comments

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September 28, 2001

via UPS and e-mail

Hon. Janet Hand Deixler
Secretary
Public Service Commission
of the State of New York
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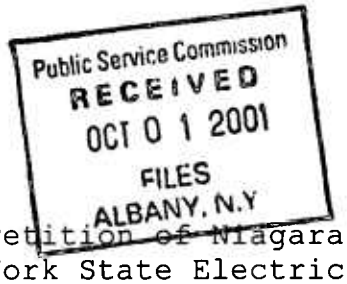
Albany, New York 12223



Re: Case 01-E-0011 - Joint Petition of Niagara Mohawk Power Corporation, New York State Electric & Gas Corporation, Rochester Gas & Electric Corporation, Central Hudson Gas and Electric Corporation, Constellation Nuclear, LLC and Nine Mile Point Nuclear Station, LLC for Authority Under Public Service Law §70 to Transfer Certain Generating and Related Assets and for Related Approvals

Dear Secretary Deixler:

Enclosed please find an original and twenty-five (25) copies of "Reply Comments on Behalf of Central Hudson Gas & Electric Corporation in Response to Comments in Opposition to Joint Proposal" for filing in the above-referenced proceeding.

Copies have been served on the parties on the active party list.

Respectfully submitted,

Robert J. Glasser

RJG:cw
Enclosures
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cc: Hon. William Bouteiller (UPS and email)
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STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

Joint Petition of Niagara Mohawk Power Corporation, New York State Electric & Gas Corporation, Rochester Gas and Electric Corporation, Central Hudson Gas & Electric Corporation, Constellation Nuclear, LLC and Nine Mile Point Nuclear Station, LLC for Authority under Public Service Law Section 70 to Transfer Certain Generating and Related Assets and for Related Approvals.	:	Case 01-E-0011

REPLY COMMENTS ON BEHALF OF
CENTRAL HUDSON GAS & ELECTRIC CORPORATION
IN RESPONSE TO COMMENTS
IN OPPOSITION TO JOINT PROPOSAL

These Reply Comments are submitted on behalf of Central Hudson Gas & Electric Corporation ("Central Hudson") in accordance with the schedule established in the September 18, 2001 Notice Inviting Comments On The Joint Proposals Concerning Niagara Mohawk Power Corporation, Rochester Gas and Electric Corporation, and Central Hudson Gas & Electric Corporation. These Reply Comments are limited to responding to such portions of the September 25, 2001 "Comments of Eliot Spitzer Attorney General of the State of New York Regarding Settlement Proposals" ("OAG Comments"), the letter from Mr. John J. Mavretich to the Secretary on behalf of the Honorable Maurice D. Hinchey, ("Hinchey/Mavretich Letter") and the September 25, 2001 letter to the Secretary on behalf of New York State Electric and Gas Corporation ("NYSEG Letter"), as relate to Central Hudson's interests in this proceeding.

OAG Comments

The OAG Comments incorrectly define stranded costs, assert that Central Hudson has such incorrectly defined stranded costs and demand that the Commission exact some $200-300 million from Central Hudson's shareholders. In addition, the OAG Comments incorrectly attribute to the Central Hudson Joint Proposal a provision that it does not contain, and the OAG claims that the disposition of the costs of the Power Purchase Agreement should not be determined in the instant Joint Proposals but in separate rate cases.

A. Stranded Costs

The OAG incorrectly asserts (OAG Comments at 4) that "the four regulated utilities owning interests in Nine Mile auctioned off those interests for a sale price lower than each utility's remaining book value reflecting the costs of building the plants." OAG is wrong and the OAG knows that it is wrong as related to Central Hudson. On the very next page of its comments, the OAG acknowledges that Central Hudson paid off its NMP2 plant costs. In fact, Central Hudson's current book costs for NMP2 are zero today, have been zero since the end of January, 2001 and will be zero when the Closing takes place.

With respect to stranded costs, the OAG states that "[t]he difference between the sale price and the cost of each utility's interest [in NMP2] is a loss, commonly referred to in utility

regulation as a 'stranded cost.'" As noted above, the OAG's application of this definition to Central Hudson is incorrect. Central Hudson's cost of NMP2 is zero so that Central Hudson will realize a gain, not a loss on the sale of NMP2. Furthermore, the true definition of strandable costs is those costs that may not be recoverable in the market.[1] Given that Central Hudson has already recovered its generation costs (both fossil and NMP2) from the market, it is obvious that Central Hudson has no strandable costs and no stranded costs.

In addition, the OAG seeks to apply its definition on an asset by asset basis and thus attempts to hold utility investors responsible as insurers of the economic viability of <u>each</u> generating plant investment, viewed in isolation. As Central Hudson has explained previously,[2] the Commission has twice rejected this concept, which was earlier called the "economic loss" theory, including specifically rejecting its application to NMP2. The OAG offers no basis for believing that the discredited "economic loss" theory could now be retroactively applied to NMP2 with any legitimacy.

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[1] In contrast to the OAG's attempt at a "definition," the Commission's web site contains the following definition of stranded costs: "Prudent costs that a utility has an obligation to pay for (*e.g.*, long-term contracts or payments on a generation plant) that may not be recoverable due to obsolescence or market changes."

[2] See, March 6, 2001 Letter herein on behalf of Central Hudson Gas & Electric Corporation, at 7-12.

The OAG objects to the application of the proceeds from Central Hudson's fossil plant auction to write off Central Hudson's NMP2 book costs, but in addition to being misplaced, this objection comes too late. This specific use of the fossil plant sale proceeds to eliminate Central Hudson's NMP2 plant costs was accepted, adopted and approved by the Commission in Opinion No. 98-14 and again in the Commission's (January 25, 2001) Order Clarifying Prior Order in Case 96-E-0909. The extent to which Central Hudson's "...customers have a claim on the ...profits from the sale of utility assets..." was thus resolved in 1998, ratified in January of this year and is not open for re-litigation here.

Contrary to the OAG Comments (at 6-7), Central Hudson is not asking "...the Commission to confirm that the utility may retire its Nine Mile Two costs by keeping the profits from the sale of other power plants instead of returning those profits to customers." The use of the fossil auction gain to eliminate Central Hudson's NMP2 book costs has already happened and Central Hudson neither requested, nor requires, any further approval. The accounting referred to in the instant Joint Proposal is obviously based on the fact that Central Hudson's NMP2 book costs have already been eliminated, but Central Hudson has not asked and has no reason to ask the Commission to approve the NMP2 write-off in the Joint Proposal because the Commission has already approved it.

The OAG's confused reference (OAG Comments at 9) to the ALJ's Recommended Decision in the pending Central Hudson rate cases adds nothing. That RD is currently before the Commission for de novo review and a Joint Proposal settling all issues is also before the Commission currently. The instant Joint Proposal in the present case, however, invokes no debate over the Commission's authority.[3]

B. Power Purchase Agreement

The OAG states that the instant Central Hudson Joint Proposal calls for a "proposed true-up mechanism[]" (OAG Comments at 11) and asserts that the rate treatment for the Power Purchase Agreement "is better addressed in the utilities' [sic] rate proceedings..." (Id.). It appears that the OAG has not read the instant Central Hudson Joint Proposal, which specifically calls for implementation of the treatment identified in the Joint Proposal developed in the pending Central Hudson rate cases, Cases 00-E-1273 and 00-G-1274. Moreover, Central Hudson's rate case Joint Proposal does not employ a "true up mechanism" of the

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[3] Central Hudson sold its fossil plants in reliance upon the Restructuring Settlement Agreement that was accepted and adopted by the Commission as its own in Opinion No. 98-14 and the Commission accepted that performance. Both Central Hudson and the Commission have ratified the terms of the Restructuring Settlement Agreement by their conduct. While Central Hudson has had no reason to challenge the Commission's authority in these circumstances, in fact, it is the OAG which seeks to re-litigate these long-settled agreements (after Central Hudson fully performed). It is, however, inconceivable that these arrangements are open to the after the fact alterations that the OAG seeks belatedly to impose.

type included in the Niagara Mohawk and RG&E Joint Proposals in the instant proceeding. Finally, the OAG was a party to the 1273 and 1274 cases, has already submitted comments to the Commission on the Joint Proposal in those cases and should not be heard to re-litigate the rate case Joint Proposal here.

Hinchey/Mavretich Letter

The Hinchey/Mavretich Letter attempts to attack the three Joint Proposals by relying on statements by the Staff Policy Panel that Staff itself has pulled back from as part of the settlements reflected in the Joint Proposals.[4] For example, while the Hinchey/Mavretich Letter alleges Staff identifies "adverse economic impacts associated with the NMP units" (Letter at 3), the fact is that the Staff itself now supports the Joint proposals as reflecting a sound and proper resolution of the proceeding.[5]

The law favors settlement. Allowing Hinchey/Mavretich (as non-settling parties) to attack a settlement on the basis of a settling party's litigation position inevitably chills the settlement process and is counter-productive. It is also inappropriately presumptuous for Hinchey/Mavretich (as non-

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[4] As reflected, for example in Part III.B of the Central Hudson Joint proposal (at 13-14), the Staff and Central Hudson have agreed to cease the litigation of this matter between them.

[5] As Staff has stated in its September 25, 2001 Statement in Support (at 6), the Joint Proposal's provisions "contains numerous provisions that benefit ratepayers and fairly resolves the long-simmering, contentious issues relating to Central Hudson's interest in NMP2."

settling parties) to "impeach" Staff's willingness to accept a settlement through quoting back Staff's earlier litigation position, as if to imply that there is something inherently improper in a party's compromise of its litigation position to achieve a settlement.[6]

The Hinchey/Mavretich Letter is based on the same flawed and discredited "economic loss" concept that is relied upon by the OAG, as discussed above. The Hinchey/Mavretich Letter (at 4) suggests that the Commission engage in an imaginary "conversation" in which it would repudiate its earlier rejection of the economic loss concept and now retroactively apply it to NMP2. The Hinchey/Mavretich Letter, as part of its suggestion, brings forth an assessment of the economics of NMP2 that is incorrect, and as imaginary as the "conversation" the Letter conjures. It is also entirely irrelevant. This proceeding is not about embroiling the parties in an after the fact study of the economic success of NMP2.[7] The Commission has already decided that, as matter of policy, generating units should generally be sold by the former vertically integrated utilities

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[6] Staff itself recognized that it faced litigation risk (Statement in Support at 6) and after due deliberation chose settlement. Hinchey/Mavretich (as non-settling parties) should not have the luxury of impugning a settlement merely because another litigant's joinder in the settlement eliminated the coattail they were attempting to ride.

[7] Central Hudson has previously moved for an order so concluding, which motion remains unresolved.

and the Commission specifically called for an auction of NMP2.[8]

In Central Hudson's case specifically, the Commission and Central Hudson agreed that using the proceeds from the sale of Central Hudson's fossil generating plants to write down/write off its NMP2 costs represented suitable "mitigation" for strandable costs. In fact, strandable costs were not merely reduced by Central Hudson, they were eliminated and significant net benefits to customers remain after eliminating strandable costs.[9] Unsatisfied by Central Hudson's elimination of strandable costs, or by the hundreds of millions of dollars in additional customer benefits that Central Hudson produced, Hinchey/Mavretich (and the OAG) greedily demand that Central Hudson's shareholders be forced to contribute apparently an additional $200-300 million to customers. Their positions are particularly unreasonable as applied to Central Hudson and should be rejected.

NYSEG Letter

The September 25, 2001 letter refers to the potential that NYSEG has reached a settlement of this matter. As of September 27, 2001, NYSEG advised the parties that, in fact, such

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[8] See, Order of April 25, 2000 in Case 99-E-0933.

[9] The Hinchey/Mavretich Letter and the OAG's Comments (OAG Comments at 3, 6-7) employ sophistry to suggest that Central Hudson's Joint Proposal, which does not call for any future recovery of revenues from customers to amortize a "regulatory asset" related to stranded NMP2 plant costs, is the same as the Niagara Mohawk and RG&E Joint Proposals, which both call for the future recovery from customers of significant revenues to amortize quantified "regulatory assets."

settlement has been reached. Nonetheless, NYSEG has not withdrawn its September 25, 2001 letter, nor indicated an intention of doing so, and it is therefore necessary that Central Hudson set forth for the record its objections to NYSEG's position in that September 25, 2001 letter.

The NYSEG letter asks the Commission to order Constellation to enter into a new operating agreement with NYSEG for NMP2.[10] That request is relevant only in the event that NYSEG were to continue to be an owner of NMP2,[11] but NYSEG has not explained either how, presuming Commission approval of the settlement reflected in the NYSEG/Staff Joint proposal, it can remain an owner of NMP2 or why it might be in its customers' interests for it to do so.

Central Hudson submits that NYSEG's request should not be entertained by the Commission.

First, the premise of NYSEG's request is inconsistent with the premise of the NYSEG/Staff Joint Proposal.

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[10] It should be noted that it is questionable whether Constellation, a non-jurisdictional entity that does not currently own any utility property in New York, could be ordered to enter into negotiations with NYSEG at this time.

[11] NYSEG asserts that "...the public interest mandates that the Commission require Constellation to negotiate a new operating agreement with NYSEG, to take effect upon Constellation's acquisition of the interests of the other cotenants, assuming the possibility that NYSEG's interest is not acquired...The existing operating agreement is insufficient to protect the interests of a minority owner when there is a majority owner-operator of the unit." (Letter at 2, emphasis added.) Neither of these assertions was shown in the Letter to have any legitimate basis.

Second, NYSEG has not presented any justification for its apparent belief that it may continue to be an owner of NMP2. The Commission has already decided, as a matter of policy, both that generation should not be owned and operated by vertically integrated utilities and that generation should be owned and operated by competitive entities.[12] Although NYSEG's Letter essentially assumes an exception from the Commission's now long-standing policies, NYSEG fails entirely to address why such an outcome would be in the interests of NYSEG's customers.

Third, at the Procedural Conference on Friday, September 14, 2001, NYSEG represented, in response to a pointed inquiry from the Presiding Administrative Law Judge, that it continued to be an applicant for the transfer of interests in NMP2 that NYSEG joined in requesting in January of this year.[13] In its Letter, however, NYSEG assumes and implicitly asks the Commission to assume that in fact, NYSEG will not transfer its NMP2 interests. Judging by a particularly emphatic part of the earlier NYSEG

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[12] A recent illustration of the Commission's policy is set forth in Case 01-E-0040, Order Authorizing Asset Transfer (Issued and Effective August 31, 2001) at 8: "The proposed sale of Con Edison's nuclear generation plants, and the associated facilities, generally comports with the policies of the Commission announced in 1996 to open the electric system to competition and allow generation companies to sell their power."

[13] Judge Bouteiller's pointed inquiry was entirely appropriate and proper in view of NYSEG's withdrawal from participation in an earlier transfer of its NMP2 interests.

Interlocutory Appeal,[14] NYSEG may fully intend to rely on the "regulatory out" provisions of the APA. Should that scenario come to pass, however, there may well be questions of prudence concerning management's decisions. The Commission should avoid any statement now, such as suggesting that a revised operating agreement is desirable in any way, because doing so may prejudice the later situation.

Fourth, one may reasonably view NYSEG's current position as an attempt (albeit a misplaced attempt) to amend or evade NYSEG's existing contractual obligations through resort to the Commission.[15] NYSEG has already consented to a staged closing of 50.1% of the interests in Nine Mile Point Unit 2 ("NMP2"). As shown in section 7.1(d) of the Asset Purchase Agreement ("APA"), the Buyer is obligated to proceed to Closing with Sellers holding

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[14] As stated at 8 of the NYSEG Interlocutory Appeal: "A ruling by the Commission adopting any one of those opposition issues would result in unsatisfactory regulatory treatment."

[15] Furthermore, the Commission generally does not intrude into contract disputes. See, Case 92-E-0032, Erie Energy Associates - Petition for a Declaratory Ruling that its Power Purchase Contract with New York State Electric & Gas Corporation Remains in Effect, Declaratory Ruling (Issued March 4, 1992) and Case 94-E-0098, et al., Niagara Mohawk Power Corporation - Joint Petition for Authority to Transfer Hydroelectric Generating Assets, Order Approving Transfer of Hydroelctric Generation Facilities and Making Other Findings (Issued May 27, 1999). NYSEG's assertions before the Commission about a new operating agreement itself causes concern about NYSEG's fidelity to its obligations under section 6.4(a) of the APA. NYSEG's present request represents an "action" that "...would reasonably be expected to prevent or materially impede, interfere with or delay..." the closing of at least 50.1% of the NMP2 interests, including Central Hudson's interests.

"at least 50.1%" of the interests in NMP2 and mutuality of contract binds NYSEG to this provision. Moreover, NYSEG's APA obligation to close is not subject to any condition precedent related to establishment of a new operating agreement. Furthermore, there is no provision of the APA which purports to allow NYSEG unilaterally to impose a new condition precedent to that obligation. These considerations also indicate that Commission should avoid any statement now which could be construed as suggesting that a revised operating agreement is desirable in any way.

Conclusion

None of the opposing comments have presented a legitimate basis for failing to adopt the Central Hudson/Staff Joint Proposal. It should be adopted promptly so that the Closing of the transaction may be completed soon.

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Respectfully submitted,

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