greater, would that impact the spreads under which
19 borrowings could be made or refinancings?

20 A. (Azagra) I think markets -- capital markets -- debt
21 capital markets, in this case, take into account each specific
22 issuance of debt securities, what is the current rating of that
23 specific issuance at that time.

24 So I think when you issue debt in the debt capital

1 market you will have term sheet in which you will say which is
2 the rating of the Company which is issuing those bonds at that
3 time.

4 And I think you will see the three ratings there.
5 So the markets will assess where they would position those
6 specific securities within that rating category. I think since
7 those ratings are issued by a company which is part of -- will be
8 part of a different company, I think the market will assess that.

9 Q. Is it your expectation that the market will allow Energy
10 East to borrow money at a lower interest rate due to it being
11 owned by Iberdrola?

12 A. (Azagra) As long as we keep rating differential our
13 opinion is yes.

14 Q. And that -- and we testified earlier that until rates are
15 reset those savings would not be returned to customers. That's
16 your understanding?

17 MR. SCHWARTZ: I think, Your Honor, we are going
18 past the scope of the redirect.

19 MR. MAGER: That was my final question, Your Honor.
20 If I can get -- I will withdraw it and stick with the record on
21 it.

22 JUDGE EPSTEIN: Any other cross? Anything further,
23 Mr. Schwartz?

24 MR. SCHWARTZ: No, Your Honor. Thank you.

1 JUDGE EPSTEIN: Okay. Thank you, panel. You are
2 excused. A discussion of scheduling off the record.

3 (DISCUSSION OFF THE RECORD.)

4 JUDGE EPSTEIN: We had a discussion about the
5 offered witnesses.

6 STEVEN M. FETTER, after first having been duly
7 sworn, was examined and testified as follows:

8 MR. JARED JOHNSON:

9 Q. Mr. Fetter, could you please provide your full name and
10 address for the record.

11 A. Steven M. Fetter, F-E-T-T-E-R. And my address is 1489
12 West Warm Springs Road, No. 110, Henderson, Nevada, 89014.

13 Q. And do you have before you a 44-page document of
14 questions and answers entitled, "Rebuttal Testimony of Steven M.
15 Fetter," dated January 31, 2008?

16 A. Yes, I do.

17 Q. Was that document prepared by you?

18 A. Yes, it was.

19 Q. Mr. Fetter, do you have any corrections to your rebuttal
20 testimony?

21 A. There is one typo on page 14 in footnote number 5. The
22 very last exhibit cited in the sentence, "This report is attached
23 hereto as exhibit" -- it says "SMF-2." It should be "SMF-3."

24 Q. Mr. Fetter, with that one correction, if I were to ask

1 you the questions set forth in your rebuttal testimony today
2 would your answers be the same as they were in the testimony?

3 A. Yes.

4 Q. Do you adopt this as your sworn rebuttal testimony in
5 this proceeding?

6 A. Yes.

7 MR. JARED JOHNSON: Your Honor, may we have the
8 rebuttal testimony of Steven M. Fetter copied into the record as
9 if given orally.

10 JUDGE EPSTEIN: Yes, please.

11 (The following is the prefiled testimony of Steven
12 M. Fetter:)

13

14

15

16

17

18

19

20

21

22

23

24

STEVEN M. FETTER**1 INTRODUCTION AND BACKGROUND**

2 Q. PLEASE STATE YOUR NAME, TITLE, AND BUSINESS ADDRESS.

3 A. My name is Steven M. Fetter. I am President of Regulation UnFettered. My
4 business address is 1489 W. Warm Springs Rd., Suite 110, Henderson, NV
5 89014.

6 Q. ON WHOSE BEHALF ARE YOU TESTIFYING?

7 A. I am testifying on behalf of Iberdrola S.A., which I shall refer to as "Iberdrola" or
8 the "Company".

9 Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?

10 A. I am President of Regulation UnFettered, a utility advisory firm I started in April
11 2002. Prior to that, I was employed by Fitch, Inc. ("Fitch"), a credit rating agency
12 based in New York and London. Prior to that, I served as Chairman of the
13 Michigan Public Service Commission ("Michigan PSC").

14 Q. WHAT IS YOUR EDUCATIONAL BACKGROUND?

15 A. I graduated with high honors from the University of Michigan with an A.B. in
16 Communications in 1974. I graduated from the University of Michigan Law
17 School with a J.D. in 1979.

18 Q. PLEASE BRIEFLY DESCRIBE YOUR ROLE AS PRESIDENT OF
19 REGULATION UNFETTERED.

20 A. I formed a utility advisory firm to use my financial, regulatory, legislative, and
21 legal expertise to aid the deliberations of regulators, legislative bodies, and the

STEVEN M. FETTER

1 courts, and to assist them in evaluating regulatory issues. My clients include
2 investor-owned, municipal and international electric, natural gas and water
3 utilities, state public utility commissions and consumer advocates, non-utility
4 energy suppliers, international financial services and consulting firms, and
5 investors.

6 Q. WHAT WAS YOUR ROLE DURING YOUR EMPLOYMENT WITH FITCH?

7 A. I was Group Head and Managing Director of the Global Power Group within
8 Fitch. In that role, I served as group manager of the combined 18-person New
9 York and Chicago utility team. I was originally hired to interpret the impact of
10 regulatory and legislative developments on utility credit ratings, a responsibility I
11 continued to have throughout my tenure at the rating agency. In April 2002, I left
12 Fitch to start Regulation UnFettered.

13 Q. HOW LONG WERE YOU EMPLOYED BY FITCH?

14 A. I was employed by Fitch from October 1993 until April 2002. In addition, Fitch
15 retained me as a consultant for a period of approximately six months shortly after
16 I resigned.

17 Q. HOW DOES YOUR EXPERIENCE RELATE TO YOUR TESTIMONY IN
18 THIS PROCEEDING?

19 A. My experience as a Commissioner on the Michigan PSC and my subsequent
20 professional experience analyzing the U.S. electric and natural gas sectors – in
21 jurisdictions involved in restructuring activity as well as those still following a

STEVEN M. FETTER

1 traditional regulated path – have given me solid insight into the importance of a
2 regulator’s role in setting rates, determining appropriate terms and conditions of
3 service for all regulated utilities, and considering issues related to utility mergers
4 and acquisitions. These are the factors that enter into the process of utility credit
5 analysis and formulation of individual company credit ratings. It is a well-
6 established fact that a utility’s credit ratings have a significant impact as to
7 whether that utility will be able to raise capital on a timely basis and upon
8 favorable terms.

9 Q. HAVE YOU PREVIOUSLY SPONSORED TESTIMONY BEFORE
10 REGULATORY AND LEGISLATIVE BODIES?

11 A. Since 1990, I have on numerous occasions testified before the U.S. Senate, the
12 U.S. House of Representatives, the Federal Energy Regulatory Commission, and
13 various state legislative and regulatory bodies on the subjects of credit risk within
14 the utility sector, electric and natural gas utility restructuring, fuel and other
15 energy adjustment mechanisms, utility mergers and acquisitions, utility
16 securitization bonds, and nuclear energy. With regard to approval of utility
17 mergers, I have previously testified on that issue on behalf of Cinergy
18 Corporation, Cincinnati Gas & Electric Company, and Union Light, Heat and
19 Power Company in their merger with Duke Energy Corporation before the
20 Indiana Utility Regulatory Commission (in Case No. 42873), the Public Utilities

STEVEN M. FETTER

1 Commission of Ohio (in Case Nos. 05-732-EL-MER and 05-733-EL-AAM), and
2 the Kentucky Public Service Commission (in Case No. 2005-00228).

3 My full educational and professional background is presented in Exhibit
4 ___ (SMF-1).

5 Q. DOES YOUR TESTIMONY ADDRESS STAFF'S RESPONSES TO
6 INFORMATION REQUESTS RELATED TO THE STAFF POLICY PANEL'S
7 DIRECT TESTIMONY ADDRESSING THE ISSUES DISCUSSED IN YOUR
8 TESTIMONY?

9 A. Yes. I have received and reviewed several responses by Staff to information
10 requests related to the Staff Policy Panel's direct testimony and have specifically
11 addressed some of the responses in my rebuttal testimony. However, additional
12 analysis will be required to review and possibly specifically address many of
13 Staff's responses as there was insufficient time to complete my review in the time
14 provided to submit my testimony. I further note that in certain responses, Staff
15 has indicated that it intends to revise certain exhibits and I reserve the right to
16 modify my rebuttal testimony at hearing to address any changes to Staff's
17 exhibits.

18 Q. ARE YOU SPONSORING ANY EXHIBITS?

19 A. Yes. In addition to my first exhibit, which is my educational and professional
20 background, I sponsor the following: Exhibit ___ (SMF-2) is an S&P Research
21 publication entitled "U.S. Electric Utility Companies, Strongest to Weakest";

STEVEN M. FETTER

1 Exhibit __ (SMF-3) is an S&P research report entitled "U.S. Utilities Ratings
2 Analysis Now Portrayed in the S&P Corporate Ratings Matrix"; Exhibit ____
3 (SMF-4) is a Moody's report entitled "Moody's downgrades Iberdrola to A3/P-2;
4 Stable outlook"; Exhibit __ (SMF-5) contains a copy of certain interrogatory
5 responses referenced in this testimony; and Exhibit ____ (SMF-6) is an S&P
6 Research Report entitled "Energy East Corp.," November 16, 2007.

7 **EXECUTIVE SUMMARY**

8 Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?

9 A. I have reviewed the prepared testimony of the New York Public Service
10 Commission Staff Policy Panel ("Staff", "Policy Panel" or "PP") and will rebut
11 the following views expressed by those individuals:

12 a) "Credit ratings are snapshots of a company's existing circumstances and
13 by nature are subject to change when a company's circumstances
14 inevitably change," (PP at 151), and that "S&P has put NYSEG and
15 RG&E on watch for a downgrade if the transaction is completed." (PP
16 at 167-168);

17 b) that reports by S&P and Moody's support the Policy Panel's belief
18 that: "it is unlikely that the Company can sustain an "A"
19 rating....Moreover,...the capital structure of Iberdrola is not consistent
20 with an "A" rating currently and any increase in its leverage will make
21 a downgrade or multiple downgrades more likely," (PP at 151-162),

STEVEN M. FETTER

- 1 and that Iberdrola's latest strategic plan, including an extensive capital
2 investment program, could lead to Iberdrola's ratings being
3 downgraded, (PP at 163);
- 4 c) that Iberdrola's financial standing could make it more difficult for
5 NYSEG and RG&E "to raise capital in the financial markets at
6 reasonable terms," (PP at 164-165), and that S&P has "indicated
7 specifically that bond rating downgrades for NYSEG and RG&E are
8 likely if the transaction is approved." (PP at 167-168);
- 9 d) that "the Commission should insist on...ring fencing conditions" as a
10 condition of approval of the merger, (PP at 174);
- 11 e) that "the investment community [has] rendered an assessment on
12 Iberdrola's affect on NYSEG and RG&E" because NYSEG "issued
13 debt 225 basis points above 10-year treasuries" while other companies
14 issued debt at lower spreads (approximately 30 basis points lower
15 compared to such treasuries), and the reasons the Policy Panel
16 provides for the discrepancy in those spreads, (PP at 175-178);
- 17 f) the presence of Goodwill at Iberdrola as "an impediment to
18 [Iberdrola's] credit quality," (PP at 179-193); and
- 19 g) the Policy Panel's discomfort with Iberdrola's capital structure and its
20 potential impacts on ratemaking and credit ratings, (PP at 194-210).
- 21

STEVEN M. FETTER**1 CREDIT RATINGS OVERVIEW**

2 Q. WHAT CREDIT RATINGS DO IBERDROLA, ENERGY EAST AND ITS
3 REGULATED UTILITY SUBSIDIARIES CURRENTLY HOLD?

4 A. Iberdrola's current corporate (senior unsecured) credit ratings are "A-" from
5 Standard & Poor's ("S&P") and the equivalent "A3" from Moody's. Both ratings
6 have a Stable outlook. These ratings equate to mid-level investment-grade ratings.
7 Fitch's issuer default rating for Iberdrola is 'A' with a Negative outlook.
8 Energy East and its regulated subsidiaries, NYSEG and RG&E, currently hold
9 corporate credit ratings of "BBB+" from S&P. At Moody's, Energy East holds a
10 senior unsecured rating of "Baa2", while NYSEG and RG&E are rated at "Baa1".
11 These ratings have a Negative outlook at both S&P and Moody's. At Fitch, Energy
12 East's issuer default rating is 'BBB' with a Stable outlook; NYSEG is at 'BBB' with
13 a Negative outlook; and RG&E is at 'BBB-' with a Stable outlook. The ratings of
14 Energy East and its subsidiaries equate to low-to-mid-level investment-grade ratings.

15 Q. PLEASE GENERALLY DESCRIBE THE CREDIT RATINGS PROCESS.

16 A. Credit ratings reflect a credit rating agency's independent judgment of the general
17 creditworthiness of an obligor or the creditworthiness of a specific debt instrument.
18 While credit ratings are important to both debt and equity investors for a variety of
19 reasons, their most important purpose is to communicate to investors the financial
20 strength of a company or the underlying credit quality of a particular debt security
21 issued by that company. Credit rating determinations are made through a committee

STEVEN M. FETTER

1 process involving individuals with knowledge of a company, its industry, and its
2 regulatory environment.

3 Corporate credit ratings analysis considers both qualitative and quantitative
4 factors to assess the financial and business risks of fixed-income issuers. A credit
5 rating is an indication of an issuer's ability to service its debt, both principal and
6 interest, on a timely basis. It also at times incorporates some consideration of
7 ultimate recovery of investment in case of default or insolvency.

8 Q. CAN YOU PROVIDE A BRIEF DISCUSSION ON WHY CREDIT RATINGS
9 ARE IMPORTANT FOR REGULATED UTILITIES AND THEIR
10 CUSTOMERS?

11 A. Yes. It is a well-established fact that a utility's credit ratings have a significant
12 impact as to whether that utility will be able to raise capital on a timely basis and
13 upon reasonable terms. As respected economist Charles F. Phillips stated in his
14 treatise on utility regulation:

15 Bond ratings are important for at least four reasons: (1) they are used
16 by investors in determining the quality of debt investment; (2) they
17 are used in determining the breadth of the market, since some large
18 institutional investors are prohibited from investing in the lower
19 grades; (3) they determine, in part, the cost of new debt, since
20 both the interest charges on new debt and the degree of difficulty

STEVEN M. FETTER

1 **in marketing new issues tend to rise as the rating decreases; and**
2 **(4) they have an indirect bearing on the status of a utility's stock and**
3 **on its acceptance in the market.¹ [Emphasis supplied.]**

4 **Thus, the lower a regulated utility's credit rating, the more the utility will**
5 **have to pay to raise funds from debt and equity investors to carry out its capital-**
6 **intensive operations. In turn, the ratemaking process factors the cost of capital for**
7 **both debt and equity into the rates that consumers are required to pay. Thus, a utility**
8 **with strong credit ratings is not only able to access the capital markets on a timely**
9 **basis at reasonable rates, it also is able to share the benefit from those attractive**
10 **interest rate levels with customers since cost of capital gets factored into utility rates.**

11 **Q. PLEASE DESCRIBE THE QUALITATIVE FACTORS USED BY THE RATING**
12 **AGENCIES IN RATING UTILITY COMPANIES.**

13 **A. The most important qualitative factors include regulation, management and business**
14 **strategy (including management's transparency, credibility, and ability to deliver**
15 **upon its commitments), and access to energy, gas and fuel supply with recovery of**
16 **associated costs.**

17 **Q. PLEASE EXPLAIN YOUR THOUGHTS ON THE IMPORTANCE OF**
18 **REGULATION WITHIN THE CREDIT RATINGS PROCESS?**

¹ C.J. Phillips, Pub. Utils. Reports, Inc., *The Regulation of Public Utilities, Theory and Practice* at 250 (1993). See also Public Utilities Reports Guide: "Finance," Pub. Utils. Reports, Inc. at 6-7 ("Generally, the higher the rating of the bond, the better the access to capital markets and the lower the interest to be paid.").

STEVEN M. FETTER

1 A. Regulation is a key factor in assessing the credit profile of a utility because a state
2 public utility commission determines retail rate levels (recoverable expenses
3 including depreciation and operations and maintenance, fuel cost recovery, and
4 return on investment), the terms and conditions of service, and, in a case like this,
5 the future structure of the utilities within its regulatory jurisdiction.

6 Since the mid-1990s when many states, including New York, introduced
7 industry restructuring plans and opportunity for greater competition, regulation has
8 become an even more important factor as the nature of a utility's responsibilities in
9 providing energy services to customers has undergone dramatic change. In some
10 states, industry restructuring was the result of plans formulated by the state
11 legislature. In other states, the regulators, rather than the legislators, have
12 determined the nature and pace of restructuring, or whether it would occur at all.

13 This situation thus affects utility investors' decisions because, before major
14 investors will be willing to put forward substantial sums of money, they will want to
15 gain comfort that regulators understand the economic requirements and the financial
16 and operational risks of a rapidly changing industry and that their decision-making
17 will be fair and will have a significant degree of predictability.

18 For these reasons, rating agencies look for the consistent application of
19 sound economic regulatory principles by the commissions. If a regulatory body
20 were to encourage a company to make investments based upon an expectation of the
21 opportunity to earn a reasonable return, and then did not apply regulatory principles

STEVEN M. FETTER

1 in a manner consistent with such expectations, investor interest in providing funds to
2 such utility would decline, debt ratings would likely suffer, and the utility's cost of
3 capital would increase.

4 Q. IN VIEW OF THE INDUSTRY CHANGES AND EVENTS DETAILED ABOVE,
5 DO THE ACTIONS OF UTILITY REGULATORS TODAY DRAW EVEN
6 MORE ATTENTION FROM THE FINANCIAL COMMUNITY?

7 A. Yes, without a doubt. Regulation has always garnered the attention of Wall Street,
8 but, years ago, seemingly only during the days leading up to a commission's rate
9 case decision. This began to change around the time that Fitch hired me in 1993 to
10 serve in the role of regulatory analyst and assess regulatory, legislative and political
11 factors that could affect a utility's financial strength. When California announced its
12 ultimately ill-fated restructuring plan in 1994, the entire financial community,
13 especially the rating agencies, took much greater notice of regulators and how they
14 carried out their responsibilities, not only with regard to rate-setting, but even more
15 importantly the manner in which they undertook to change the way the entire utility
16 industry had operated for over 100 years.

17 S&P highlighted how the changing dynamics within the electric utility
18 industry that I reference above have elevated the importance of regulation to the
19 financial community:

20 In recent years, [S&P's] emphasis on the decisions by state
21 commissions has been less pronounced simply because so many

STEVEN M. FETTER

1 jurisdictions have been working through multiyear restructuring
2 transition periods. During this time, rates were frequently frozen,
3 and companies and customers have been adjusting (albeit with
4 limited success) to the opportunity that customers have to choose
5 alternate power suppliers. But the confluence of the approaching end
6 of these transition periods and the growing need in certain regions of
7 the country for significant resource additions is quickly returning the
8 regulatory arena to center stage. In assessing the regulatory
9 environment in which a utility operates, [S&P's] analysis is guided
10 by certain principles, most prominently consistency and
11 predictability, as well as efficiency and timeliness. For a regulatory
12 scheme to be considered supportive of credit quality, commissions
13 must limit uncertainty in the recovery of a utility's investment. They
14 must also eliminate, or at least greatly reduce, the issue of rate-case
15 lag that may prove detrimental if a utility needs rate relief.²

16 Q. COULD YOU PLEASE DESCRIBE THE QUANTITATIVE FACTORS USED
17 BY THE RATING AGENCIES?

18 A. Yes. Financial performance continues to be a very important element in credit rating
19 analysis. Credit rating agencies and fixed-income analysts utilize analytical ratios to
20 understand the credit profile of a utility, with S&P publicly explaining the three

² S&P Research: "U.S. Utility Regulation Returns to Center Stage," April 14, 2005.

STEVEN M. FETTER

1 financial measures that it views as most important in its analysis of utility
2 companies: Funds from Operations (“FFO”) Interest Coverage; Funds from
3 Operations / Total Debt; and Total Debt / Total Capital. While all three ratios are
4 important, S&P has noted the agency’s greater emphasis on cash flow measures, or
5 the first two ratios: “Cash flow analysis is the single most critical aspect of all credit
6 rating decisions.”³ Thus, as I address further below, the ratio most emphasized by
7 the Staff Policy Panel -- Total Debt / Total Capital -- is the ratio given least emphasis
8 by the rating agencies themselves. I note that rating agencies may adjust these key
9 ratios to reflect imputed debt and interest-like fixed charges flowing from purchased
10 power agreements and certain other off-balance sheet obligations.⁴

11 Building upon those key ratios, S&P has been the most explicit of the three
12 major rating agencies in explaining how it views the interplay between quantitative
13 and qualitative factors. As part of its utility credit rating process, S&P arrives at a
14 “Business Risk Profile” designation that it considers in concert with its “Financial
15 Risk Profile.” Financial Risk is assessed based upon indicative ratios for the three
16 key credit measures cited above; the weaker the Business Risk Profile designation,
17 the stronger the financial ratios must be in order to support an investment-grade
18 rating.

19 Q. WHAT DOES S&P'S BUSINESS RISK PROFILE DESIGNATION REFLECT?

³ S&P Research: “A Closer Look at Ratings Methodology,” November 13, 2006.

⁴ See, e.g., S&P Research: “Standard & Poor’s Methodology for Imputing Debt for U.S. Utilities’ Power Purchase Agreements,” May 7, 2007.

STEVEN M. FETTER

1 A. The Business Risk Profile designation reflects S&P's assessment of qualitative
2 factors such as regulation, markets, operations, competitiveness, and management.
3 Interestingly, on November 30, 2007, S&P announced that it had inserted utility
4 companies into its longstanding "Corporate Ratings" matrix, and that this new
5 framework superseded its prior "Utility Financial Targets" matrix.⁵ Thus, while
6 previously S&P had measured business profiles on a '1' (meaning very strong) to
7 '10' (meaning very weak) scale, going forward S&P will rank business risk as
8 'Excellent', 'Strong', 'Satisfactory', 'Weak', or 'Vulnerable'. However, it is
9 important to note that S&P stated in its recent report announcing the change that
10 "Regulated utilities and holding companies that are utility-focused virtually always
11 fall in the upper range ("Excellent" or "Strong") of business risk profiles."⁶ Thus,
12 analysts using this new matrix will be faced with the seemingly anomalous situation
13 that a utility designated as 'Strong' (or the second highest of the five business risk
14 profile rankings) will actually reside within the lower half of all U.S utility business
15 risk profiles, basically at a below average level. Similarly, under S&P's new
16 framework, Financial Risk Profiles will be designated as 'Minimal', 'Modest',

⁵ The Policy Panel makes frequent reference (at pp. 154, 191, 199 and 266) to S&P's Research: "New Business Profile Scores Assigned for U.S. Utility and Power Companies; Financial Guidelines Revised," June 2, 2004. However, that research report and "Utility Financial Targets" matrix has been superseded by S&P Research: "U.S. Utilities Ratings Analysis Now Portrayed in the S&P Corporate Ratings Matrix," November 30, 2007, with a modified methodology process as explained in the text above. This report is attached hereto as Exhibit ~~(SMF-2)~~ (SMF-3).

⁶ S&P Research: "U.S. Utilities Ratings Analysis Now Portrayed in the S&P Corporate Ratings Matrix," November 30, 2007. This report is attached hereto as Exhibit ___ (SMF-3).

STEVEN M. FETTER

1 'Intermediate', 'Aggressive', or 'Highly Leveraged', words that are not necessarily
2 accurate descriptions of the strategies adopted by regulated utilities or the actions
3 taken by their regulators.

4 Q. WHY IS S&P'S METHODOLOGY MEANINGFUL TO YOU?

5 A. I believe that S&P's methodology helps facilitate a general understanding of how
6 a credit rating agency carries out the process of formulating a credit rating and the
7 factors that go into such a determination.⁷

8 **REBUTTAL OF POLICY PANEL TESTIMONY**

9 Q. THE POLICY PANEL DESCRIBES CREDIT RATINGS AS "SNAPSHOTS OF
10 A COMPANY'S EXISTING CIRCUMSTANCES" (PP AT 151) AND THAT
11 S&P HAS PUT NYSEG AND RG&E ON WATCH FOR A DOWNGRADE IF
12 THE TRANSACTION IS COMPLETED. IS THE PANEL ACCURATE IN ITS
13 DESCRIPTIONS?

14 A. No, it is not. The Policy Panel professes to speak for how the financial
15 community and the credit rating agencies will view Iberdrola, NYSEG and RG&E
16 once the merger is consummated, but its understanding of the workings of credit
17 rating agencies is deeply flawed.

⁷ I focus here on S&P's ratings methodology, as opposed to those at Moody's or Fitch, due to the greater transparency of S&P's ratings process owing to its explanation of the methodology and how it is implemented in published reports. *See, e.g.*, S&P Research: "U.S. Utilities Ratings Analysis Now Portrayed in the S&P Corporate Ratings Matrix," November 30, 2007, and S&P Research: "U.S. Electric Utility Companies, Strongest to Weakest," November 30, 2007. For a comparison, see Moody's Research: "Rating Methodology: Global Regulated Electric Utilities," March 2005.

STEVEN M. FETTER

1 Q. PLEASE EXPLAIN THE FLAWS IN THE POLICY PANEL'S DISCUSSION
2 OF CREDIT RATINGS?

3 A. Credit ratings are not, as the Policy Panel asserts, snapshots in time. Both S&P
4 and Moody's publish definitions of their ratings, and related outlooks and watch
5 status. S&P's definitions are as follows:

6 A Standard & Poor's rating evaluates default risk over the life of a debt
7 issue, incorporating an assessment of all future events to the extent they
8 are known or can be anticipated. But we also recognize the potential for
9 future performance to differ from initial expectations. Rating outlooks
10 and CreditWatch listings address this possibility by focusing on the
11 scenarios that could result in a rating change.

12
13 Ratings appear on CreditWatch when an event or deviation from an
14 expected trend has occurred or is expected, and additional information is
15 necessary to take a rating action.... A listing does not mean a rating
16 change is inevitable...

17
18 A rating outlook is assigned to all long-term debt issuers and assesses the
19 potential for a rating change. Outlooks have a longer time frame than
20 CreditWatch listings – typically, two years – and incorporate trend or risks

STEVEN M. FETTER

1 with less certain implications for credit quality. An outlook is not
2 necessarily a precursor of a rating change or a CreditWatch listing...

3
4 CreditWatch designations and outlooks may be "positive," which indicates
5 a rating may be raised, or "negative," which indicates a rating may be
6 lowered..."Stable" is the outlook assigned when ratings likely will not be
7 changed, but it should not be confused with expected stability of the
8 company's financial performance...

9
10 Issuer ratings...focus entirely on the default risk of the entity. Long-term
11 issue ratings also take into account risks pertaining to loss-given-
12 default...both the issuer and issue rating definitions are expressed in terms
13 of default risk, which refers to the capacity and willingness of the obligor
14 to meet its financial commitments on time, in accordance with the terms of
15 the obligation.⁸

16 Q. HOW DOES S&P DEFINE THE RATING CATEGORIES AT ISSUE WITHIN
17 THIS PROCEEDING: "A" AND "BBB"?

18 A. S&P defines those categories as follows:

⁸ S&P Research: "Corporate Ratings Criteria – Standard & Poor's Role in the Financial Markets; Ratings Definitions; The Rating Process," March 9, 2006.

STEVEN M. FETTER

1 ‘A’: An obligation rated ‘A’ is somewhat more susceptible to the adverse
2 effects of changes in circumstances and economic conditions than
3 obligations in higher rated categories. However, the obligor’s capacity to
4 meet its financial commitment on the obligation is still strong.

5
6 ‘BBB’: An obligation rated ‘BBB’ exhibits adequate protection parameters.
7 However, adverse economic conditions or changing circumstances are more
8 likely to lead to a weakened capacity of the obligor to meet its financial
9 commitment on the obligation.⁹

10 Q. DOES MOODY’S VIEW THE SITUATION SIMILARLY?

11 A. Yes, it does. Moody’s states that:

12 Long-term obligation ratings are opinions of the relative credit risk of fixed-
13 income obligations with an original maturity of one year or more. They
14 address the possibility that a financial obligation will not be honored as
15 promised...

16
17 Issuer Ratings are opinions of the ability of entities to honor senior
18 unsecured financial obligations and contracts.

19

⁹ *Id.*

STEVEN M. FETTER

1 A Moody's rating outlook is an opinion regarding the likely direction of an
2 issuer's rating over the medium term. Where assigned, rating outlooks fall
3 into the following four categories: Positive, Negative, Stable, and
4 Developing....

5
6 Moody's uses the Watchlist to indicate that a rating is under review for
7 possible change in the short-term.¹⁰

8 **Q. AND HOW DOES MOODY'S DEFINE THE 'A' AND 'BBB' CATEGORIES?**

9 **A. Moody's defines them as:**

10 "Obligations rated A are considered upper-medium grade and are subject to
11 low credit risk."

12 and

13 "Obligations rated Baa are subject to moderate credit risk. They are
14 considered medium-grade and as such may possess certain speculative
15 characteristics."¹¹

16 **Q. BASED UPON THOSE DEFINITIONS, WHAT DO YOU GLEAN FROM THE**
17 **POLICY PANEL'S COMMENTS NOTED ABOVE?**

18 **A. It is clear that S&P and Moody's do not view their credit rating determinations as**
19 **"snapshots" of an existing moment in time, and this is confirmed by my experience**

¹⁰ "Moody's Rating Symbols and Definitions," March 2007.

¹¹ *Id.*

STEVEN M. FETTER

1 as head of the utility ratings practice at Fitch. When assigning a rating, we would
2 convene a rating committee, consider both qualitative and quantitative factors
3 (including financial forecasts), and come to our best judgment as to the appropriate
4 rating for a security until its maturity. As noted, at the time of assignment of a
5 rating, an outlook is provided to indicate the potential direction of a rating's
6 movement during the medium-term, usually two to three years. If an unforeseen
7 event were to occur that could affect the rating during the near-term (usually six to
8 twelve months), then a Watch designation is assigned, usually with the likely
9 direction of rating movement indicated.

10 Q. IS IT THE S&P NEGATIVE "*WATCH*" DESIGNATION ON NYSEG AND
11 RG&E THAT THE POLICY PANEL IS CONCERNED ABOUT?

12 A. It would appear that that is what is troubling the Policy Panel (*see, e.g.,* PP at 167),
13 but such concerns are misplaced. Both NYSEG and RG&E currently have Negative
14 *outlooks* assigned to their ratings by S&P and Moody's, not, as Staff appears to
15 indicate, Negative Watch designations.¹² This would signal *potential* negative
16 movement over a two to three year horizon – a time period that is likely to be well
17 beyond when the Commission decides whether to approve this merger or not. The
18 Policy Panel concedes (PP at 167) that the Negative "watches" (which should be
19 "outlooks") relate to both the regulatory climate within New York State relating to

¹² In some parts of their testimony, the Policy Panel seems to confuse a negative "outlook" with a negative "watch". Compare PP at 158 (referring correctly to a negative "outlook") with PP at 167 (referring to a "watch for a downgrade").

STEVEN M. FETTER

1 NYSEG and RG&E, along with the Commission's consideration of the Iberdrola –
2 Energy East merger. In view of the assignment of a (medium-term) outlook rather
3 than a (near-term) Watch designation, I believe the Negative outlook relates
4 primarily to the regulatory climate within the state as it pertains to Energy East and
5 its subsidiaries over the next few years, supplemented by issues that have arisen of
6 late related to the regulatory review of the merger (rather than the merits of the
7 transaction itself). It is no coincidence that the rating agencies put these Negative
8 outlooks in place in September 2006, following the issuance of the Commission's
9 electric rate decision for NYSEG. As described below, the August 2006 rate order
10 precipitated these Negative outlooks.

11 Q. THE POLICY PANEL INDICATES THAT S&P AND MOODY'S REPORTS
12 POINT TO A LIKELY DOWNGRADE OF IBERDROLA OUT OF THE 'A'
13 CATEGORY, WITH THE POTENTIAL FOR MULTIPLE DOWNGRADES. IS
14 THIS WHAT THE REPORTS SAY?

15 A. No, they do not. The Policy Panel misinterprets the S&P and Moody's reports by
16 focusing only on the risks cited by the rating agencies in their reports, without
17 balancing them against the positive aspects of Iberdrola cited in those same reports.
18 This one-sided interpretation of the S&P and Moody's reports is not an appropriate
19 basis upon which to conclude that the subject transaction will be harmful. Every
20 utility faces risks – to consider only negative factors provides a skewed perspective
21 about a company and leads one to make inaccurate assumptions about credit ratings,

STEVEN M. FETTER

1 as has happened here. Rating agencies deliberate over all qualitative and
2 quantitative factors relevant to a company's credit ratings, and then publish credit
3 ratings and factors supporting those determinations to provide investors, other
4 interested parties, and the general public with full information about those ratings. A
5 rating agency speaks through its publicly disseminated press releases and reports.

6 Q. IS THERE ANY MERIT TO THE POLICY PANEL'S CONTENTION (PP AT
7 159) THAT, BY THE STANDARDS OF AN S&P REPORT (EXHIBIT PP-17),
8 IBERDROLA'S PRO FORMA DEBT RATIO IMPLIES A 'BBB' BOND
9 RATING?

10 A. No, there is not. The Staff Policy Panel has taken one ratings criterion, the Total
11 Debt / Total Capital ratio, and elevated it to become, in Staff's view, the sole
12 relevant criterion for credit ratings -- an approach that is manifestly contrary to the
13 multiple criteria that credit ratings agencies carefully weigh and examine before
14 assigning a rating (in this case, for example, Iberdrola's 'A-' rating from S&P). As I
15 discussed above, S&P has explained that (i) Funds from Operations ("FFO") Interest
16 Coverage and (ii) Funds from Operations / Total Debt are the two most important
17 financial measures used to rate companies' debt which, of course, explains why
18 Iberdrola is not and should not, as Staff suggests, be rated 'BBB'. Iberdrola has
19 coverage ratios commensurate with an 'A' category rating.¹³

¹³ See S&P Research Update: "Spain's Iberdrola Affirmed at 'A-/A-2' on IPO Completion; L-T Off Watch; Outlook Stable," December 13, 2007 ("The IPO proceeds will finance this growth

STEVEN M. FETTER

1 Interestingly, under its new methodology (announced in November 2007),
2 S&P has classified NYSEG and RG&E as having Excellent business profiles and
3 Aggressive financial profiles.¹⁴ Under that updated methodology, S&P equates such
4 profiles with a 'BBB' rating.¹⁵

5 Q. PLEASE DESCRIBE FURTHER YOUR ANALYSIS OF THE S&P AND
6 MOODY'S REPORTS AS THEY PERTAIN TO THE POTENTIAL FOR A
7 FURTHER CREDIT RATING DOWNGRADE OF IBERDROLA?

8 A. A review of the most recent public pronouncements by S&P and Moody's on
9 Iberdrola presents a very different picture than the one presented in the Policy
10 Panel's testimony. On December 13, 2007, S&P affirmed its 'A-' corporate credit
11 rating on Iberdrola, removing it from Negative CreditWatch, and assigning a Stable
12 outlook. The rating action followed upon successful completion of the IPO of

and are key to maintaining credit metrics that are consistent with an 'A-' rating....Credit metrics should remain in line with the levels indicated."). The report is attached as an exhibit to the Joint Petitioners' Policy Panel. *See also* Moody's Investors Service: "Moody's downgrades Iberdrola to A3/P-2; Stable outlook," December 12, 2007 ("Moody's expects Iberdrola's ratios to be positioned at the low end of the expected range for an A3 rating for a company with this business risk profile...these ratios are anticipated to improve gradually."). This report is attached hereto as Exhibit ____ (SMF-4).

¹⁴ *See* Exhibit ____ (SMF-2) (S&P Research: "U.S. Electric Utility Companies, Strongest to Weakest").

¹⁵ *See* Exhibit ____ (SMF-3) (S&P Research: "U.S. Utilities Ratings Analysis Now Portrayed in the S&P Corporate Ratings Matrix").

STEVEN M. FETTER

1 Iberdrola Renovables, with the proceeds slated to secure the Company's financial
2 profile during the period of its new strategic capital investment plan (2008-2010).¹⁶

3 Unlike the Policy Panel's testimony, S&P detailed the balance between
4 positive and negative rating factors:

5 The ratings reflect Iberdrola's strong position as one of Spain's dominant
6 vertically integrated electricity utilities and the regulated and quasiregulated
7 nature of its electricity distribution and renewable operations, respectively,
8 which together contribute about 40% of EBITDA and provide cash flow
9 stability and predictability. They also reflect the group's increased earnings
10 diversity – both geographic and operational – through the acquisition of
11 Scottish Power...

12
13 These strengths are offset by increasing competitive pressure in the Spanish
14 electricity market, Iberdrola's exposure to electricity price volatility, and the
15 group's weaker capital structure resulting from the Scottish Power deal. In
16 addition, Iberdrola must now face the challenge of integrating the acquired
17 business.

18

¹⁶ S&P Research Update: "Spain's Iberdrola Affirmed at 'A-/A-2' on IPO Completion; L-T Rating Off Watch; Outlook Stable," December 13, 2007.

STEVEN M. FETTER

1 Iberdrola is one of the world's largest energy companies...Over the next
2 three years, Iberdrola will undertake a large investment program of 24.2
3 billion euros...Renewable energy will represent the core of the group's
4 future growth, and accounts for about 50% of expected organic investments.
5 The IPO proceeds will finance this growth and are key to maintaining credit
6 metrics that are consistent with an 'A-' rating.¹⁷

7 Q. HOW DOES S&P VIEW THE BALANCE BETWEEN POSITIVE AND
8 NEGATIVE FACTORS?

9 A. S&P assigned a Stable outlook to Iberdrola's ratings. The agency explained its
10 conclusion:

11 The stable outlook reflects [S&P's] expectations that Iberdrola will focus on
12 consolidating its operations and that its management will be consistent with
13 its commitment to strengthen the group's capital structure. Credit metrics
14 should remain in line with the levels indicated. The ratings could be lowered
15 if credit metrics are weaker than anticipated because of lower profit margins,
16 large acquisitions, or a more aggressive dividend policy. Changes to the
17 regulatory framework for renewable energies (rate-of-return reduction,
18 elimination of tax credits) would also have a negative impact on the rating.
19 An upgrade is unlikely in the short term.¹⁸

¹⁷ *Id.*

¹⁸ *Id.*

STEVEN M. FETTER

1

2

All in all, S&P, through its assignment of a Stable outlook, sees relative stability for Iberdrola's ratings over the next couple of years, at rating levels above those of Energy East.

4

5

Q. HOW DO THE MOODY'S REPORTS DESCRIBE IBERDROLA'S CURRENT SITUATION?

6

7

A. In very similar fashion. On December 12, 2007, Moody's downgraded Iberdrola from an 'A2' rating to 'A3'. In doing so, Moody's stated that the downgrade incorporated "the partly debt-funded acquisition of Scottish Power in April 2007; the recently announced IPO of Iberdrola's renewables subsidiary...; and an ambitious investment strategy for 2008-2010 [that includes] the expected acquisition of Energy East Corporation..., subject to regulatory approvals."¹⁹ On December 13, 2007, Moody's published a report on Iberdrola, citing the Company's business strengths and weaknesses, and, like S&P, emphasized several positive aspects of the business profile of Iberdrola while affirming a Stable outlook:

9

10

11

12

13

14

15

16

17

18

19

Iberdrola's A3/P-2 ratings reflect Moody's overall low/medium assessment of Iberdrola's business risk for an electric utility, following the recent corporate actions and taking into account its revised strategic plan. This risk assessment reflects the significantly increased scale of the group, its

¹⁹ See Exhibit ___ (SMF-4) ("Moody's downgrades Iberdrola to A3/P-2; Stable outlook").

STEVEN M. FETTER

1 geographic spread and diversification of risks, particularly those of
2 regulation, generation pricing and fuel technology...

3
4 Nonetheless, this risk assessment factors a degree of integration and
5 execution risk as the company has expanded into new markets in which it
6 has had less prior experience, and, in addition, the group has ambitious
7 growth targets which may not be achieved if operating conditions become
8 more difficult...

9
10 Iberdrola is well-placed to make good progress given its size, scale and
11 diversified exposure to fairly favourable regimes in Iberia, the UK and US.
12 It has long-term agreements with a range of turbine manufacturers; an
13 experienced team in the development of sites and management of operations
14 which should help offset key risks that include the speed at which the
15 pipeline can be processed given possible delays in receiving permissions
16 and/or accessing equipment; possible regulatory change; construction risk
17 and weather conditions...

18
19 Ambitious growth targets in the UK may be challenged by competitive
20 activity and there are a number of regulatory and political challenges in
21 Spain as the electricity system is transitioning only gradually to a fully

STEVEN M. FETTER

1 liberalized market. Overall, commodity and generation pricing risks remain
2 the most volatile component of the group's portfolio although these are
3 somewhat limited by the vertical hedge of the UK and Spanish operations
4 and the various hedging and risk-mitigating techniques Iberdrola employs.²⁰

5 Q. HOW DOES MOODY'S VIEW THE BALANCE BETWEEN POSITIVE AND
6 NEGATIVE FACTORS?

7 A. Moody's assigned a Stable outlook to Iberdrola, explaining that:

8 The rating outlook is stable although Iberdrola's ratios are expected to be
9 positioned at the low end of the rating range for the A3 rating category
10 applied for its business risk... Should the company fail to achieve growth
11 targeted, or should negative regulatory or pricing developments affect the
12 company, then pressure could develop on these ratios. Nonetheless,
13 Moody's believes the company is committed to an A3 rating and that it
14 would consider means at its disposal to reinforce its financial position if
15 necessary.²¹

16 The 'A3' rating is equivalent to S&P's 'A-' rating, and Moody's has
17 matched S&P's Stable outlook, signifying relative stability for the medium term.

18 Q. IN ITS RESPONSE TO REQUEST FOR INFORMATION IBER/EE IR NO. 27
19 (EXHIBIT __ (SMF-5), THE POLICY PANEL NOTES THAT IBERDROLA

²⁰ Moody's Global Credit Research: "Credit Opinion: Iberdrola S.A.," December 13, 2007 (attached as an exhibit to the Joint Petitioners' Policy Panel).

²¹ *Id.*

STEVEN M. FETTER

1 CURRENTLY HAS A "CREDIT DEFAULT SWAP-IMPLIED" CREDIT
2 RATING OF Baa1 AND A "DEFAULT PREDICTOR-IMPLIED" CREDIT
3 RATING OF Baa2, BOTH ASSIGNED BY MOODY'S. DOES THIS MEAN
4 THAT IBERDROLA'S MOODY'S CREDIT RATINGS EQUATE TO EITHER
5 Baa1 OR Baa2?

6 A. No, Iberdrola's Moody's credit ratings do not. Moody's has explained that such
7 implied ratings are *not* an input into credit ratings decisions themselves, but rather
8 are functions of comparing its assigned credit ratings to measures calculated as a
9 result of bond and swap market trading levels and certain financial accounting ratios
10 – all for the purpose of providing the investor with as much raw data as the rating
11 agency can. Moody's itself clearly distances the process of assigning its credit
12 ratings from the numerical calculations underlying the two implied "ratings"
13 identified by Staff:

14 **For bond-implied ratings and credit default swap-implied ratings, gaps**
15 **and movements of one or two notches are generally not significant for**
16 **several reasons. First, one notch differences are often attributable to**
17 **"rounding error." At some point, a cutoff must be made for what constitutes,**
18 **for instance, an A2 credit. For credits close to this cutoff, small fluctuations**
19 **in market pricing could drive the market implied rating in line with Moody's**
20 **rating one day and away from it the next.**

21

STEVEN M. FETTER

1 Second, the spreads used to infer bond-implied ratings or credit default
2 swap-implied ratings may be influenced by non-credit factors, such as
3 liquidity risk.

4
5 Third, in many cases, credit spreads and credit default swap spreads are
6 representative indicative quotes that may be an imperfect indicator of a
7 security's likely trading price....

8
9 Moody's analysts use these tools to identify where there are material and
10 systematic gaps between our ratings and the ratings implied by market data
11 or financial accounting ratios. **They use them to inform themselves of how**
12 **their opinions differ from those held by the broader market or those**
13 **generated by purely quantitative models, so that they are prepared to**
14 **clearly articulate the reasons for those differences to market**
15 **participants. Market implied ratings are not, however, an "input" into**
16 **their rating decisions.**

17
18 Market-based measures are inherently volatile and produce many false
19 positives and false negatives. We remain committed to producing opinions

STEVEN M. FETTER

1 that look beyond each day's news to provide much more stable, although
2 equally predictive, measures of long-term credit risk. [Emphasis supplied.]²²

3 Thus, far from pointing to the direction that Iberdrola's credit ratings will be
4 going, the two implied "ratings" identified by the Policy Panel are either
5 insignificant indicators or have led the Moody's analysts to look even more closely
6 at the factors leading the agency to assign an 'A3' rating to Iberdrola with a Stable
7 outlook.

8 Q. THE POLICY PANEL EXPRESSED CONCERN THAT IBERDROLA'S
9 EXTENSIVE CAPITAL INVESTMENT PROGRAM COULD LEAD TO A
10 DOWNGRADE OR MULTIPLE DOWNGRADES (SEE, E.G., PP AT 169). CAN
11 YOU ADDRESS ITS CONCERN?

12 A. As can be seen in the rating agency reports cited above, S&P and Moody's have
13 fully incorporated Iberdrola's strategic plan into their current ratings and outlooks.
14 It is my understanding that Iberdrola has consistently stated its commitment to
15 maintaining an 'A' category rating before and after announcement of its strategic
16 investment plan. The Company's recent steps show that it has strong ability to
17 access the capital markets when necessary, and, indeed, Iberdrola has already issued
18 the equity needed to finance the acquisition of Energy East, as well as concluding a
19 successful IPO that will provide the bulk of the funding needed for the strategic plan.

²² Moody's Products and Services: "Market Implied Ratings: Frequently Asked Questions,"
September 2006.

STEVEN M. FETTER

1 What should be clear is that, if Iberdrola is able to continue its strong past
2 performance and maintain its commitment to having an 'A' category rating, both of
3 which the rating agencies believe the Company can do, S&P and Moody's do not
4 see that the capital investment plan will threaten the stability of Iberdrola's current
5 credit rating level.

6 Q. THE POLICY PANEL WARNS THAT IBERDROLA'S FINANCIAL
7 STANDING COULD HARM NYSEG'S AND RG&E'S ACCESS TO THE
8 CAPITAL MARKETS AND THAT S&P HAS INDICATED THAT RATING
9 DOWNGRADES ARE LIKELY FOR NYSEG AND RG&E IF THE MERGER IS
10 APPROVED (PP AT 167-168). COULD YOU ADDRESS THESE COMMENTS?

11 A. Yes. First, when the merger was announced, both S&P and Moody's affirmed their
12 ratings on Energy East, NYSEG, and RG&E and maintained the existing Negative
13 outlooks -- thus, there was *no change* to the companies' ratings following the
14 transaction's announcement. Second, Iberdrola's 'A-/A3' ratings are higher than
15 those of Energy East at 'BBB+/Baa2' and its subsidiaries at 'BBB+/Baa1'. When
16 you factor in Iberdrola's Stable outlook versus Energy East's and its subsidiaries'
17 Negative outlooks, investors are looking at basically a one-and-a-half notch rating
18 differential between Iberdrola and NYSEG/RG&E and a one-and-a-half to two-and-
19 a-half notch difference between Iberdrola and Energy East. Such differential in
20 ratings is significant. Indeed, in view of Iberdrola's stated commitment to maintain
21 its rating status in the 'A' category, the greater likelihood is that once the merger has

STEVEN M. FETTER

1 been approved and a successful transition has concluded, the affiliation with the 'A-'
2 rated Iberdrola might allow Energy East, NYSEG and RG&E to escape their
3 Negative outlooks and potentially improve their ratings to Iberdrola's level. S&P
4 described such a situation in its 2005 "Corporate Ratings Criteria:"

5 A weak entity owned by a strong parent usually – although not always – will
6 enjoy a stronger rating than it would on a standalone basis. Assuming the
7 parent has the ability to support its subsidiary during a period of financial
8 stress, the spectrum of possibilities still ranges from ratings equalization at
9 one extreme to very little or no help from the parent's credit strength at the
10 other. The greater the gap to be bridged, the more evidence of support is
11 necessary."²³

12 Here, it is important to note that Iberdrola's cash flow coverages are
13 markedly stronger than those of Energy East. For example, for 2006, Iberdrola's
14 FFO interest coverage was 3.9x compared to Energy East at 2.7x. Iberdrola's
15 FFO/Total Debt ratio was 18.5% as compared to Energy East at 14.2%. These

²³ S&P Research: "Corporate Ratings Criteria: Rating Methodology," June 9, 2005. *See also* Moody's Credit Opinion: "Energy East Corporation," December 26, 2007 ("Moreover, if Iberdrola is successful in acquiring EEC and then takes aggressive steps to reduce structural subordination by lowering or eliminating debt at the EEC and/or other operating company levels, then such a strategy could at least help stabilize the outlook for EEC and the rated subsidiaries within the current EEC family. Indeed, depending on the magnitude, such steps might even contribute to higher ratings for some of the lower rated entities in the current EEC family (i.e. those with senior unsecured debt rated Baa1 or lower.").

STEVEN M. FETTER

1 differences are significant and could serve to support improved ratings at Energy
2 East.²⁴

3 Turning to the Policy Panel's following comment about S&P's intentions
4 (PP at 167-168):

5 Q. Have either credit agency indicated specifically that bond rating
6 downgrades for NYSEG and RG&E are likely if the transaction is
7 approved?

8 A. Yes, Exhibit ___ (PP-4) contains two reports from S&P, one for NYSEG
9 and the one for RG&E. These reports express concern over the financial
10 metrics, i.e., the high debt leverage; Iberdrola would exhibit as the
11 ultimate parent of NYSEG and RG&E. These reports also expressed
12 some concern over the last NYSEG rate decision, which lowered the
13 Company's rates. As a result of these concerns and others, S&P has put
14 NYSEG and RG&E on watch for a downgrade if the transaction is
15 completed.

16 I earlier discussed the inaccuracy in the Panel's use of the phrase "watch for
17 a downgrade."

18 Q. DO YOU HAVE OTHER CONCERNS WITH THE STATEMENTS BY STAFF
19 QUOTED ABOVE?

²⁴ S&P Research: "Iberdrola, S.A.," September 18, 2007 (attached to the Staff Policy Panel as Exhibit __ (Policy Panel - 15); S&P Research: "Energy East Corp.," November 14, 2007, attached hereto as Exhibit ___ (SMF-6).

STEVEN M. FETTER

1 A. Yes. Unfortunately, the Staff, in describing the S&P report, explicitly, or, at a
2 minimum, implicitly misleads the Commission with regard to S&P's placement of a
3 Negative outlook on NYSEG and RG&E. That action did not occur upon
4 announcement of the Iberdrola-Energy East merger on June 26, 2007. Rather that
5 action came almost a year earlier, on August 25, 2006, and was "based on the
6 [NYPSC's] decision to approve a one-year rate plan that reduces [NYSEG's]
7 electric delivery rates by \$36.2 million annually starting in January 2007....[a
8 decision that] will pressure credit measures in 2007, which were already expected to
9 be weak for the ratings." S&P concluded, "An outlook revision to stable is not
10 anticipated in the near term, given the need for regulatory relief that is unlikely to
11 occur before 2008."²⁵

12 The announcement of the merger did add nuance to S&P's outlook, but in no
13 way reached the level of a "watch for a downgrade if the transaction is completed."

14 In the November 14, 2007 report cited by the Policy Panel, S&P indicated that:

15 The negative outlook indicates that ratings could be lowered one notch
16 depending on Iberdrola's ultimate financing structure for the acquisition.
17 Moreover, potential regulatory outcomes that could hurt cash flow metrics
18 would precipitate lower ratings. Ratings stability at the current level is
19 highly dependent on a balanced capital approach at Energy East, consistent

²⁵ S&P Research Update: "Energy East and Units Outlook Revised to Negative After New York Regulators Cut Unit's Rates," August 25, 2006.

STEVEN M. FETTER

1 cash flow metrics, and supportive regulatory outcomes. Higher ratings are
2 limited by the company's persistent high debt.²⁶

3 Q. DID MOODY'S EXPRESS A VIEW ON THIS QUESTION?

4 A. Yes, it did. On December 26, 2007, Moody's stated that its Negative outlook on
5 Energy East and its subsidiaries:

6 reflects the consolidated financial and operating challenges that exist within
7 the consolidated family. These challenges primarily result from the outcome
8 of the affiliated NYSEG's general rate case in August 2006 plus the
9 uncertainties about whether the modified fixed price option approved earlier
10 this year by the NYPSC for NYSEG's retail electric customers can provide
11 sufficient impetus for overcoming some of these challenges....In addition,
12 the negative outlook recognizes the aforementioned pending transaction with
13 Iberdrola.²⁷

14 Q. HOW DO YOU READ THE COMMENTS FROM S&P AND MOODY'S IN
15 THESE REPORTS?

16 A. That the clear precipitating event for the Negative outlooks was the August 2006
17 rate order, and that the rating agencies did not see a potential positive resolution to
18 the problem until another rate proceeding could occur, perhaps by 2008. Already
19 existing financial and operating challenges "primarily result[ing]" from regulatory

²⁶ S&P Research: "New York State Electric & Gas Corp.," November 16, 2007.

²⁷ Moody's Global Credit Research: "Credit Opinion: Energy East Corporation," December 26, 2007.

STEVEN M. FETTER

1 risks faced by NYSEG in New York continued to be key to the rating agencies'
2 analyses – through that language, Moody's clearly characterizes this as the primary
3 challenge. The Iberdrola-Energy East merger was laid onto this difficult regulatory
4 situation, and, by necessity, has become part of the rating agencies' overall vigilant
5 posture in light of the possible regulatory action associated with this proceeding,
6 as opposed to the business merits of the transaction. But by no means has S&P or
7 Moody's validated the Policy Panel's statement that NYSEG and RG&E are "on
8 watch for a downgrade if the transaction is completed."

9 Q. WOULD YOU SUPPORT THE POLICY PANEL'S CALL (PP AT 174, 206) FOR
10 THE COMMISSION TO INSIST UPON RING FENCING PROVISIONS AS A
11 CONDITION OF MERGER APPROVAL?

12 A. I would not support such conditions as part of merger approval here based upon
13 ratings or rating agency reports. While effective ring fencing can isolate the risks
14 of individual subsidiaries in a corporate family, the Commission must be mindful
15 that this can cut both ways. Ring fencing can also concentrate risks within
16 subsidiaries of a corporation. For example, a poor regulatory decision or a decline in
17 sales could leave a subsidiary financially reeling without access to the broader
18 corporate safety net. Basically, a financially strong holding company's ability to
19 support a weaker performing subsidiary could be compromised if strong ring fencing
20 were to be put in place.

STEVEN M. FETTER

1 Here, Iberdrola is a global leader among electric utilities. It has a wide
2 geographic reach and significant business operational diversity, including substantial
3 experience interacting with regulators and public officeholders. The Company has a
4 stronger credit profile than Energy East, NYSEG and RG&E, and can access the
5 capital markets – both equity and debt – more easily and upon more reasonable
6 terms. Moreover, one major benefit of such a merger would be the ability to tap into
7 an extensive base of management expertise. In view of all of these beneficial
8 characteristics that Iberdrola brings to the table – and the negative side to ring
9 fencing restrictions discussed above, I believe it would be a mistake to create hard
10 and fast rules restricting, if not prohibiting, financial and operational interaction
11 between Iberdrola and Energy East and its subsidiaries.²⁸

12 **Q. THE POLICY PANEL STATES THAT “THE INVESTMENT COMMUNITY**
13 **[HAS] RENDERED AN ASSESSMENT ON IBERDROLA’S AFFECT ON**
14 **NYSEG AND RG&E” BECAUSE, AS SHOWN ON EXHIBIT PP-19, NYSEG**
15 **ISSUED DEBT 225 BASIS POINTS ABOVE 10-YEAR TREASURIES ON**
16 **NOVEMBER 29, 2007, APPROXIMATELY 30 BASIS POINTS HIGHER THAN**
17 **DEBT ISSUED BY OTHER SIMILAR COMPANIES WITHIN THE SAME**
18 **TIMEFRAME. DO YOU AGREE WITH THIS ASSESSMENT?**

²⁸ See Fetter, Steve, “Perspective: Don’t Fence Me Out,” Public Utilities Fortnightly, October 2004 (“Hard-and-fast ring-fencing rules are not the best way to maintain order in the partially deregulated utility sector.”).

STEVEN M. FETTER

1 A. No, I do not, for the reasons discussed in the rebuttal testimony of the Rate
2 Adjustment Panel.

3 Q. CAN YOU COMMENT UPON THE POLICY PANEL'S BELIEF THAT THE
4 AMOUNT OF GOODWILL AT IBERDROLA WILL HAVE A NEGATIVE
5 EFFECT ON ITS CREDIT RATINGS?

6 A. "Goodwill" is the excess price paid over and above book value of tangible assets.
7 Goodwill has been accumulated on Iberdrola's balance sheet in large part from its
8 acquisition of Scottish Power with more to go on its books upon completion of the
9 pending merger with Energy East. Goodwill is subject to an annual impairment test
10 and is subject to possible write-down, as are all assets, whether tangible or
11 intangible. Goodwill occurs when accounting principles do not allow for write-up of
12 an asset to its apparent true value. Rating agencies do not view Goodwill as a
13 primary indicator of the risk profile of a company, and the lack of focus on Goodwill
14 by S&P and Moody's in their reports on the proposed merger bears this out.

15 Instead, cash flow will be the driver of Iberdrola's ratings, as it will be in the
16 assessment of Goodwill impairment. Accordingly, if Iberdrola is able to maintain its
17 strong operational performance while continuing to properly manage its business
18 risks, which the rating agencies expect it to be able to do, its credit ratings should be
19 stable and the potential for Goodwill impairment should be small. It is only when
20 Goodwill impairment poses a threat to a company's capital structure that rating

STEVEN M. FETTER

1 agencies will focus upon potential negative credit profile effects. The rating
2 agencies have not indicated the need to do so here.

3 Q: IN ITS RESPONSE TO REQUEST FOR INFORMATION IBER/EE IR NO. 51
4 (EXHIBIT __ (SMF-5), STAFF STATES THAT "WHILE NOT MENTIONED IN
5 ANY REPORT, STAFF BELIEVES IT IS NOT A COINCIDENCE THAT
6 IBERDROLA'S GOODWILL HAS RISEN AS ITS CREDIT QUALITY HAS
7 DECLINED," AND THEN DESCRIBES THIS HIDDEN MOTIVE IT HAS
8 UNCOVERED AS "EVIDENCE." "THEREFORE," THE STAFF CONCLUDES,
9 "EVIDENCE INDICATES THAT GOODWILL IS PLAYING A ROLE IN THE
10 CREDIT QUALITY DECLINE OF IBERDROLA." DO YOU AGREE WITH
11 THIS CONCLUSION?

12 A: No, I do not. Rating agencies do not base reported credit ratings on factors that are
13 not mentioned in their reports. They explain the strengths and weaknesses
14 underlying a company's credit ratings as has been fully explored within the agency
15 reports and the testimony in this case. If Goodwill was the driver of a credit profile
16 decline for Iberdrola or any other rated entity, all three rating agencies would
17 mention it, rather than none.

18 Q: STAFF SUGGESTS THAT GOODWILL BE TREATED AS SIMILAR TO DEBT
19 LEVERAGE (PP AT 255). DO YOU AGREE WITH THIS SUGGESTION?

STEVEN M. FETTER

1 A: No, I do not. Goodwill is not debt and it should not be treated as such. Goodwill is
2 not included in a rating agencies' calculation of debt leverage,²⁹ just as it is not
3 included in a regulatory commission's assessment of capital structure as it relates to
4 ratemaking activities. As I stated above, it is only when Goodwill impairment poses
5 a threat to a company's capital structure that rating agencies will focus upon
6 potential negative credit profile effects, though they still do not treat impaired
7 Goodwill as debt.

8 Q. THE POLICY PANEL'S RATEMAKING AND RATINGS DISCUSSIONS
9 HAVE A HEAVY FOCUS ON IBERDROLA'S CAPITAL STRUCTURE. DO
10 THEIR ARGUMENTS CAUSE CONCERN FOR YOU?

11 A. I believe that focus is misplaced. First, NYSEG and RG&E will maintain a capital
12 structure that is regulated by the NYPSC. At the same time, these utilities could
13 benefit from the higher credit ratings at Iberdrola. Indeed, over time, all other things
14 being equal, the superior ratings and financial standing of Iberdrola should have a

²⁹ For example, S&P defines Total Debt to Total Capitalization as "Long-term debt (including amount for operating lease debt equivalent) plus current maturities, commercial paper, and other short-term borrowings" divided by "Long-term debt (including amount for operating lease debt equivalent) plus current maturities, commercial paper, and other short-term borrowings plus shareholders' equity (including preferred stock) plus minority interest." See S&P Research: "Corporate Ratings Criteria," 2000. Similarly, Fitch defines "Debt as % of Total Capitalization" as "Total debt (short- and long-term debt), including debt of financing trusts or debt supporting trust preferred securities, plus current portion of long-term debt and capitalized lease obligations" divided by "Total debt (short- and long-term debt), including debt of financing trusts or debt supporting trust preferred securities, plus current portion of long-term debt and capitalized lease obligations plus preferred and preference stock plus common equity." See Fitch Research: "U.S. Electric and Gas Financial Peer Study," May 2007.

STEVEN M. FETTER

1 positive impact on the credit ratings of Energy East and its two regulated
2 subsidiaries.

3 As for how Iberdrola's capital structure could affect its ratings, I emphasize
4 again that the primary concern of both rating agencies and investors is the ability of
5 an issuer to pay interest and principal when due. As a result, and as explained
6 above, the most important quantitative metrics in the ratings process are cash flow
7 measures that relate directly to such ability to meet financial commitments on a
8 timely basis. Such focus can clearly be seen in the rating agencies' reactions to the
9 NYPSC's August 2006 rate order for NYSEG. The Negative outlooks that were
10 placed on Energy East and its subsidiaries in August 2006 were driven by the cash
11 flow implications of the Commission decision. Energy East's capital structure was
12 unaffected by that rate order, and subsequently, in March 2007, Energy East's
13 capital structure was improved through the issuance of 10 million shares of common
14 equity. Yet the Negative outlooks remain – and the rating agencies remain focused
15 on Energy East's cash flow.

16 Finally, on December 13, 2007, both S&P and Moody's indicated comfort
17 with Iberdrola's debt level. Moody's stated that steps Iberdrola has taken related to
18 its Scottish Power and Energy East acquisitions, and divestments including its
19 successful IPO "should allow the company to stay within its leverage target of

STEVEN M. FETTER

1 50%.³⁰ S&P on that same day said that the proceeds from the IPO “will enable the
2 group to maintain gearing below 50%.”³¹

3 **CONCLUSION**

4 Q. DO YOU HAVE CONCLUDING THOUGHTS?

5 A. Yes. The concept of utility regulation is to provide a surrogate for the
6 competitive market that is not present when a company possesses monopoly or
7 near-monopoly status with regard to an essential good, such as utility service.
8 Based on my experience as a state regulator, it is not the purpose of regulators to
9 step into the shoes of management and make strategic business decisions. Nor is
10 it the role of regulators to usurp the function of the major rating agencies and
11 determine likely rating impacts different than those highlighted by the agencies.
12 The Staff Policy Panel attempts to do both of these things here. The NYSPSC
13 should focus on preserving the financial and operational health of the two
14 regulated utilities within its jurisdiction. That decision is easier here than in most
15 cases because Iberdrola has indicated its intent to take the necessary steps to
16 maintain both the financial standing and operational reliability of NYSEG and
17 RG&E on a going forward basis, after the merger has been consummated.
18 Moreover, in addition to that intent, Iberdrola, as one of the most preeminent and

³⁰ Moody’s Global Credit Research: “Credit Opinion: Iberdrola S.A.,” December 13, 2007.

³¹ S&P Research Update: “Spain’s Iberdrola Affirmed at ‘A-/A-2’ on IPO Completion; L-T Rating Off Watch; Outlook Stable,” December 13, 2007.

STEVEN M. FETTER

1 respected utility holding companies in the world, also possesses the wherewithal
2 to deliver on those promises.

3 Q. DOES THIS CONCLUDE YOUR TESTIMONY?

4 A. Yes it does.

5

1 BY MR. JARED JOHNSON:

2 Q. Mr. Fetter, turning to your exhibits. Were the following
3 exhibits prepared by you or under your direction or provided by
4 another party in response to an information request or
5 interrogatory in this proceeding: Exhibit SMF-1, your curriculum
6 vitae, Exhibit SMF-2, an SMP research publication entitled, "US
7 Electric Utility Companies: strongest to weakest," Exhibit
8 SMF-3, an SMP research report entitled, "US Utilities Ratings
9 Analysis Now Portrayed in the S&P Corporate Ratings Matrix,"
10 Exhibit SMF-4, Moody's report, entitled, "Moody's Downgrades
11 Iberdrola to A3P2 Stable Outlook," Exhibit SMF-5, a Staff --
12 Staff responses to IBER/EEIR Number 27 and IBER/EEIR Number 51.
13 And finally, Exhibit SMF-6, an SMP research report entitled,
14 "Energy East Corporate" dated November 16, 2007?

15 A. Yes, I prepared all those or with regard to the data
16 requests, they were Staff responses.

17 MR. JARED JOHNSON: Thank you.

18 Your Honor, may we have these exhibits marked for
19 identification.

20 JUDGE EPSTEIN: Yes, those will be 64 through 69.

21 (Exhibits 64 through 69 marked for identification.)

22 MR. JARED JOHNSON: Thank you, Your Honor. The
23 witness is now available for cross-examination.

24 CROSS EXAMINATION

1 BY MR. VAN RYN:

2 Q. Good afternoon.

3 A. Good afternoon.

4 Q. Could you turn to page 22 of your testimony.

5 A. I am there.

6 Q. And you state that Iberdrola has coverage -- you state
7 that Iberdrola has coverage ratios commensurate with an A rating;
8 is that correct?

9 A. Yes. I cite reports from S&P and Moody's to that effect.

10 Q. And if you look at page 33 of your testimony you say that
11 Iberdrola has an FFO interest coverage of 3.9 times and FFO total
12 debt of 18.5 percent; is that correct?

13 A. That was for 2006.

14 Q. Subject to check would you accept that Standard & Poor's
15 guidelines for an A rating are FFO interest coverage of 4.25
16 times and FFO total debt of 27 percent?

17 A. Which document are you referring to?

18 Q. Standard & Poor's Harvard ratings criteria for power
19 companies.

20 A. What year was that done?

21 Q. You can find it at Staff policy panel 15.

22 A. I think I saw it. I didn't see a date on it. I was
23 wondering if you have the entire document.

24 MR. JARED JOHNSON: Your Honor, could we take a

1 minute to get a copy of the document to the witness.

2 MR. VAN RYN: Sure.

3 A. I found it and I note that I don't see any date on the
4 document.

5 MR. VAN RYN: Staff will have to supply that, Your
6 Honor. The witness also points out it's policy panel 17 -- Staff
7 policy panel 17.

8 Q. Would you compare the interest coverage and total debt
9 figures for Iberdrola to those shown on the chart on page 33 and
10 give us your conclusions.

11 A. Well, as I mentioned in my testimony, a date for this
12 document would be very important because on November 30th, 2007
13 S&P issued a new document and moved away from its prior ranges
14 for financial ratios.

15 Q. That was for domestic companies?

16 A. It was for -- actually it was for domestic and -- yes,
17 it's for domestic utility companies. And I believe it's one of
18 the exhibits to my testimony.

19 Q. Do you believe that would apply to a European company?

20 A. As I mentioned in regard to a data request, since
21 November 30th, 2007 I have not seen that S&P has provided any
22 ranges for a European utility company.

23 What I can say is that in December S&P issued a
24 report in which it noted the financial ratios for Iberdrola and

1 indicated that they were consistent with the A rating as I noted
2 in my testimony.

3 Q. Returning to the question: Can you compare the financial
4 standards you gave us to the ones on this chart?

5 A. The ones from 2006?

6 Q. Yes.

7 A. One can take those dated numbers and compare them to a
8 dated report. I think it's much better to take more recent
9 numbers from December and -- within the same document take S&P's
10 opinion on what those numbers mean.

11 MR. VAN RYN: Your Honor, I have here a recent
12 credit analysis from Moody's for Iberdrola dated February 2008.
13 I would like it marked for identification.

14 JUDGE EPSTEIN: 70.

15 (Exhibit 70 marked for identification.)

16 Q. Could you turn to page 12.

17 A. I am there.

18 Q. There it states, "The financial risk profile for
19 Iberdrola is expected to stay weakly positioned for its rating
20 category."

21 A. Can you direct me to the paragraph.

22 Q. It says it in the heading.

23 A. That's what the heading says.

24 Q. Please turn to page 5 of your testimony.

1 A. Of my testimony?

2 Q. Yes.

3 A. I am there.

4 Q. On there it appears you are critical of Staff's statement
5 that credit ratings are snapshots of the Company's existing
6 circumstances; is that correct?

7 A. I am critical of that statement.

8 MR. VAN RYN: Your Honor, I would like marked for
9 identification a document containing two articles on the snapshot
10 character of credit company ratings.

11 JUDGE EPSTEIN: 71.

12 (Exhibit 71 marked for identification.)

13 Q. The first of these articles beginning on page 1 is from
14 the New York Times and the second beginning on page 3 is from the
15 Wall Street Journal.

16 Do these articles relate to recent problems in the
17 subprime mortgage market?

18 If you could look down four paragraphs --

19 A. On the first page?

20 Q. -- on the first page to the last sentence in that
21 paragraph. Could you read that for us?

22 A. Read the fourth paragraph?

23 Q. The last sentence in the fourth paragraph, "In recent
24 months?"

1 A. "In recent months the agencies have quickly, though
2 critics say belatedly, downgraded hundreds of mortgage bond
3 ratings."

4 Q. Would you say that quickly and belatedly indicates that
5 sometimes credit ratings are just a snapshot of the
6 circumstances?

7 A. No. I still -- for the reasons I give in my testimony I
8 do not view them as snapshots and I don't think this sentence
9 indicates that.

10 I think this sentence indicates that with regard to
11 the subprime or the mortgage bond ratings the agencies, through
12 engaging additional information and perspective, determined that
13 they should downgrade a large number of those types of
14 securities.

15 Q. Could you please turn to page 7 of the document.

16 A. Is it the one with 7 at the bottom?

17 Q. Yes.

18 A. I am there.

19 Q. If you could read the last sentence in quotations on that
20 page.

21 A. I lost where you want me to go.

22 Q. The very last sentence on the page begins with a
23 quotation mark.

24 MR. JARED JOHNSON: Your Honor, I ask--if the

1 witness needs a minute to put this in context I ask that he have
2 that before he starts reading quotations.

3 MR. VAN RYN: Sure. He can have as much time as he
4 likes to read it and think about it.

5 A. The last sentence on page -- my page 7 is not in quotes.

6 JUDGE EPSTEIN: Is it the "despite then" that's on
7 the bottom of page 7?

8 MR. VAN RYN: Yes, I believe it is, Your Honor.

9 JUDGE EPSTEIN: Okay. That's the penultimate
10 sentence on the bottom of page 7.

11 MR. VAN RYN: Guess what, I am wrong. Thank you for
12 the correction.

13 A. I am still trying to get my hands around penultimate.

14 I am reading the whole paragraph for perspective
15 before I say anything aloud.

16 Q. Thank you.

17 A. Now, what do you want me to read?

18 Q. If you could read the sentence in quotations.

19 A. "Despite all that data your original predictions with the
20 performance of 2006 loan pools have proven to be completely and
21 utterly wrong."

22 Q. Do you believe that indicates sometimes credit ratings
23 are just a snapshot of current conditions?

24 A. No. I -- for the same reason I gave before, which is the

1 rating agencies getting additional information and new
2 perspective and made changes to ratings which are not a snapshot
3 in time, it represents their new perspective with regard to these
4 unusual instruments going forward.

5 Q. From time to time it's correct that companies made
6 presentations to credit rating agencies like S&P's and Moody's;
7 is that correct?

8 A. That's an accurate statement.

9 Q. Do you have available to you the most recent
10 presentations that Iberdrola has made to Moody's and S&P's?

11 A. I don't believe so.

12 MR. VAN RYN: Your Honor, I would like to make a
13 transcript request for those if there have been any since the
14 last the Company supplied to us. There may not be.

15 MR. SCHWARTZ: Your Honor, I don't know if Iberdrola
16 fully understands what's being requested here and the relevance
17 for it. Is the question whether there are ratings agencies
18 presentations that deal with Energy East?

19 MR. VAN RYN: No, Iberdrola's overall credit rating.

20 I think all we are asking here is if they've made
21 any presentations that have changed anything in the prior
22 presentation Staff has seen.

23 MR. SCHWARTZ: We could certainly agree to identify
24 any changes.

1 MR. VAN RYN: Thank you. I have nothing further,
2 Your Honor.

3 MR. MAGER: I do.

4 JUDGE EPSTEIN: Mr. Mager.

5 BY MR. MAGER:

6 Q. You indicated previously that rating agencies often will
7 meet with the utilities that they evaluate. Is that what you
8 testified to?

9 A. Yes, along with meeting with regulators and Staff and
10 basically any individuals who can provide the rating agency and
11 its analyst with relevant information.

12 Q. Okay. And so when a rating agency discusses a utility's
13 strategy, for instance, it's likely that that information has
14 come from the utility itself in many cases?

15 A. Usually the utility will make a presentation and then the
16 rating agency individuals will ask questions or request
17 additional information, but the Company would make a
18 presentation.

19 Q. Could you look at what's been marked as Exhibit 70, which
20 is a Moody's document, which I believe you have in front of you.
21 It was marked during the cross-examination by Staff.

22 A. Yes.

23 Q. That's that document.

24 A. I have that.

1 Q. And that was published by Moody's in February of 2008?

2 A. Yes. That's my understanding.

3 Q. And can you turn to page 10 of that document.

4 A. I am there.

5 Q. When there is a section that says "North America," the --
6 Moody's is defining Energy East Corporation as EEC; is that
7 correct?

8 A. Yes.

9 Q. Now, the third paragraph under that heading it states,
10 "The acquisition of EEC, a group of regulated gas and electric
11 utility companies in the northeastern of the USA, will reinforce
12 Iberdrola's position in the US following its acquisition of the
13 US renewables unit PPM from Scottish Power and will provide it
14 with a taxable income which it can utilize in its US renewables
15 business which is supported by certain tax incentives."

16 Do you see that?

17 A. I see that paragraph.

18 Q. Is that indicative of information that the credit rating
19 agency is likely to get from the utility?

20 A. I'll read it again, if that's okay.

21 Q. Certainly.

22 A. Now, could I hear the question again.

23 Q. Certainly. Is that type of information indicative of the
24 information that a rating agency is likely to get from the

1 utility?

2 A. Well, this paragraph includes kind of two concepts
3 related to your question. The first is with regard to the
4 specifics they would get that kind of information during a
5 presentation.

6 With regard to whether it will reinforce, a Company
7 might offer its opinion with what certain facts will lead to, but
8 the rating agency has to agree and be comfortable before they
9 would put it out as their opinion.

10 Q. So, when Moody's suggests that the acquisition of Energy
11 East may provide it with taxable income which it can utilize in
12 its renewables business, that information not only likely would
13 have been provided by Iberdrola but also Moody's would have to
14 agree with that assessment?

15 A. Well, I was thinking more about the phrase, will
16 reinforce as more of an opinion as opposed to provide it with a
17 taxable income which it can utilize in its US renewables business
18 which is supported by certain tax incentives.

19 I would view that phrase as more factual as opposed
20 to opinion. And so I would guess that is information that would
21 have been provided. And as long as Moody's does not have a
22 reason to believe it's not accurate would include in its report.

23 Q. How timely are these reports usually?

24 A. What do you mean by "timely"?

1 Q. This is published in February 2008 at some point. Would
2 that be -- they would rely on, I am guessing, pretty recent
3 information and communications with the utility to prepare this?

4 A. There is usually at least a couple of presentations a
5 year. And if in a situation like this with a major acquisition
6 there might be more, but there are certainly ongoing interactions
7 by phone and that sort of thing.

8 And so I would expect that Moody's had put out a
9 report that I believe is one of my exhibits in December. And now
10 it's published. This is February. And this is much more
11 substantial than the two or three pages in December.

12 So I would expect they did a lot of research and
13 interaction with Iberdrola in order to bring this report up to
14 publishing standards.

15 MR. MAGER: Thank you. I have nothing further, Your
16 Honor.

17 JUDGE EPSTEIN: Mr. Brew.

18 MR. BREW: Thank you. Just to follow up on this,
19 Mr. Fetter.

20 BY MR. BREW:

21 Q. Would a draft like this be vetted with the utility for
22 accuracy?

23 A. Back when I headed the Fitch group we'd provide a draft
24 to make sure it's factually correct, but we would not let an

1 issuer edit our opinions.

2 Q. Right, but the statement you just talked about in terms
3 of the taxable income, statements like that would be checked for
4 factual accuracy?

5 A. When I was at Fitch we did it. I would expect Moody's
6 would do the same thing.

7 MR. BREW: Thank you.

8 JUDGE EPSTEIN: Further cross? Redirect?

9 MR. JARED JOHNSON: Your Honor, I would just like to
10 ask for a minute.

11 JUDGE EPSTEIN: Sure.

12 MR. JARED JOHNSON: I just have a couple of
13 questions.

14 REDIRECT EXAMINATION

15 BY MR. JARED JOHNSON:

16 Q. Mr. Fetter, Staff asked you a question from a Moody's
17 2008 credit report regarding Iberdrola. Do you still have that
18 in front of you?

19 A. I do.

20 Q. On page 12 you were referred to a heading that says
21 "Financial Risk Profile Is Expected To Stay Weakly Positioned For
22 Its Rating Category," which might suggest that Iberdrola's credit
23 rating could soon be revisited downward.

24 Could you explain how you interpret that?

1 A. In fact, it's interesting because from just the heading
2 it would appear what you said, Mr. Johnson, that we are looking
3 at a downward step soon to come.

4 But when you actually read the section under that
5 heading it leads to a very different conclusion. Near the bottom
6 of the page starting with the words "Moody's notes" -- and I'll
7 just read from there, "Moody's notes, however, that the Company
8 is large and diversified which should help mitigate the commodity
9 and regulatory risks in its portfolio."

10 And then it goes on to say, The Company has stated
11 that it is committed to an A3 rating, and then Moody's offers its
12 opinion that the Company has demonstrated a judicious use of
13 equity to fund its acquisitions and has also committed to
14 maintain a leverage of 50 percent. We therefore believe that it
15 will use reasonable means at its disposal if necessary to
16 maintain an A3 rating profile.

17 And in fact, earlier in the report the same idea was
18 introduced by Moody's on page 4 under the section entitled, "Key
19 Rating Consideration." The very last phrase under that section
20 states, "Moody's would expect the Company to use means at its
21 disposal to maintain its financial targets and its commitment to
22 a rating in the A category."

23 And I know that that has been a theme that Moody's
24 has stated over the last year or two with regard to the Company's

1 commitment to the A category.

2 Q. Thank you. Just one other question. Turning to page 11
3 of the Moody's report. At the top of that page there is a
4 paragraph which discusses the negative outlooks for Energy East
5 and it also discusses -- has some discussion regarding the
6 proposed transaction.

7 Could you comment on your view of what this part of
8 the Moody's report says about the relative financial health of
9 Iberdrola and its ratings as compared to Energy East?

10 A. In fact, Mr. Johnson, with regard to the part of your
11 question about this proposed transaction, let me start on page 12
12 and then return to page 11.

13 On page 12, in the next to last paragraph on the
14 page, is the statement, "The rating, which is the A3, also
15 factors in completion on the EEC transaction but does not assume
16 acceptance of unduly harsh conditions related to regulatory
17 approval of the transaction nor to the current rate review which
18 EEC and its subsidiaries are undergoing."

19 So it's clear Moody's is focusing on what kind of
20 regulatory conditions might come out of this review. And they
21 give as an example on page 11 some of the negative ramifications
22 that can come out of a nonsupportive regulatory decision.

23 That's the very first sentence on page 11. "The
24 negative outlooks for EEC and its subsidiaries reflect in part

1 the financial and operating challenges resulting from a
2 surprisingly unfavorable decision NYSEG received in its general
3 rate case decided in August 2006."

4 MR. JARED JOHNSON: Thank you, Mr. Fetter.

5 Your Honor, that's all I have on redirect.

6 JUDGE EPSTEIN: Anything further?

7 MR. VAN RYN: I have nothing further, Your Honor.

8 JUDGE EPSTEIN: Okay. Thank you, Mr. Fetter. You
9 are excused.

10 We will reconvene if it's agreeable to everyone at
11 9:00 a.m. tomorrow in the third-floor hearing room. And as I
12 mentioned, we are obligated to clear out this room tonight. The
13 third-floor hearing room is secured to the same extent as this
14 one. In other words, it's locked except for the cleaning crew.
15 If you need more secure arrangements than that I can discuss that
16 with you.

17 (Hearing adjourned.)

18
19
20
21
22
23
24

INDEX OF WITNESSES

	Direct	Cross	Red	Rec
Azagra, Laurito, Rude	464	587	717	727
Radigan	704			
Fetter	733	780	791	

INDEX OF EXHIBITS

Exhibit	Marked
42 JPP-1	587
43 JPP-2	587
44 JP-3	587
45 JPP-4	587
46 JPP-5	587
47 JPP-6	587
48 JPP-7	587
49 JPP-8	587
50 JPP-9	587
51 Maine Order	588
52 Maine Stipulation	588
53 Main Bench Analysis	589
54 Appendix from Bench Analysis	595

1	55	Response Iber 203	598
2	56	Response Iber 227	598
3	57	Response Iber-8-S	601
4	58	Market Watch article	602
5	59	Confidential document	
6	60	Response Iber-0228	688
7	61	Letter dated 4/27/07 from Laurito	689
8	62	Article - Electricity trends in New York Compared to trends in price regulated states	717
9	63	Response Iber-0157	reserved
10	64	SMF-1	779
11	65	SMF-2	779
12	66	SMF-3	779
13	67	SMF-4	779
14	68	SMF-5	779
15	69	SMF-6	779
16	70	Moddy's analysis for Iberdrola 2/08	782
17	71	Credit Company Ratings articles	783

18

19

20

21

22

23

24