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June 6, 2013

Hon. Jeffrey Cohen,
Acting Secretary
New York State Public Service Commission
Three Empire State Plaza
Albany, NY 12223

Re: Case 12-M-0192 — Joint Petition of Fortis Inc., FortisUS Inc., Cascade Acquisition Sub Inc., CH Energy Group, Inc., and Central Hudson Gas & Electric Corporation for Approval of the Acquisition of CH Energy Group, Inc. by Fortis Inc. and Related Transactions

Dear Secretary Cohen:

On May 30, 2013, the Joint Petitioners submitted a letter to each of the Commissioners[1] offering certain "final enhancements" to the Joint Proposal ("JP"). The new offer appears to be a unilateral attempt to modify the JP since no other parties were consulted. Neither the Citizens for Local Power ("CLP") nor the Consortium in Opposition to the Acquisition ("Consortium") were consulted as would be appropriate under the Commission's Settlement Guidelines.

The proposed "final enhancements" reflect a one-year rate freeze through July 1, 2015, extended job security of one-year for union employees (previously and separately agreed to with the union) and two-years for non-union employees, a doubling of the community support provision to ten years, and the addition of one additional director to the Board of Directors of Central Hudson "who reside, do business or work within Central Hudson's service territory."

The letter then turns to more unabashed advocacy for the deal, with a reference to the already committed $5 million in economic development funds, the previously announced CAPEX program and a discussion of the Fortis transaction versus the alternative.

This response is submitted by CLP and the Consortium. First, the fact that the Joint Petitioners felt compelled to add unilaterally "final enhancements" constitutes an

[1] Hopefully, this response will be circulated to the Commissioners in due course.

admission that the Joint Proposal was and continues to be inadequate since the enhancements are nothing more than a very thin layer of icing on a very bad deal. All of these so-called "final enhancements" can be provided by Central Hudson on a stand alone basis.

Second, a one-year rate freeze could simply mean that Central Hudson does not need a rate increase. More probably this "final enhancement" stems from a clinical assessment by the Joint Petitioners' management that Central Hudson's currently authorized return on equity of 10% (with sharing starting above 10.5%) would most likely be reduced by approximately 100 basis points (1%) if rates were being set today. The trend of recent Commission decisions[2] support this conclusion. Even lower ROEs are responsibly supported in some of the recommendations of the non-utility major parties in the currently pending Con Ed electric, gas and steam rate cases[3]. Perhaps Central Hudson is over earning. Perhaps Central Hudson should be reducing rates immediately. The Public Utility Law Project is addressing this issue in its separate response to the Joint Petitioners May 30, 2013 letter. CLP and the Consortium support and agree with PULP's cogent arguments on this point.

Third, as will be shown, this deal makes no economic sense. Why does the addition of $444 million of goodwill make any sense if there are no synergies to support such a monumental creation of a non-performing asset, particularly if Central Hudson is left to stand alone. It has stood alone quite well since 1926 when it was formed and there is no reason to suspect it cannot continue for many decades without Fortis. Indeed, Central Hudson is better off as a stand-alone company than to marry into a family with lower credit, an ever expanding portfolio of non-performing assets that is more heavily leveraged. Staff and the other signatories to the Joint Proposal have insisted on what can only be characterized as the most comprehensive ring-fencing provisions to date. Obviously, these provisions are deemed to be necessary because of the perceived risk that must be higher than in any other deal approved by the Commission to date. This in and of itself should be considered carefully, particularly since it is not known whether these protections will actually work in the presence of a Fortis financial collapse.

Before going further, it helps to just stop and look at this transaction. Here are the facts taken from Central Hudson's 2012 10-K filing ("10-K") with the SEC:

	($000)
Long-Term Debt	$459,950
Preferred	$9,027
Equity	$469,661

[2] Case 12-E-0201, Order Approving Electric and Gas Rate Plans in Accord with Joint Proposal (Issued and Effective March 15, 2013), at page 18. "The ROE and the overall cost of capital equitably reflect the current economic conditions as well as the additional business and financial costs inherent in the acceptance of a three year rate plan. The 9.3 percent ROE is consistent with investor expectations while being slightly below other recently authorized rate plans [footnote omitted]"

[3] For example, see the Prefiled Testimony of DPS Staff witness Craig E. Henry filed May 31, 2013 in Case 13-E-0030 wherein Mr. Henry recommends an 8.7% ROE for a single year rate plan.

Total Capitalization	$938,638
Average Shares Outstanding (undiluted)	14,909
Purchase Price per share	$65
Equity Purchase Cost	$969,085
Total Transaction Value	$1,438,062
Excess over Capitalization	$499,424
Excess over Capitalization %	**53.2%**

As a result of the Commission's long-standing earnings base – capitalization adjustment, Central Hudson's returns are set on the total capital structure, in this case $938.638 million. The excess capitalization over the actual capital structure of almost $500 million will not now or will ever be part of the rate making process in New York. Most of that total is comprised of goodwill ($444 million) and the balance is likely to arise over rate base items such as working capital that will be reduced in the earnings base – capitalization adjustment.

Why would any intelligent businessman pay 53.2% more than the earning capacity of the business? Utilities are prized for their ability to generate consistent cash returns out of which significant cash dividends are paid to shareholders. So why would someone pay $1500 for the same revenue stream from the same risk profile one could get for $1000?

Well one might say that such a large premium is necessary to establish a beachhead in the United States from which to launch other acquisitions. Or it might be a justified investment to acquire a business that is rapidly growing because future organic growth supports the deal.

The organic growth rational can be ruled out quickly as can be seen from the following:

Weather normalized deliveries

Calendar Year	2012	2011	2010
Electric (GWHs)	5067	5114	5210
Gas (MCF)	11,260	11,575	10976

Both electric and gas deliveries are either flat or trending down on a weather normalized basis. So the deal cannot be based on organic growth. As to the beachhead argument, is that worth almost $500 million or a 53% premium? Fortis would do better to buy real beachfront property. So that proposition does not make sense.

By the way, this flat to down trend is not unique to Central Hudson, but this trend is believed to be seen in virtually all electric and gas service territories in the northeast.

Upgraded energy efficiency appliances in homes and businesses, coupled with the recession, poor jobs picture and increased general awareness of the benefits of conservation are finally curbing the country's previously insatiable appetite for energy. We are now doing more with less.

So the only remaining rational for this deal is that Fortis must purchase revenue to keep its earnings growing. In a presentation made on May 9, 2013 at the Fortis annual shareholders meeting, a dramatic chart was presented as part of management's report to shareholders. It is reproduced in Appendix A to this letter. Over the forty year period, Fortis has been able to increase dividends per share by 9.5% (compound annual growth rate). This is an extraordinary achievement and Central Hudson, if this acquisition is approved, will now be assimilated into the Fortis collective to continue this upward trajectory. What this means is that Central Hudson ratepayers will be looking at approximately 13% annual increases in delivery rates to become part of the Fortis team throwing off dividends to the voracious parent. This is simply achieved by calculating the comparable contribution Central Hudson will be required to make every year to keep the Fortis dividend party going.

But since the current rates, now proposed to be frozen until July 1, 2015, are producing approximately $46 million in net operating income[4] that will leave only $24 million after the long term debt interest expense is paid. Average long-term debt interest expense is 4.83%. That means that $22.2 million goes to servicing the debt, leaving less than $24 million to service the remaining assets of approximately $970 million ($1,438 million less $459 million in long term debt and $9 million in preferred). That produces a 2.5% return on equity. This is not just a bad deal. It is a terrible deal. And the only way it is going to work out is the same way it is playing out in British Columbia – non-stop rate increases forever. Please see Appendix B to CLP and the Consortium's Brief Opposing Exceptions.

To continue its historic dividends per share increase of 9.5%, Central Hudson can be expected to see a 13% increase in delivery rates[5] based on comparable revenue requirements, retention rates and dividend payouts. This is a direct consequence of the transaction and Fortis' business model and dividend policy. If that policy were to change, then there would be a direct and adverse effect on the share price of Fortis. The point here is that the 13% increase in delivery rates does not reflect other costs that inevitably go up. Rather this is the baseline required for Central Hudson to keep up in its new family. One can bet that if it does not keep up then there will be visits from Newfoundland. So much for the vaunted independence Fortis touts to sell this bad deal.

Fortis cannot really afford this deal. Contrary to its assertions that it has greater access to capital, it has insufficient financial resources to purchase Central Hudson and live up to its commitments. In Joint Petitioners' letter, there is a statement on page 4 that will be debunked shortly. "Fortis' strong credit rating, greater scale and access to capital will enable Central Hudson to make these necessary capital expenditures, as well as

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[4] Average net operating income for the last three years is $46.1 million. 10-K at page 53.
[5] Analysis provide by Harry Levant, Financial Analyst, customer of FortisBC.

participate more fully in Governor Cuomo's Energy Highway initiative, which can improve reliability, reduce costs and bring more renewable energy to the Hudson Valley."

The fact is that this deal makes it more likely that Central Hudson will not be able to make the capital improvements required since Fortis credit rating is lower and it does not have access to capital. In fact, if Fortis acquires Central Hudson it will be short on cash by approximately $140 million in the first year. There is no showing on the record that Central Hudson cannot fully participate in the Governor's Energy Highway initiative. Saying it is so, is not proof. The Joint Petitioners seem to believe if something is said often enough it becomes true, at least at the time and for the purpose intended. The Joint Petitioners also seem to forget that they have the burden of proof.

Lets look at the sources and uses of funds for this transaction:

Central Hudson	
Forecast Earnings, 1 yr. after closing	$46.0
Incremental interest ($500M-downloaded)	-$25.0
Incremental Interest - 2013 capital program	-$4.0
Available for dividends to Fortis	$17.0
Fortis Management Fee (annual)[6]	-$2.0
Fortis Corporate Costs (annual, non-duplicative)[7]	-$3.3
Fortis needs to cover dividends on $600M	-$23.0
Shortfall to Fortis	-$11.3
One time dividend catch up Subscription Financing	-$23.0
One time $50M contribution	-$50.0
Cost to Achieve Acquisition (one time)	-$30.0
Change in Control Payments to CH Execs	-$24.0
Total year one shortfall after closing	-$138.3

Sure, Fortis has a $2.2 billion credit line[8] with only approximately 22% utilization, but the overpayment relative to the earning capacity of Central Hudson and the expected first year results makes no financial sense other than it allows Fortis to maintain the appearance of revenue growth at the expense of real shareholder value that is readily seen as being substantially diluted. As seen above, Fortis also has to make provision for the $24 million in change in control payments to the top executives. So the negative cash flow is over $100 million in the first year – what a deal! And lets not forget the cost to achieve this debacle -- $15 million for each company.[9] As can be seen from the above

[6] Fortis response to DPS-M325 (Staff's DPS-M125).
[7] Fortis response to DPS-M472 (Staff's DPS-M272).
[8] Fortis response to DPS-M290 (Staff's DPS-M90).
[9] Fortis response to DPS-M202 (Joint) – Revised.

the first year shortfall is almost $140 million and is probably significantly higher considering the unanticipated advertising and public relations campaign launched in response to CLP and the Consortium.

Next the Joint Petitioners use fear to motivate the Commission to approve the acquisition. To turn away Fortis "would send a message to other businesses that the State is not 'open for business'." A sophisticated business owner reviewing the above is more likely to see that the State is out to protect its existing business owners and residents and thereby make New York a very good place to do business. In fact, the rejection of this deal is actually doing Fortis a favor since it will be able to extricate itself from a sink hole it is not likely to dig itself out of for some time.

Finally, a most curious sentence appears on the last page. "Central Hudson's future as an independent utility will be uncertain with litigation a strong possibility and its employees distracted." The $49.25 million of one-time benefits to be slowly dribbled into rates over an indeterminate timeframe would be lost and Central Hudson would have to come in for an immediate rate increase. Because this transaction produced $444 million of non-performing good will, the acquisition will put strain on the combined operations of both companies leading to the higher cost of capital to both.

From whence comes the claim of "uncertain future with litigation"? Is this a veiled threat meant to coerce the Commission to do what should not be done? "[A] strong possibility that its employees would be distracted," is indeed an ironic statement since there is nothing so distracting than a change in ownership and control to the employees of the target, particularly by a growth addicted holding company. As it turns out, Fortis cannot afford the JP no less the enhancements it now proposes. The only reasonable response to these "final enhancements" is to conclude that they are wholly insufficient to move the needle in favor of this acquisition. In fact, the rate freeze is actually a benefit to the shareholders, making the risks and detriments of this transaction even worse, if that is at all possible.

The Commission is urged to reject this acquisition since it is in no one's interest other than Fortis (and that is highly questionable) and Central Hudson's senior executives. Central Hudson's ratepayers deserve better than to be shackled to an untrustworthy and financially unsustainable company.

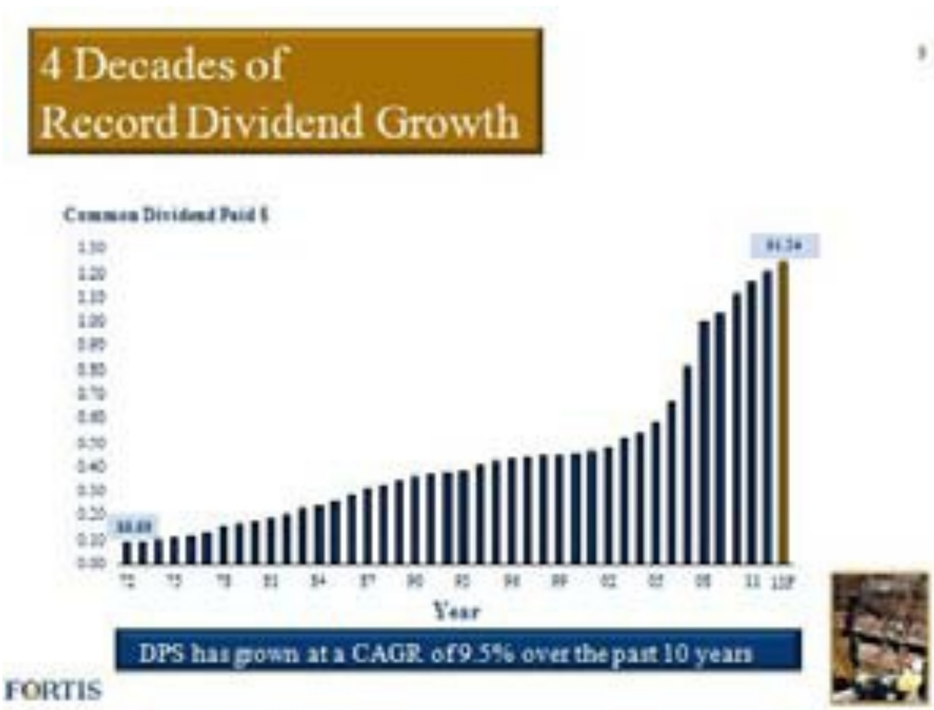
In accordance with previously agreed procedures, all Parties have consented to electronic service, and I here attest that I am serving these documents on the Party List for this case

Very truly yours,
Daniel P. Duthie
Daniel P. Duthie

DPD:bsb
cc: Hon. David L. Prestemon
Hon. Rafael A. Epstein

APPENDIX A

How Much Will Utility Ra Need to Increase for Fortis to sustain their 40 year track record for dividend increases?



Average increase in CH profit required to sustain this record of dividend growth
$2.2M(1)

Minimum annual utility rate increase at closing to sustain dividend growth
13%

Why is dividend policy so important? It is integral to a company's ability to acquire financing and tsustain investor confidence.

(1) Based on NPV discount rate averaging 5%.

(2) DPS-M330 (Staff's DPS-M130) [Fortis] –June 15, 2012. (Including goodwill)