

STATE OF NEW YORK  
PUBLIC SERVICE COMMISSION

- CASE 12-M-0066 - New York State Electric & Gas Corporation, Rochester Gas and Electric Corporation, RGS Energy Group, Inc., Iberdrola USA Networks, Inc., Iberdrola USA, Inc., and Iberdrola Finance UK Limited - Petition of for Approval of an Internal Reorganization Pursuant to Public Service Law §70.
- CASE 12-E-0065 - Iberdrola Renewables Holdings, Inc. - Petition for a Declaratory Ruling Regarding the Application of Public Service Law §70.
- CASE 10-M-0551 - Comprehensive Management Audit of Iberdrola, S.A., Iberdrola USA, Inc., New York State Electric and Gas Corporation, and Rochester Gas and Electric Corporation.

NOTICE SOLICITING COMMENTS ON  
STAFF REPORT

(Issued March 25, 2013)

In an Order Directing Submission of a Management Audit Implementation Plan and Establishing Further Procedures on Corporate Structure and Governance Issues that was issued August 28, 2012 in Cases 12-M-0066 and 10-M-0551, Staff of the Department of Public Service (Staff) was directed to engage in collaborative discussions with parties interested in these proceedings, and to prepare a Staff Report addressing corporate structure and governance issues raised in Case 10-M-0551 and corporate reorganization issues raised in Case 12-M-0066.<sup>1</sup> The collaborative discussions have concluded. The Staff Report On Reorganization and Related Management Audit Issues has been prepared and is attached.

Interested parties are invited to submit comments on the Staff Report by April 5, 2013. Parties should submit

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<sup>1</sup> Related and similar issues are raised in Case 12-E-0065.

comments electronically to the Secretary by e-filing through the Department's Document and Matter Management System (DMM),<sup>2</sup> or by e-mail to [secretary@dps.ny.gov](mailto:secretary@dps.ny.gov). Parties unable to file electronically may mail or deliver their comments to the Hon. Jeffrey C. Cohen, Acting Secretary, New York State Public Service Commission, Three Empire State Plaza, Albany, New York, 12223-1350. All comments filed with the Secretary will be posted to the Commission's Web site and become part of the official case record.

(SIGNED)

JEFFREY C. COHEN  
Acting Secretary

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<sup>2</sup> [http://www.dps.ny.gov/DMM Registration.html](http://www.dps.ny.gov/DMM%20Registration.html); How to Register with DMM, <http://www.dps.ny.gov/e-file/registration.html>.

STATE OF NEW YORK  
DEPARTMENT OF PUBLIC SERVICE



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***STAFF REPORT ON REORGANIZATION AND  
RELATED MANAGEMENT AUDIT ISSUES***

Dated: March 25, 2013  
Albany, New York

TABLE OF CONTENTS

	<u>Page</u>
INTRODUCTION.....	1
The Reorganization Proceedings.....	1
The Audit Proceeding.....	2
The Additional Procedures.....	4
Staff’s Conclusions.....	5
THE FILINGS.....	6
The Petition in Case 12-M-0066.....	6
The First Supplemental Filing.....	9
The Second Supplemental Filing.....	15
The Petition in Case 12-E-0065.....	16
DISCUSSION.....	18
Risks Posed By the Reorganization.....	19
The Reorganization Conditions.....	23
A. Financial Conditions.....	23
B. The Debt Issuance Recommendation.....	24
C. Governance Conditions.....	31
D. Appendix I of the Merger Order.....	33
E. Affiliate Relationship Conditions.....	37
F. The IEP Relationship.....	38
G. The Gas Executive and Gas Operations.....	40
CONCLUSION.....	43

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STAFF REPORT ON REORGANIZATION AND  
RELATED MANAGEMENT AUDIT ISSUES  
(March 25, 2013)

INTRODUCTION

The Reorganization Proceedings

In a petition filed on February 23, 2012 in Case 12-M-0066, New York State Electric & Gas Corporation (NYSEG), Rochester Gas and Electric Corporation (RG&E), RGS Energy Group, Inc. (RGS), Iberdrola USA Networks, Inc. (Networks), Iberdrola USA, Inc. (IUSA), and Iberdrola Finance UK Limited (IBFL) (collectively, the Petitioners) request approval of the reorganization of the corporate holding company ownership structure upstream from NYSEG and RG&E. That petition was supplemented on September 27, 2012 (First Supplement) and on February 1, 2013 (Second Supplement).

Moreover, in Case 12-E-0065, Iberdrola Renewables Holdings, Inc. (IRHI) request issuance of a Declaratory Ruling regarding the same holding company reorganization at issue in Case 12-M-0066. IRHI maintains that its participation in the upstream reorganization transaction need not be reviewed

further, because it is subject to lightened ratemaking regulation.<sup>1</sup> Following the filing of the petitions in Cases 12-M-0066 and 12-E-0065, Department of Public Service Staff (Staff) conducted discovery into the facts and circumstances underlying the relief requested in the petitions.

The Audit Proceeding

While Case 12-M-0066 and Case 12-E-0065 were pending, an independent, third-party consultant was conducting a management audit into the operations and management of NYSEG, RG&E, and their upstream owners in Case 10-M-0051. Some of the issues raised in the management audit, including those arising out of an examination of the relationship between the Petitioners and their ultimate parent, Iberdrola, S.A. (IBE, a corporation organized in Spain), bear on the issues raised in the corporate reorganization petitions. Staff engaged in the management audit process, by working with the independent consultant and the Petitioners and IBE on audit Recommendations.

A Final Audit Report was promulgated on June 4, 2012, and the Petitioners provided written comments addressing the issues raised in that Report on June 18, 2012. In the Audit Recommendations Order issued August 28, 2012,<sup>2</sup> the audit issues were considered, and the audit's Recommendations were analyzed. The Order required the Petitioners to submit an implementation plan for complying with most of the Recommendations made in the

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<sup>1</sup> Case 04-E-0643, Flat Rock Wind Power II LLC, Order Providing For Lightened Regulation (issued December 20, 2004); Case 02-E-0362, Flat Rock Wind Power LLC, Order Granting a Certificate of Public Convenience and Necessity and Providing For Lightened Regulation (issued June 17, 2004).

<sup>2</sup> Case 10-M-0551, et al., supra, Order Directing the Submission of a Management Audit Implementation Plan and Establishing Further Procedures on Corporate Structure and Governance Issues (issued August 28, 2012)(Audit Recommendations Order).

audit, but the Commission directed that some of the audit Recommendations and issues be considered in conjunction with the issues pending in the reorganization proceedings.

In the Audit Recommendations Order, corporate governance issues are labeled as among the most important aspects of the audit. The Order requires that these issues be analyzed fully and considered carefully. Moreover, since the issues the new corporate structure poses were not analyzed in the audit, evaluation of the reorganization should proceed in conjunction with pursuing the questions on corporate structure raised in the audit.

Two of the audit findings bearing on the reorganization proceedings were modified in the Audit Recommendations Order. Instead of, pursuant to Recommendation 2.1, immediately suspending the authorization allowing NYSEG and RG&E to purchase services from Iberdrola Energy Projects, Inc. (IEP), a construction service firm that is an IBE subsidiary and is thereby affiliated with NYSEG and RG&E through IBE, the Order directs that an analysis of the costs of IEP services be conducted in conjunction with the further study of staffing levels at NYSEG and RG&E that is also the subject of Recommendation 11.1. Moreover, it is concluded in the audit that consolidation of NYSEG and RG&E into one utility would not produce appreciable savings. That finding is rejected in the Order, as based on insufficient data and as premature. Both of these issues were remanded for further consideration in the reorganization proceedings.

It was also decided in the Audit Recommendations Order that issues related to the Sarbanes-Oxley Act (SOX) were not sufficiently addressed in the audit. As a result, a further inquiry into the Merger Order condition obligating IUSA to

comply with SOX required additional consideration in the reorganization proceedings.

The Audit Recommendations Order also established the additional procedures to be followed in the reorganization proceedings. The Order requires the Petitioners to make a supplemental filing showing how the proposed reorganization can be configured to alleviate the deficiencies described in the audit. After the supplemental filing is made, the Order directs that collaborative discussions be conducted. At the conclusion of the collaborative, Staff is to prepare a Staff Report and present the Report to the Commission.

The Additional Procedures

Subsequent to issuance of the Audit Recommendations Order, further inquiry into reorganization issues was conducted in light of the recommendations transferred to the reorganization proceedings in the Audit Recommendations Order. Commencing on October 18, 2012, Staff met with the Petitioners and other interested parties for the purposes of conducting additional discovery and discussing the issues raised by the reorganization and the audit recommendations. Meetings continued from time to time thereafter, until Staff was satisfied it had obtained the relevant information necessary to evaluate the reorganization in conjunction with the audit recommendations.<sup>3</sup> Following the conclusion of the meeting and discovery process, Staff embarked upon the preparation of this Staff Report to frame the issues for further consideration and obtain comments from interested parties.

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<sup>3</sup> The discussions at the meetings were treated as confidential pursuant to the Commission's settlement procedures, albeit the structure of these proceedings and the issues raised in them were not amenable to resolution through a settlement embodied in a joint proposal.

Staff's Conclusions

Staff concludes that, although the proposed reorganization does not result in any change in the ultimate ownership of NYSEG and RG&E, because they remain indirect wholly-owned subsidiaries of IBE, the reorganization nonetheless poses the potential for harms to the interests of captive utility ratepayers. As a result, Staff recommends that conditions be imposed that forestall those harms. As conditioned, the reorganization may then be approved as in the public interest.

To accomplish the protection of the public interest necessary to allow for approval of the reorganization, Staff proposes twenty-seven Conditions, listed at Appendix A. Moreover, Staff addresses the twelve audit action Recommendations, the Recommendation where no action was proposed, issues raised by the no-action audit finding that was rejected, and the interpretation of the Merger Order SOX requirement, which were transferred to the reorganization proceedings in the Audit Recommendation Order. The thirteen audit Recommendations and their treatment are listed in Appendix B; two of the audit Recommendations, the reversed no-action audit finding, and the SOX issues are resolved through reorganization Conditions. Compliance with those latter Conditions will be enforced in Case 12-M-0066.

As to the eleven remaining audit Recommendations, the Petitioners' implementation filings to date in compliance with the Audit Recommendations Order appear to meet the spirit of seven of the Recommendations. Nonetheless, compliance with three Recommendations requires further clarification and action by the Petitioners, and, for one Recommendation, the Petitioners' implementation filing explication is unsatisfactory. Compliance efforts for that Recommendation

should begin anew, as guided here. Compliance concerning these audit matters would be addressed in the ongoing audit review and implementation process in Case 10-M-0551.

The Petitioners' submittals in this proceeding are summarized below. Following that summary, the corporate restructuring issues the filings and the audit raise are presented, and Conditions addressing reorganization issues and evaluations of compliance with audit Recommendations are proposed.

#### THE FILINGS

##### The Petition in Case 12-M-0066

The Petitioners begin by describing their proposed reorganization of the corporate holding company structure upstream from NYSEG and RG&E as consisting of the insertion of two intermediate holding companies into that upstream structure. Currently, IBUSA owns directly RGS, is the intermediate holding company owning NYSEG and RG&E. IBUSA, in turn, is owned directly by IBE. As the Petitioners describe it, the corporate reorganization would be accomplished by first inserting IBFL into the ownership structure between IBUSA and IBE. IBFL is an existing wholly-owned subsidiary of IBE organized in the United Kingdom, which currently owns directly all of IRHI, the second largest wind generation facility operator in the U.S.

Second, Networks, a newly-created company, would be inserted into the ownership structure between IBUSA and RGS, as the wholly-owned subsidiary of IBUSA and the direct owner of RGS. Networks would thereby become the indirect owner of NYSEG and RG&E. The final feature of the corporate reorganization is the consolidation of IRHI, under IUSA, into the newly-created holding company structure specific to the U.S. As a result, IRHI would move from direct ownership by IBFL to direct

ownership by IBUSA, with IBFL owning IBUSA directly and IRHI indirectly.<sup>4</sup>

The corporate reorganization, the Petitioners stress, will not alter the ownership of NYSEG and RG&E approved in the Merger Order,<sup>5</sup> with IBE remaining the ultimate upstream parent owning all of the interest in NYSEG and RG&E, without any transfer of any of those interests to any third party. The Petitioners contend that the reorganization is purely an intra-corporate restructuring that will not alter the management structure in place at NYSEG or RG&E, modify the composition of their Boards of Directors, or affect the safe and adequate provision of electric and gas service by NYSEG or RG&E under their existing rates, terms or conditions. The Petitioners also note that the Merger Order approval conditions will remain in place, including the requirement that \$275 million in positive benefit adjustments be furnished to NYSEG and RG&E ratepayers, IBE's commitment to invest \$200 million in new wind generation in New York, and the various other safety, reliability, market power, financial and corporate protections.

The purpose of the reorganization, the Petitioners state, is to effectuate IBE's strategy of reorganizing its operating companies on a country-specific basis, thereby creating additional efficiencies by centralizing operations. The Petitioners argue that the creation of Networks will further separate IBE's regulated business operations from its ownership and operation of renewable generation facilities through IRHI.

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<sup>4</sup> While RGS remains in the corporate structure as an intermediate holding company, it is not actively managed and is a corporate shell whose activities need not be considered further (to the extent it remains primarily inactive).

<sup>5</sup> Case 07-M-0906, Iberdrola, S.A., Order Authorizing Acquisition Subject to Conditions (issued January 6, 2009).

The Petitioners also affirm that NYSEG and RG&E customers will not bear any of the costs incurred in effectuating the reorganization, and that no recovery of any of those costs will be sought from New York ratepayers.

After the reorganization is completed, the Petitioners elaborate, IBUSA will serve as the owner of all of IBE's interests in the U.S., including IRHI, which will hold IBE's interests in lightly-regulated or unregulated businesses operating in competitive markets, including renewable and thermal generation and gas storage and marketing operations. Networks will serve as the owner of IBE's interests in regulated electric and gas utilities operating in the U.S.

The Petitioners believe that the reorganization is in the public interest. The Petitioners reiterate that the reorganization is purely intra-corporate; will not affect IBE's ultimate upstream ownership interest as the parent of its U.S. subsidiaries; will not affect rates or services in New York; and, will not modify the benefits and protections provided for in the Merger Order.

Nonetheless, the Petitioners point out, insertion of Networks into IUSA's current role as the direct owner of RGS and the indirect owner of NYSEG and RG&E requires the transfer of certain financial and corporate protection Conditions, from Appendix 1 of the Merger Order, to Networks from IUSA. Accordingly, the Petitioners propose that Networks assume IUSA's commitments to use Generally Accepted Accounting Principles (GAAP), to comply with the provisions of the SOX as if it were still bound directly by those provisions, and to remain subject to annual attestation audits, under Merger Order Appendix I §§5(a)-(d). Just as IUSA currently is under Merger Order Appendix I §2(b), Networks would be rated by major credit rating agencies, and would be subject to the credit quality and other

credit commitments set forth at Appendix I. Otherwise, both IUSA and Networks would remain subject to the requirements of Appendix I, including §1(c) goodwill restrictions, §3(a) money pooling constraints, §3(b) finance default provisions, §5(e) conditions related to books and records, and §5(f) financial statement requirements. The Petitioners reiterate that no property is transferred to a new owner as a result of the reorganization.

The First Supplemental Filing

As required in the Audit Recommendations Order, the Petitioners supplemented their filing in Case 12-M-0066 on September 27, 2012. The Petitioners note that the reorganization has been approved by the Federal Energy Regulatory Commission, and regulatory agencies in Maine and New Hampshire.<sup>6</sup>

The Petitioners provided additional information on the reorganization. Prior to the reorganization, they explain, the IUSA Board of Directors consists of seven Directors, including two independent Directors having the background and experience needed to contribute to the understanding and consideration of utility customer needs. The only ISUA employee on the Board, they elaborate, is IUSA's Chief Executive Officer (CEO). The remaining Directors are comprised of IBE officers, and Directors of other IBE subsidiaries, having exceptional backgrounds and experience that brings substantial expertise to Board deliberations. The Petitioners maintain that an independent assessment conducted by PriceWaterhouseCoopers LLC (PWC) in 2011

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<sup>6</sup> Iberdrola Finance UK Limited, 139 FERC ¶62,021 (April 6, 2012); Docket No. 2012-93, Central Maine Power Company, Corrected Order (Maine PUC, May 8, 2012); Case No. DG12-051, Petition to Approve Reorganization, Order No. 25,366 (New Hampshire PUC, May 15, 2012).

found that the IUSA Board performed effectively with a high degree of compliance with internal company policies and rules and in alignment with trends in corporate governance.<sup>7</sup>

After the reorganization, the Petitioners continue, Networks will be formed under the same Board of Directors previously in place for IUSA. According to the Petitioners, the Final Audit Report contained positive findings on IUSA's corporate governance and the structure of its existing Board, including its focus on New York needs and the effective operation of New York utilities, and the engagement in, and awareness of, New York conditions and requirements.

As to new IUSA's Board after the reorganization, the Petitioners maintain its role will be to coordinate the development of policies, strategies, and guidelines in the U.S. that implement IBE's management goals. Networks, the Petitioners assert, will effectively manage, control and supervise the utility businesses under its aegis, through companies specific to the States where they operate. The IUSA Board, they report, will be modeled on other country-specific holding companies within IBE, and it is anticipated that it will include one Director with a special connection to New York and an appreciation of New York needs.

Meanwhile, IBFL will remain organized in the U.K. Its Board of Directors consists of four members, all of whom are IBE employees, and the intent is that it may engage in certain IBE intra-group financings with other entities.

The Petitioners maintain that the reorganization is consistent with good governance. They relate that IBE's corporate governance system conforms to existing best practices

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<sup>7</sup> In its assessment, PWC evaluates trends in corporate governance at what it describes as "unlisted companies."

and is periodically updated to take into account evolving best practice principles. This corporate governance framework, they claim, provides for extensive consideration of customer interests and is properly transparent.

The Petitioners then address the audit Recommendations transferred to the reorganization proceeding. In the Final Audit Report, Recommendation 2.7 highlighted the importance of yearly self-assessments of Board performance. To fulfill this requirement, the Petitioners explain, an annual assessment of Board performance is conducted by an independent third party that reports its findings to the Audit and Compliance Committee (A&CC) of the Board, which is chaired by an independent Director. Recommendation 2.4, the Petitioners continue, provides for a Board review of CEO performance, which Networks will properly perform after the reorganization is consummated. The Networks Board will also ensure proper review of executive compensation and benefits, pursuant to Recommendations 14.8 and 14.9.

According to the Petitioners, the Networks Board of Directors will properly oversee capital budget formation, by establishing priorities, approving budgets, and monitoring budget implementation, satisfying Recommendation 10.3. Similarly, the A&CC will conduct internal auditing functions, ensure legal and governance compliance, and investigate potential misconduct, in conformance with Recommendation 14.5.

The Petitioners also maintain that IUSA has satisfied the Merger Order requirement that it comply with the provisions of SOX as if it were still bound directly by those provisions, and that compliance will continue. The Petitioners dispute an interpretation of that requirement as mandating compliance as if it were a publicly-traded U.S. company. In conformance with SOX and Recommendation 14.2, the Petitioners continue, NYSEG and

RG&E will proceed with the "dekeying" process, for identifying and ensuring proper controls for financial reporting are in place pursuant to internal review and independent external audit analyses.

The Petitioners report that IUSA has adopted a new Code of Ethics that properly establish principles for dealings among affiliates and avoidance of cost-subsidization. As a result, the Petitioners believe they are in compliance with Recommendation 14.4, on statements of values and principles in a Standards of Conduct.

While Recommendation 14.5 propounds a structure where IUSA's chief officer for ethics and compliance will report directly to the IUSA CEO instead of to the IUSA General Counsel, the Petitioners maintain that IUSA's ethics compliance programs have been very effective and were designed with the advice of a leading consultant. The Petitioners promise to undertake further evaluation of this recommendation in light of best practices.

The Petitioners also promise that executive communications will be streamlined under a more fully-empowered IUSA CEO. After the reorganization, Networks will ensure that its CEO will be accountable for performance directly to the Networks Board. It will also maintain effective lines of communication with IUSA, and will participate in Networks' global group, which is a venue for sharing information among IBE's various regulated subsidiary companies. The Petitioners therefore conclude they have satisfied Recommendations 2.3, 2.5 and 2.6.

Turning to the remaining audit recommendations transferred to the reorganization proceedings, the Petitioners address Recommendation 2.1, which provided for the indefinite suspension of contracting for work between NYSEG and RG&E and

Iberdrola Energy Projects, Inc. (IEP), the engineering services firm affiliated with the utilities through IBE. The Petitioners point out that it was decided in the Audit Recommendations Order that, prior to suspension of the relationship, the utilities should be afforded the opportunity to demonstrate that use of IEP should continue.

The Petitioners maintain that IEP charges less than other external contractors for similar services and IEP's costs also compare favorably to the costs of using internal resources to perform the work. The Petitioners state that IEP offers other benefits, such as the sharing and implementation of best practices through an engineering firm that operates world-wide; the standardization of management that can be accomplished within a family of companies; and, the immediate ability to support increased infrastructure investments. The Petitioners report that NYSEG and RG&E are developing an Engineering Resource Plan premised upon an evaluation of the optimal mix of internal and external resources for obtaining engineering services, which should be available for review by the end of 2012.

In Recommendation 2.2, the Petitioners report, proposals are made to strengthen the strategic focus of the NYSEG and RG&E gas businesses. The Petitioners explain that the utilities have already taken steps to bolster the gas organization, including the creation and staffing of new positions and the realignment of programs under the gas operations management control where they can be better directed. The utilities, the Petitioners argue, should not be required to take additional steps, or to consolidate the gas business under a single executive as suggested in Recommendation 2.2.

Addressing the issue of consolidating NYSEG and RG&E into one entity, the Petitioners note that the premise that

consolidation would result in savings was rejected in the Final Audit Report, albeit, in the Audit Recommendations Order, the issue is referred to these reorganization proceedings. The Petitioners state that further discussion of the issue is welcomed, but that its resolution may be best accomplished outside of the reorganization and audit proceedings.

The Petitioners also discuss additional ring-fencing measures that might better separate the regulated utilities from IRHI and IBE, particularly from a credit ratings perspective. Pointing out that strong ring-fencing measures are already in place pursuant to the Merger Order, the Petitioners also note that there are scenarios where an adverse rating at IBE could adversely affect NYSEG and RG&E ratings. An additional measure that could assist in breaking that linkage, the Petitioners explain, is a minimum common equity ratio requirement at each utility that would restrict its ability to pay dividends if the requirement were not satisfied.

The Petitioners also suggest that implementation of such a measure could lead to evaluation of NYSEG and RG&E ratings on a stand-alone basis, rendering some existing ring-fencing measures unnecessary. As the Petitioners see it, the existing ring-fencing measure prohibiting distribution of utility dividends whenever the rating of IBE or IUSA is reduced to the lowest investment grade upon a negative watch could trap in the utilities equity upon which the allowed return could not be earned. The Petitioners imply that this outcome is unreasonably restrictive.

The Petitioners conclude by expressing their support for collaborative discussions on the issues raised in the Audit Recommendations Order. They also request, however, that the process be completed promptly so that the reorganization may be accomplished by the beginning of 2013.

The Second Supplemental Filing

In the second supplement filed on February 1, 2013, additional information was provided on reorganization and audit issues. The Petitioners agreed to reconfigure the reorganization, so that IBFL will not be inserted into the corporate ownership structure upstream from IUSA as initially proposed. As a result, IUSA will remain a direct, wholly-owned subsidiary of IBE.

After reconsidering the financial transparency and reporting obligations imposed on IUSA in the Merger Order, as listed Appendix I there, the Petitioners clarified their position and limited those obligations that IUSA should be relieved of, by the transfer of the obligations to Network's responsibility. As a result, they propose that Networks, and not IUSA, submit presentations made to credit rating agencies, Appendix I §2(a); file a plan to remedy certain credit rating downgrades, Appendix I §2(f); comply with the provisions of SOX, Appendix I §5(c); and, perform an annual attestation audit with an independent auditor, Appendix I §5(d).

The Petitioners provide additional information on the NYSEG and RG&E gas organization that is the subject of Recommendation 2.2, detailing the relationship among the gas executives and the utility's upper management and what they describe as the extensive gas experience and expertise of those gas executives. The Petitioners also further explain the operations of the current gas organization, describe improvements they have made to that organization, and discuss gas supply responsibilities.

Addressing the use of IEP, the Petitioners submit the total monthly spending of NYSEG and RG&E on IEP projects for the twelve months ended October 2012. The Petitioners maintain that current utilization of IEP is best measured by focusing on the

latter portions of that period, rather than the entire twelve-month period. The Petitioners argue that pegging utilization of IEP at the later month levels is necessary to avoid any disruptions in their capital spending programs that restrictions on continued use of IEP at existing levels would entail.

The Petitioners also provide updated and revised implementation plans for the remaining audit Recommendations transferred to the reorganization proceedings. The Petitioners explain that their Audit Implementation Plan as revised should be deemed adequate to establish compliance with the audit Recommendations, subject to their actual implementation. The Petitioners state they will continue to work cooperatively to fully implement the Recommendations, in conformance with the process in Case 10-M-0551 for updating, every four months, the implementation plans for all the management audit Recommendations, starting with the updates scheduled for June 2013.

Finally, the Petitioners point out that all other approvals to proceed with the reorganization have been obtained, and that the anticipated schedule for closing the reorganization has lagged. They ask that all reorganization issues be decided by mid-April 2013.<sup>8</sup>

The Petition in Case 12-E-0065

In its petition, IRHI requests issuance of a Declaratory Ruling finding that its participation in the reorganization need not be reviewed further. IRHI notes that it is a direct, wholly-owned subsidiary of IBFL, and is the owner

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<sup>8</sup> The Petitioners also ask that the petition in Case 12-E-0065, described below, be acted upon promptly, in advance of the resolution of the reorganization proceeding issues raised in Case 12-M-0066, so that the Case 12-E-0065 transaction can be closed before the end of the first quarter of 2013.

of several wind generation facilities in New York. Included in that category are a 50% interest in the 322 MW Maple Ridge Wind Farm located in Lewis County, which is subject to lightened ratemaking regulation, and sole ownership of the 74 MW Hardscrabble Wind Farm located in Herkimer County, which is a qualifying alternative energy facility exempt from electric corporation regulation under PSL §§2(2-b), 2(4) and 2(13).<sup>9</sup>

IRHI stresses that there will be no change in its ultimate ownership, with IBE remaining its ultimate, exclusive parent. As a result, IRHI believes that the reorganization is an intra-corporate restructuring of a lightly-regulated company that is outside the scope of §70 review.<sup>10</sup>

Even if it is determined that the reorganization is not exempt from review as an intra-corporate reorganization, IRHI asserts no further review of the transaction is needed because the Wallkill Presumption applies. As decided in the Wallkill Order,<sup>11</sup> IRHI explains, PSL §70 regulation does not adhere to a transfer of ownership interest in parent entities upstream from the affiliates owning and operating New York competitive electric facilities, unless there were a potential for harm to the interests of captive utility ratepayers sufficient to overcome the presumption. Maintaining that its participation in the corporate reorganization cannot enable it to exercise market power in any form, and does not otherwise

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<sup>9</sup> Case 04-E-0643, Flat Rock Wind Power II LLC, Order Providing For Lightened Regulation (issued December 20, 2004); Case 02-E-0362, Flat Rock Wind Power LLC, Order Granting a Certificate of Public Convenience and Necessity and Providing For Lightened Regulation (issued June 17, 2004).

<sup>10</sup> Case 07-E-0584, NRG Energy, Inc., Declaratory Ruling on Review of An Intra-Corporate Transaction (issued July 23, 2007).

<sup>11</sup> Case 91-E-0350, Wallkill Generating Company, L.P., Order Establishing Regulatory Regime (issued April 11, 1994).

pose the potential for harm to captive ratepayer interests, IRHI argues that it qualifies for the Wallkill Presumption, ending the need for any additional review of its participation in the reorganization. IRHI asks that its petition be ruled upon no later than the time of decision on the petition filed in Case 12-M-0066.

#### DISCUSSION

The corporate holding company reorganization that the Petitioners and IRHI propose poses the potential for risks accruing to the detriment of captive NYSEG and RG&E ratepayers. Moreover, the corporate governance issues raised in the audit require the adoption of corrective measures to remedy deficiencies that could also redound to the detriment of captive ratepayers. Compliance with the audit recommendations transferred from the audit proceeding to the reorganization proceedings must also be considered, and, where necessary, additional actions or measures must be undertaken to ensure compliance.

As the Petitioners point out, however, the reorganization proposed does not involve any transfer of assets or bring any new owners into the IBE corporate structure. Since the ownership of IBE and its affiliates remains the same, as approved in the Merger Order subject to the conditions adopted there, the issues of ownership or market power do not arise anew in the reorganization proceedings. Nevertheless, the proposed restructuring more closely links New York's regulated utilities and their ratepayers to IBE's U.S. affiliates that operate in competitive markets, raising risks not present under the prior structure. If, however, the harms posed to ratepayers can be mitigated through conditions that modify the proposed corporate

structure to reduce risk to the benefit of ratepayers, the reorganization can be approved as in the public interest.

The Conditions Staff proposes as necessary to justifying approval are set forth in Appendix A. These Conditions address to the extent practicable: financial protections that shield ratepayers from the potential for adverse consequences that could attend the reorganization; corporate governance requirements that further protect ratepayers and address the issues raised in the audit; and, affiliate relationship requirements that separate the regulated utilities and their ratepayers from the risks the posed by the affiliations with IBE and its competitive market subsidiaries.

Moreover, compliance with the audit Recommendations transferred to the restructuring proceedings is addressed in Appendix B. There, Staff has identified the additional efforts it believes necessary to achieve compliance for those Recommendations where the Petitioners have not yet demonstrated that their plans for achieving compliance are adequate to date. With these measures in place, the issues presented in these proceedings would be resolved, and the reorganization could be permitted to proceed.<sup>12</sup>

#### Risks Posed By the Reorganization

The salient feature of the reorganization, as the Petitioners currently propose it, is the transformation of IUSA from a holding company owning only regulated utility subsidiaries to a holding company that also owns IRHI and its suite of competitive market businesses. Prior to the

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<sup>12</sup> Approval of the reorganization in Case 12-M-0066, where the impacts on fully regulated utilities and their ratepayers is at issue, carries with it approval in Case 12-E-0065, where the impacts related to IRHI would be reviewed with less scrutiny because it is subject to lightened ratemaking regulation.

reorganization, IUSA was purely a utility operation raising only the risks of affiliation with its service company subsidiaries that furnish shared services. NYSEG and RG&E purchase those services instead of providing them through their own personnel. Since the service companies deal only with regulated utilities, the risks posed by affiliation with competitive market participants are absent. Long-established principles of managing and accounting for the type of affiliate relationship are adequate to supervise the relationship between the service companies and the New York utilities and avoid impacts adverse to New York ratepayers.

Moving IRHI and its competitive operation into the IUSA alters fundamentally the role of the holding company structure. Formerly, the impact of IRHI's competitive market activities was isolated from the New York utilities because IRHI's financial circumstances could affect those utilities only through IRHI's impact on IBE itself. The conditions adopted in the Merger Order ring-fenced the New York utilities from difficulties IBE might encounter. Now, however, IRHI's credit ratings and the financial difficulties it might encounter would affect IUSA, the owner of the New York utilities, and could be more readily and directly transmitted to New York ratepayers.

Moreover, formerly IRHI filed its own tax return for its U.S. operations. Post-reorganization, IUSA will file a consolidated tax return for the operations of both its utilities and IRHI. A consolidated tax return joins the regulated and competitive market affiliates together and could expose New York ratepayers to tax liabilities that are the responsibility of IRHI and IBE.

The closer relationship between regulated and competitive market companies poses other potential problems. Currently, the IUSA service companies limit their operations to

relationships with regulated utilities. Now that IRHI would join the IUSA family, it might desire to purchase services as well.<sup>13</sup> Providing services to a competitive market participant as well as to regulated utilities raises the specters of cross-subsidization, misallocation, and hidden transaction costs.

These features are already present in the relationship between the regulated companies and IEP. That engineering affiliate provides services to both the utilities and competitive market companies. Consequently, the risks present in that relationship must be considered further. IEP's role also raises the additional issue of using affiliate services instead of creating the capability to perform those services at the regulated New York utilities themselves.

Moreover, corporate governance requires further attention because of the audit Recommendations. In the audit, IUSA Board of Directors engagement was described as "weak," and it was criticized for its lack of focus and lack of leadership in examining, monitoring and driving corrective actions. Further criticisms of the IBE and IUSA Board operations included lack of independent oversight by the IUSA Board, which is described as comprised of an insufficiently diverse membership; domination of IUSA and subsidiary Boards by Spanish executives and systemic problems in the relationship between Spanish governance and U.S. affiliate operations; insufficient regulatory transparency; and, inadequate informational flows.

The creation of Networks as an intermediate holding company between IUSA and U.S. utility operations does not cure either the adverse impacts attending IRHI's affiliation with

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<sup>13</sup> For example, since the regulated and unregulated affiliates will be filing a consolidated tax return, some administrative tax preparation costs that are a joint responsibility could be incurred at the service company level.

IUSA or the corporate governance deficiencies. Given Networks' position as a wholly-owned subsidiary of IUSA, it would merely transmit any IRHI-caused difficulties from IUSA through to the New York utilities. Moreover, the same problems concerning corporate governance of IUSA would also affect Networks, as the Petitioners do not propose to structure Networks much differently from the current structuring of IUSA. As a result, the reorganization as proposed would expose New York ratepayers to the potential of substantial harm and could not be approved for that reason.

Nonetheless, the potential for impacts adverse to ratepayers attending the proposed reorganization can be satisfactorily cured, and ratepayers adequately protected, through an appropriate package of reorganization Conditions. These Conditions would advantage ratepayers by enhancing the protections insulating them from financial or organizational difficulties that IBE might confront. For example, the Conditions would erect a barrier against the transmogrification of IBE into a vehicle for transmitting to New York ratepayers the risks attending the well-known effects of the financial crisis that have spread across the entire Spanish economy. An improved governance structure could also be arrived at, alleviating the concerns raised in the audit.

A properly conditioned reorganization would enable IBE to better manage its holding company structure in the U.S. The parent could achieve more efficient operation through the reorganization, and the efficiencies attending holding company ownership, as mentioned in the Merger Order, would be better realized. Moreover, consolidated tax returns combining regulated utility and competitive market operations are a common feature of U.S. holding company operations. IBE should be allowed to pursue a holding company structure deemed generally

acceptable in the U.S., if ratepayer harms can be avoided. As a result, approval of the reorganization is warranted and would be reasonable, if satisfactorily conditioned.

The Reorganization Conditions

Conditions to mitigate the potential for harm attending the proposed reorganization are needed in three areas. First, financial protections separating the New York utilities from adverse impacts attending financial difficulties at IRHI or IBE are needed. Second, corporate governance should be addressed. Third, affiliate relationships between the New York utilities, Networks and its service companies, and other IUSA affiliates should be carefully examined, necessitating a reconsideration of the financial and corporate protection conditions that were first adopted in the Merger Order.

A. Financial Conditions

Financial conditions begin with measures for ensuring that a consolidated tax return reflecting IRHI operations does not redound to the detriment of New York ratepayers. As a result, IUSA should be required to indemnify NYSEG and RG&E if they incur any tax obligations other than those they would have experienced on a stand-alone basis. Tax benefits NYSEG or RG&E would have obtained on a stand-alone basis must continue to be attributed to them. A tax sharing agreement embodying these principles and allocating tax benefits and obligations among the IUSA companies participating in the consolidated tax return should be required (Conditions 4-6). It should be presented in a compliance filing in this proceeding made within 90 days following the closing of the reorganization transaction (the 90-day compliance filing). Of course, New York ratepayers shall not be charged any of the transaction or implementation costs arising out of or related to the reorganization (Condition 7).

To further isolate and ring-fence NYSEG and RG&E from IRHI and IBE, a minimum common equity ratio restriction should be adopted. Under this restriction, NYSEG and RG&E would be required to maintain a minimum equity ratio of no less than 300 basis points below the ratio used to set their rates. Moreover, in the event ratings at NYSEG, RG&E, Networks, IUSA or IBE are downgraded to the lowest investment grade with a negative watch, or to non-investment grade, NYSEG and RG&E would be prohibited from issuing dividends that would cause average common equity to fall below the maximum ratio employed in the NYSEG and RG&E earnings sharing mechanisms adopted in their most recent Rate Plan.<sup>14</sup> Credit rating agencies view these sorts of restrictions as providing greater ring-fencing protection for subsidiaries, like NYSEG and RG&E, from credit risk at parents, like IBE, and affiliates, like IRHI. An imputation of credit ratings to NYSEG and RG&E holding them harmless from affiliate actions offers further protection (Condition 20), as would credit rating objectives requiring maintaining credit ratings at an acceptable investment grade level (Condition 21).

Additional informational requirements would also assist in protecting ratepayers. Appropriate reporting measures and access to books and records are identified at Condition 13, and additional rate case informational requirements are set forth at Condition 23.

B. The Debt Issuance Recommendation

The costs NYSEG and RG&E incur in issuing debt should be minimized to the extent practicable. An assessment of the costs and benefits of issuing debt only through securities fully registered with the Securities and Exchange Commission (SEC) is

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<sup>14</sup> Case 04-E-0715, et al., New York State Electric & Gas Corporation and Rochester Gas and Electric Corporation, Order Establishing Rate Plan (issued September 21, 2010).

the most beneficial approach for ratepayers (Condition 2). Staff concludes, based on the results of two studies discussed below, that SEC-registered securities offer a significant long-term cost savings opportunity for NYSEG and RG&E. This approach would yield interest savings of over 40 basis points on each security issued by NYSEG and RG&E. Over a ten year period, the utilities could realize almost \$48 million (nominal) in savings, net of the estimated additional costs incurred in obtaining SEC registration. Such a change in strategy would carry with it additional benefits. Through meeting SEC requirements, the transparency of NYSEG and RG&E's financial reporting would improve, and regulatory oversight of their finances would be enhanced.

A utility may issue debt in three ways: through a public offering registered with the Securities and Exchange Commission (SEC) and subject to its full oversight; through §144A debt, which is subject to limited SEC oversight, or through a private placement free of direct SEC supervision. An SEC public issuance of debt is an offering that is sold directly to public investors. A private placement is a direct offering of securities to a limited number of sophisticated investors, typically insurance companies, pension funds, mutual funds and trusts. Securities issued as private placements include debt, equity, and hybrid securities.

Private placements are exempt from SEC registration. They are also illiquid and very difficult, if not impossible, to resell. Section 144A debt is restricted debt that can only be bought and resold by large, sophisticated buyers ("qualified buyers"). A qualified buyer is an entity that in the aggregate owns and invests at least \$100 million, or \$10 million in the case of a broker-dealer, in securities of issuers not affiliated with the entity. Typically, qualified buyers are insurance

companies or mutual funds. In recent years, NYSEG and RG&E have chosen to issue their securities exclusively through private placements.

Issuances of public securities, however, must be registered with the SEC under the Securities Act of 1933, which has a principal objective of opening to investors financial and other significant information on securities being offered for public sale. This objective is accomplished by requiring that issuing companies disclose important financial information through the registration of securities, enabling investors to make informed decisions on the purchase of a company's securities. Among the information that must be disclosed to investors are: 1) a description of the company's properties and business; 2) a description of the security to be offered for sale; 3) information about the management of the company; and 4) financial statements certified by independent accountants. The registration process carries with it SEC oversight and enforcement, which ensures consistent and accurate financial reporting. The SEC regulatory regime gives investors confidence that the financial information provided by issuers is fair and accurate and has been rigorously reviewed.

SEC registration greatly improves the transparency of the registrant's operations, financial health and management. Information on management compensation, affiliated transactions, and unexpected events, such as hedging losses like RG&E has experienced in the past, are subject to disclosure through paths not currently found in devices such as the Annual Report required under the PSL. The enhanced transparency translates into greater regulatory efficiency in protecting ratepayers from utility misfeasance, even if the value of that benefit is difficult to quantify in monetary terms.

SEC-registered debt does generate significant fees and paperwork for registrants. Based upon an analysis presented in the Central Hudson acquisition proceeding,<sup>15</sup> the on-going costs NYSEG and RG&E would incur upon becoming SEC registrants are estimated at \$1.78 million annually. However, the interest cost savings realized because of the relative liquidity of SEC-registered securities more than offset the costs of registration.

Fundamental financial theory supports the conclusion that a more liquid and more transparent security will carry a lower yield and create cost savings, because the level of transparency and liquidity has a positive effect on the return required for a particular security. The effect of the illiquidity of private placements on debt yields compared to public offerings can be ascertained in an empirical fashion. While the Petitioners may contend that yield differences between public issuances and private placements vary over time, two studies demonstrate that privately placed debt carries, over time, an overall premium when compared to fully SEC-registered debt. The first study is published by the Federal Reserve Bank of San Francisco (Reserve),<sup>16</sup> issued in November 2004, and is entitled, "Financial Contracting and the Choice between Private Placement and Publicly Offered Bonds," and is available online at <http://www.frbsf.org/publications/economics/papers/2004/wp04-20bk.pdf>. The second study is a Staff analysis of electric and gas utility issuances made during the year 2012.

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<sup>15</sup> See Case 12-M-0192, Fortis, Inc. and Central Hudson Gas & Electric Corporation, Joint Proposal (January 25, 2013).

<sup>16</sup> This study focuses on the differences between private placements and fully SEC-registered public debt and does not address §144A debt.

The Reserve study found that private placements were more likely to be subject to restrictive covenants,<sup>17</sup> and were more likely to be issued by smaller and riskier borrowers.<sup>18</sup> More importantly to this analysis, the study found that bond yield spreads were different between private placements and public issuances.

The Reserve Study presented data that showed large public private large bond issuances for large companies yielded a median 45 basis points, and a mean of 39 basis points, of savings when compared to large private issuances.<sup>19</sup> These cost savings are statistically significant, and their calculation is conservative since the net cost of a registered issuance would probably be less than reported in the working paper due to differences in the flotation costs between the two types of issuances that may be overstated in the Study. Since the working paper was published in 2004, it is useful to examine more current data to see if the size of the premium remains the same.

That step is taken in the second study performed by Staff, of electric and gas utility issuances in 2012. It yielded similar results to the Reserve Study. Data concerning issuances was collected using the Capital IQ internet service. After eliminating debt issuances that were issued on the same day by the same utility using different means of issuance

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<sup>17</sup> Staff's experience is that the utilities have issued private placement debt with very restrictive "yield to treasury" call provisions that effectively preclude the issue from being called.

<sup>18</sup> The median small issue in the study was \$40 million.

<sup>19</sup> The median large issue was \$125 million. These large amounts are consistent with the amounts that have been issued by NYSEG and RG&E.

(public, private and §144A), an analysis, attached as Table 1, was performed on 41 utility issuances. Table 1 shows that prior to adjustment for credit quality, long-term private issuances and §144A issuances were 21 basis points more expensive than public issuances.<sup>20</sup> Moreover, the companies who issued privately or through Section 144A had better average credit ratings than companies that issued publicly. All things equal, this would suggest the companies choosing private placements should have had a lower cost to issue to begin with.

While the average credit ratings of both the privately issued debt and Section 144A debt were halfway between A- rated debt and A rated, the average public issuance carried a credit rating between BBB+ rated and A- rated. Table 2 uses yield data from the Mergent Bond Record for 2012, as published in January 2013, to develop average yields in 2012 for A rated, A- rated, BBB+ rated, and BBB rated debt. This data was then interpolated to develop rate differentials between public issuances and private placements and Section 144A debt. This analysis showed that adjusted for credit quality, public debt issuance yields are 41 basis points lower than their private and §144A counterparts. This result is nearly identical to the 2004 Reserve study.

These studies demonstrate that there are real and tangible long-term benefits from issuing public issuances. The appropriate evaluation of those benefits, however, is whether they are still economical after their value is offset against the estimated annual costs of registering the SEC debt. Table 3 is a cost benefit analysis showing that the use of SEC-

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<sup>20</sup> The much smaller number of private issuances, at two, compared to the 37 to public issuances, supports the inference that public debt is the preferable option.

registered debt does indeed result in net cost benefits to ratepayers.<sup>21</sup>

This analysis is dependent upon the amounts of the debt the Companies will issue in the future and the timing of those issuances; only future SEC-registered debt will obtain the 41 basis point savings. The current RG&E financing petition in Case 12-M-0561, and the 2010 Order on the NYSEG's most recent financing request,<sup>22</sup> provide reasonable estimates of the amount of new debt each utility can be expected to issue over time (including issuances for refinancing purposes). These issuances amount to approximately \$500 million for each utility over a three year period. This translates into average annual issuances of approximately \$150 million for each utility. The analysis is premised upon an escalator rate of 2% on issuance costs that reflects the inflation rate offset by the productivity enhancements realized as the task of preparing annual reports and other registration information for the SEC becomes more familiar. The discount rate used is a conservative 7.5%, which represents an approximation of each utility's after tax cost of capital.

While in the short term, the costs of SEC registration exceed interest rate savings achieved in comparison to private placement or §144A costs, over time, however, those savings will

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<sup>21</sup> Confirming this analysis, Table 4 shows two RG&E issuances, in 2008 and 2009, where the issuance premium for private placement was 105 and 93 basis points, respectively, above the cost of comparable SEC registered debt (two NYSEG issuances and another RG&E issuance also shown in the Table are not directly comparable to other issuances because, instead of issuance immediately following the time the cost was set, issuance was delayed significantly beyond that time).

<sup>22</sup> Case 10-M-0182, New York State Electric & Gas Corporation, Order Authorizing Issuance of Securities (issued June 19, 2010).

more than offset the cost of SEC reporting and fees, resulting in the significant benefits shown in Table 3. The net present value of those savings to customers amounts to \$28.2 million over a 10-year period. Using a more conservative annual issuance amount of \$75 million, instead of the \$150 million figure discussed above, still produces net present value savings of \$8.0 million over a 10 year period. Even if issuances were sized at smaller amounts, any size disadvantage adhering to SEC registered debt is likely mirrored in the private debt market as well.<sup>23</sup>

This analysis demonstrates that there are significant, quantifiable savings from issuing debt publicly rather than continuing the companies' recent practice of issuing debt through private placements or the use of §144A debt. Consequently, a condition requiring the use of SEC-registered debt is reasonable.

C. Governance Conditions

The governance concerns raised in the audit can be addressed through properly structuring the Boards of Directors of IUSA and its various affiliates, providing for Board empowerment, and increasing transparency. Appropriate conditions in the reorganization proceedings can be coordinated with compliance measures NYSEG and RG&E have taken in conformance with audit requirements to arrive at a governance model that adequately meets the concerns that have been expressed in the audit.

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<sup>23</sup> RGE's past behavior indicates that size is not a dispositive factor in selecting between public and private debt; as its Annual Reports show, between 1992 and 2003, it frequently chose public debt as the vehicle for issuances of \$75 million or less.

As to the reorganization Conditions, governance begins with appropriate access to information, which is provided for at Condition 1. Moreover, NYSEG and RG&E should be required to provide a Quarterly Governance Report identifying changes in directors, officers or executives, listing major transactions engaged in by companies in the U.S. regulated holding company structure, and identifying significant changes in capitalization at those companies (Condition 3).

Conditions are also needed to further ensure that Directors are independent and that they are familiar with issues affecting regulated New York operations. Accordingly, at least one-third of the Directors at Networks should be independent as that term is defined by the SEC, and a lead independent Director should be designated on a rotating basis with the responsibilities listed at Condition 9. At least one-half of the Networks' independent Directors should meet the residency, work experience and other eligibility requirements listed at Conditions 9 and 14. Moreover, a mechanism should be created whereby Staff and Commissioners may submit written communications to the Networks Directors (Condition 9).

As noted in Appendix A, these provisions strike a balance between effective Board governance and burdens on company management that the Commission may wish to consider further, if strengthening of governance requirements is considered necessary. The Petitioners are advised that they are responsible for justifying the proposed balancing as sufficiently stringent.

The proper structuring of the Networks Board's A&CC is also important; two-thirds of Directors on that committee should be independent, including the Chair. The Directors should also meet requirements establishing their capabilities to address financial issues (Condition 22). Again, the proposed approach

strikes a balance between effective Board governance and burdens on company management that the Petitioners are expected to justify, instead of more stringent measures.

Other governance requirements would bolster effective and transparent administration. The same person should not hold the CEO and Chair of the Board position at the companies in the regulated U.S. corporate structure (Condition 11). Conflict of interest provisions should be adopted, preventing Directors from pursuing interests in competitors to NYSEG, RG&E and Networks, and requiring disclosure if a Director has an interest in an unaffiliated entity adverse to, or that conducts significant business with, NYSEG, RG&E or Networks (Conditions 16-17).

D. Appendix I of the Merger Order

The adoption of the proposed reorganization Conditions for financial protection and corporate governance require revisions to Appendix I of the Merger Order, where the prior financial protection and governance protections reside. A revised Appendix making the revisions is set forth at Appendix C.

When the Commission considered the financial and corporate structure issues related to the acquisition of Energy East by IBE in the Merger Order, it concluded that the risks of the IBE holding company structure required mitigation through certain conditions. Concerns were expressed about transparency in reporting, potential affiliate company abuses, the complexity of the corporate structure interfering with effective regulation, the riskiness of IBE's competitive ventures, and the possibility of harm to NYSEG and RG&E as a result of the unpredictability and potential financial deterioration associated with IBE's other enterprises. These risks could undermine the utilities' access to capital or increase its costs, and could threaten the merged companies' ability to

maintain appropriate levels of safety, reliability, and customer service performance.

Moreover, the prior financial and corporate conditions were adopted when IUSA served as the effective owner of NYSEG and RG&E (the intermediate RGS holding company being a shell). Now, both IUSA and Networks will actively engage in governance that affects NYSEG and RG&E. As a result, the Appendix I conditions must be properly allocated to the two holding companies.

The proposed corporate restructuring exacerbates the risks for NYSEG and RG&E identified in the Merger Order, and the passage of time has revealed that risks associated with the holding company structure have intensified as a result of weaknesses spreading to IBE through its association with the troubled Spanish economy.<sup>24</sup> Moreover, the proposed restructuring moves IRHI, with its riskier unregulated U.S. wind energy operations, directly under IUSA, which is also the domestic upstream parent of NYSEG and RG&E. That structure could create credit issues for IUSA.

Initially, the Petitioners requested relief for IUSA from Merger Order Appendix 1 §2(a),(b),(d), and (f) and §5(a),(c), and (d), "because Networks will assume IBUSA's current position within Iberdrola's corporate structure (i.e., as the intermediate holding company for Iberdrola's regulated U.S. electric and gas utilities)." The Petitioners state in their Second Supplemental Filing that they have been able to reduce this list to four financial transparency and reporting obligations -- Appendix 1 §2(a), §2(f), §5(c) and §5(d) -- that

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<sup>24</sup> The Petitioners themselves detail this risk at page 19 of their First Supplement.

should be moved from IUSA to Networks following the reorganization.

For the reasons discussed below, proposals to modify Merger Order conditions §2(a) and §2(f) should be rejected and §5(c) and §5(d) should be approved. Furthermore, all obligations under the Merger Order initially placed on ISA, IUSA, RGS, RG&E, and NYSEG should remain in place and be extended to include Networks as appropriate.

The Petitioners request that §2(a), which obligated IBE, IUSA, NYSEG, and RG&E to provide to Staff any presentations made to credit rating agencies, be modified to exclude IUSA. Under §2(b), however, IBE, IUSA, NYSEG, and RG&E, and now Networks as well, must register with the three major nationally and internationally recognized bond rating agencies, Standard & Poor's, Moody's Investor Service, and Fitch Ratings, and must maintain at least an investment grade credit rating. The Petitioners now want to limit the presentations required under §2(a) to those of Networks in lieu of those of IUSA, even though §2(b) remains in effect.

Section 2(f) required that if a ratings downgrade occurs, as described in Section 2(d), Iberdrola, IUSA, NYSEG, and RG&E, and now Networks as well, must be required to file a plan within 60 days explaining the remedial actions that will be taken to address and rectify the situation. A dividend payment could be made if the Commission or its designee specifically approves the payment of dividends or transfer of items of value in light of the remedial plan, or if the relevant credit rating was restored. The Petitioners request that the remedial plans be filed by Networks rather than IUSA.

Since IUSA will remain the upstream parent of Networks and the utilities, IUSA's financial condition and its relationship to the utilities and Networks finances remain

substantially linked. The concerns expressed by the Commission in the Merger Order also continue, as exacerbated by the proposed corporate structure. As a result, the Merger Order conditions should generally remain in effect after the reorganization and should continue to apply to IUSA. Rather than relieve the conditions that apply to IUSA and transfer them to Networks, the Merger Order concerns are best addressed by applying most of these conditions to both IUSA and Networks.

The rationale for the application of certain acquisition conditions to both Networks as well as IUSA is reasonable, since the Networks, in the new organizational structure, will be taking the place of IUSA under the present corporate structure. Nevertheless, IUSA remains a domestic parent, continuing many of the same functions it fulfilled under the present structure while also assuming responsibility for IRHI's higher-risk competitive market renewable operations. As a result, the Merger Order Conditions cannot be simply transferred to Networks, and most should remain in place for IUSA, so that its finances, as affected by IRHI's operations, can be monitored. Continued vigilance is necessary; thus, IUSA should not be relieved of the Merger Order Appendix I §2(a) and §2(f) requirements on providing credit rating agency presentations and submitting remedial action plans.

Appendix I §5(c) and (d), however, concern IUSA's obligations to provide annual certifications of compliance with SOX and annual attestation audits by independent auditors, respectively. The IUSA request that Networks assume those responsibilities is not objectionable. Networks will be the intermediate parent of Iberdrola's U.S. regulated operations and its financial reporting will be most relevant to PSL regulation.

With the above provisions in place, the additional protections that might be obtained by treating IUSA, under

Appendix 1 §5(c), as if it were a publically traded company for SOX purposes, instead of treating it as directly bound by the SOX provisions that would be applicable to its existing form of organization, need not be pursued further. This resolves the SOX issue transferred to the reorganization proceeding by the Audit Recommendations Order.

E. Affiliate Relationship Conditions

Because IRHI will be moved into closer proximity with NYSEG and RG&E, and in response to the audit Recommendations and criticisms regarding affiliate transactions, including the relationship between the regulated New York utilities and IEP, the reorganization should not be approved unless protections against affiliate transactions that can adversely affect ratepayers are strengthened. As a result, the Petitioners should be required to provide notification of any services that the service company affiliates of IUSA provide to IRHI, or other companies that are not subsidiaries of Networks, if the services exceed the value identified in Condition 10. The notice would be accompanied by a showing that the provision of the service would not harm New York ratepayers.

NYSEG and RG&E should also meet more stringent reporting requirements for making changes to the existing standards of conduct. In that regard, the Standards of Conduct should also be updated to reflect the changes in corporate structure effectuated through the reorganization (Condition 12). That update should be provided in the 90-day compliance filing. Staff's ability to make proposals for the modification of the Standards of Conduct should be made explicit, given the potential for transactions not reviewed here and the continuation of the use of IEP services, if permitted (Condition 15).

Moreover, the Standards of Conduct currently prevent certain interlocking of officers and directors of the New York regulated utilities with officers and directors of other affiliates. Those conditions preventing interlocking relationships should be updated and strengthened, as provided for in Condition 14. Other provisions intended to assure that NYSEG and RG&E remain independent of other IBE affiliates include requiring stand-alone treatment for ratemaking purposes (Condition 18), and requirements to maintain headquarters and emergency field operations within their service territories (Condition 19).

In the Audit Recommendations Order, it was decided that the issue of consolidating NYSEG and RG&E into a single operation required further consideration, notwithstanding that the Final Audit Report concluded otherwise. Consolidation issues, however, would better be considered subsequent to the reorganization in another more appropriate proceeding (Condition 27).

F. The IEP Relationship

As the audit requires at Recommendations 2.1 and 11.1, an in-depth analysis of the relationship between IEP and NYSEG and RG&E is needed. The Petitioners filed, on February 4, 2013, an Engineering Resource Plan addressing the levels of engineering employment the Petitioners believe are needed at NYSEG and RG&E, and identifying the engineering services each would purchase from IEP instead of relying upon in-house expertise. Evaluation of that study, however, will take some time.

In the interim, further embedment of IEP services into NYSEG and RG&E operations should be restricted, to accomplish the purpose of Recommendation 2.1 through a less stringent

remedy.<sup>25</sup> First, levels of employment should be maintained at NYSEG and RG&E sufficient to meet engineering needs without additional reliance on IEP (Condition 26). Staff has examined the confidential information NYSEG and RG&E submitted in their last rate proceeding on expected employment levels and backfilling of positions to offset the loss of employees resulting from early retirement plans. Moreover, Staff has also considered the information presented in the Engineering Resource Plan. As a result of this examination, Staff believes NYSEG and RG&E should be required to increase internal engineering resources by filling 25 internal staffing vacancies in existence as of November 20, 2012, within 90 days of the issuance of an Order here.

Second, to prevent the embedment of IEP services into utility operations through escalating purchases of services, utilization of IEP should be limited to 105%, on a dollar basis, of the current monthly payments made to IEP. This monthly run rate is set at \$1.07 million. With these provisions in place, NYSEG and RG&E should be able to meet their engineering needs without increasing the level of services purchased from IEP, freezing the relationship between the utilities and IEP until a final resolution of the issues surrounding use of IEP can be resolved.

To the extent that NYSEG and RG&E already depend on IEP services, however, the relationship should not be terminated precipitously or prematurely. To do so would disrupt capital spending and construction already scheduled to the detriment of ratepayers. Moreover, in an emergency, the utilities may require additional resources that cannot be supported by their

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<sup>25</sup> Under Recommendation 2.1 as specified in the Final Audit Report, use of IEP would have been suspended altogether.

existing employees and are best obtainable from IEP. As a result, NYSEG and RG&E should be permitted to secure additional services from IEP beyond the above restriction in the event of an emergency, but only after first consulting with Staff concerning the nature of the emergency, the additional services needed and their cost.

G. The Gas Executive and Gas Operations

In their Second Supplemental Filing, the Petitioners submitted substantial information on the structuring of the NYSEG and RG&E gas businesses, relevant to Recommendation 2.2, which suggests that the gas business should be consolidated under a single executive reporting to a utility's chief operations officer. The additional information the Petitioners have submitted demonstrates that changes they have made to the structuring of gas operations at NYSEG and RG&E, and the explanations of existing structures that were not modified, are sufficient to show that the structure now is satisfactorily configured.

One feature of that structure, however, is that a Gas Strategic Planning Committee (GSPC) has been created. The Petitioners should be required to show in the 90-day compliance filing that the GSPC meets on a regular basis, adequately discusses gas business strategy and planning, and develops long-term plans. They also should be required to submit, to the Secretary and the Director of the Office of Electric, Gas and Water, notes taken at GSPC meetings, within 30 days of the date of each meeting.

The Audit Recommendations

In their Second Supplemental Filing of February 1, 2013, the Petitioners provide additional information on their compliance with the audit Recommendations transferred to the reorganization proceedings. The Second Supplemental filing

appears to meet the spirit of a number of the Recommendations subject to continued monitoring of the implementation of the Recommendations in the ongoing audit proceeding to ensure that its intent is met. The Second Supplemental Filing therefore demonstrates that the Petitioners' compliance plans are satisfactory to date, subject to the continuing review provided for above, for Recommendations 2.3, 2.7, 10.3, 14.2, 14.4, 14.8, and 14.9. The remaining recommendations require either additional reporting or enhanced compliance efforts.

Pursuant to Recommendation 2.4, the IUSA Board will evaluate CEO and other high-level management personnel performance. To prevent a conflict of interest, a Director who reports to the officer being evaluated should be prohibited from participating in the evaluation, or deciding the officer's compensation. Written guidelines implementing this requirement should be submitted in the ongoing audit compliance process.

While declining to recommend specific remedial actions, the auditors found, in Recommendation 2.5, that there were gaps between IBE governance and IUSA operations not readily resolvable through specific actions. Many of the 27 reorganization Conditions, however, address the auditor's concerns. Conditions are aimed at improving the independence and transparency of the IUSA governance model and increasing financial separation from IBE and its competitive market affiliates, addressing to a reasonable extent the concerns raised in the audit. Therefore, so long as the Conditions are implemented, Recommendation 2.5 should be deemed satisfied.

To address a gap it perceived between IBE and IUSA governance, the auditor, in Recommendation 2.6, urged that IUSA personnel take a more central role in communicating U.S. issues to senior IBE executives and the parent Board. The Petitioners argue IUSA personnel satisfactorily communicate U.S. regulatory

requirements and other issues to IBE executives on a regular basis.

The efforts the Petitioners describe are not sufficient to demonstrate compliance with this Recommendation. Instead, additional compliance efforts are needed. The Petitioners should be required to create concrete mechanisms, for submission and review in the audit compliance process, that provide for the regularly scheduled preparation and transmission of written communications from IUSA to IBE executives and the IBE Board. The IBE executives should confirm that the communications to them were received and the communications to the IBE Board should be listed on its agendas when they are considered. These concrete mechanisms should improve communications between IUSA and IBE.

Recommendation 14.5 is directed towards improving the organizational structure for ensuring compliance with ethical responsibilities. Under the recommendation, ethics compliance reporting directly to the IUSA CEO is favored, as is the separation of ethics compliance efforts from the direct supervision of the General Counsel. While the Petitioners present some support for their argument that eliminating the General Counsel from any role in ethics compliance would be counter-productive, on the other hand, access of ethics compliance officers to the CEO is a necessary structural improvement.

The Petitioners point out that there is a separate Compliance Officer, besides the General Counsel, with independent authority to investigate ethical violations, notwithstanding that the Compliance Officer reports to the General Counsel. So long as written guidelines establishing the means and provisions for direct and immediate access of the Compliance Officer to the CEO, and other high-level officers,

are in place and are adequate to ensure the requisite access, the role of the Compliance Officer should be deemed to satisfy the intent of Recommendation 14.5. Therefore, the Petitioners shall demonstrate in the ongoing audit review process that such written guidelines are in place.

With these enhancements, the audit recommendations transferred to the reorganization proceedings are adequately addressed to date. Ongoing review of compliance, however, should continue in the audit compliance process.

#### CONCLUSION

Upon the attachment of the package of conditions recommended above to the Petitioners' proposed holding company structural reorganization, that reorganization should be permitted to proceed. Moreover, subject to the information on audit Recommendations submitted in the Second Supplemental Filing, and the enhancements described above, no further action is needed on the audit Recommendations transferred to the reorganization proceedings at this time, albeit the implementation of the Recommendations remains subject to further review to ensure compliance.

Therefore, ongoing review of the implementation of the reorganization Conditions should continue in Case 12-M-0066, subject to the compliance filing process described above. Continuing review of compliance with the audit conditions should take place in the audit compliance process, with the caveat that Recommendations 2.1 and 2.2 will be treated through reorganization conditions instead of in the audit process.

Dated: March 25, 2013  
Albany, New York

**CASE 12-M-0066/CASE 10-M-0551 – PETITION FOR APPROVAL OF A REORGANIZATION/MANAGEMENT AUDIT  
STAFF’S PROPOSED REORGANIZATION CONDITIONS**

Staff Condition	Description	Comment
1) Access to Governance Information	<p>I. The Companies shall provide access to board agendas for Networks, IUSA, IEP, IRHI, and IBE. With respect to IUSA, IEP, and Networks, the Companies shall provide access to all board and committee minutes and related materials. With respect to IBE, the Companies shall provide access to board and committee minutes and related materials, to the extent related to the U.S. businesses. With respect to IRHI, the Companies shall provide access to board and committee minutes and related materials to the extent related to the U.S. income tax matters. The Companies shall also provide additional board and/or committee minutes and/or related materials from IBE upon a specific request with a stated basis. Notwithstanding the foregoing, the Companies shall not be required to provide IBE minutes and related materials for transactions involving operating companies that are unrelated to U.S. utilities or their holding companies.</p> <p>II. During management or operations audits conducted pursuant to the Public Service Law, the companies shall provide full and complete access to all board and committee minutes and related materials.</p>	<p>Assumes:</p> <ol style="list-style-type: none"> <li>1. IBFL is removed from the ownership structure for the new IUSA.</li> <li>2. IRHI does not engage in transactions with NYSEG, RG&amp;E or Networks (other than interconnections)</li> <li>3. IEP is allowed to continue transactions with NYSEG/RG&amp;E; if those transactions are prohibited, IEP will be treated like IRHI</li> </ol>
2) Debt Securities	NYSEG and RG&E shall issue debt as fully registered SEC securities because it is the most cost effective option, and because additional benefits of fully SEC registered securities issuances include increased transparency and SEC oversight.	
3) Governance Reports	<p>The Companies shall provide to Staff a quarterly governance report to notify Staff of the following:</p> <ol style="list-style-type: none"> <li>a) changes in directors, committee members, officers or executives at NYSEG, RG&amp;E, Networks, and IUSA;</li> <li>b) a list of completed major transactions (<u>i.e.</u>, at least 5% of IUSA net assets) that relate to or affect NYSEG, RG&amp;E, Networks or IUSA; and</li> <li>c) Significant changes in capitalization at NYSEG, RG&amp;E, Networks, and IUSA.</li> </ol>	
4) Tax Indemnification	The Companies commit to have IUSA indemnify NYSEG and RG&E customers for tax obligations other than those that would have been incurred by NYSEG or RG&E on a stand-alone basis. The contractual mechanism for implementing the tax indemnification would be set forth in the Tax Sharing Agreement referenced in Recommendation #6 and shall be included for review in the 90 day compliance filing.	

5) Tax Benefits	For ratemaking purposes, NYSEG and RG&E customers shall be held harmless from any adverse tax consequences that may occur as a result of affiliation with other companies. Income tax expense charged customers will be computed as if they were able to receive the benefits of any NYSEG or RG&E losses, credits or deductions that would have been attributable to NYSEG or RG&E on a stand-alone basis, subject to normalization rules applicable to NYSEG and RG&E.	
6) Tax Sharing Agreement	After the Reorganization is completed, the consolidated U.S. taxpayer for the U.S. subsidiaries of Networks and IRHI will be IUSA. A Tax Sharing Agreement will be used to allocate tax benefits and obligations among these companies. NYSEG and RG&E shall submit the Tax Sharing Agreement as a compliance filing in this proceeding, within 90 days following the closing of the Reorganization.	
7) Restructuring Costs	NYSEG or RG&E customers shall not be charged for any implementation or transaction costs arising out of or related to the Reorganization.	
8) Minimum Equity Ratio	A minimum equity ratio requirement shall be implemented. NYSEG and RG&E shall be required to maintain a minimum common equity ratio (CER) (measured using a trailing 13-month average) at the same equity ratio used to set rates. At each month-end, NYSEG and RG&E shall be required to maintain a minimum equity ratio of no less than 300 basis points below the equity ratio used to set rates. If gas and electric equity ratios for ratemaking purposes differ within a particular Company (either NYSEG or RG&E), then the Company shall use a weighted average for purposes of this provision. In the event that NYSEG, RG&E, Networks, IBE or IUSA ratings are downgraded to the lowest investment grade with a negative watch, or ratings are downgraded to noninvestment grade, NYSEG and RG&E shall be prohibited from issuing dividends that would result in a trailing 13-month average common equity less than the maximum equity ratio utilized for the Companies' earnings sharing mechanism (e.g., currently 200 basis points above the equity ratio used to set rates).*	<i>*This would replace the current merger condition that prohibits any dividends if any of the bond ratings of the utilities or the parent companies are downgraded to non-investment grade.</i>
9) Independent Directors	<p>I. At least one-third* of the directors at Networks shall be "independent directors", as defined in SEC Rule 4200(a)(15).** At least half of the independent directors must either live or work in the service territories of NYSEG or RG&amp;E or have more than 10 years of relevant work experience in the regulated utility or energy industry, but in all cases, the Board must have at least one member who meets the residency requirement. The Companies shall report on progress in implementing this condition in the 90 day compliance filing. Staff and Commissioners may submit written communications to the Secretary of the Networks Board of Directors, and receipt of a communication will be confirmed in writing. The Board Secretary shall then provide such written communications to the Networks Board of Directors.***</p> <p>II. The Networks Board shall designate a lead independent director. The Board of Directors shall authorize an independent director, to request the chairman of the Board of directors to call a meeting of the Board of Directors whenever such independent Director deems appropriate, to request the</p>	<p><i>*In the Central Hudson/ Fortis acquisition, (Case 12-M-0192), Fortis agreed to appoint independent directors to a majority of Central Hudson's Board (see p. 21 of JP).</i></p> <p><i>**Other more stringent definitions of independence are available; this definition strikes a balance between effective Board governance and burdens on</i></p>

	inclusion of matters on the agenda for Board of Directors Meetings, and to act as a liaison and communicate any issues to the Chairman brought to the lead director if requested by the other independent directors. The lead independent director shall rotate every year.	<i>company management that the Commission may wish to consider further. ***This does not constrain additional access to Board members for interviews during audits.</i>
10) Service Company	<p>I. The Companies shall continue to comply with both the Standards of Conduct and PSL § 110 (which requires the filing of contracts with affiliates). The Companies shall file with the Secretary, copied to the Director of the Office of Accounting and Finance of the Department of Public Service, or its successor Office, all amendments and supplements to the Standards of Conduct or other related guidelines, thirty (30) days prior to making such change(s).</p> <p>II. The Companies shall notify the Secretary, copied to the Director of the Office of Accounting and Finance, of any services that Management Corp (as defined in the Standards of Conduct) provides to IRHI or other companies that are not subsidiaries of Networks in excess of 5% of net income for NYSEG and RG&amp;E. and show in the Notice that the provision of the service would not harm New York ratepayers.</p>	
11) Separation of CEO and Chair	The same person shall not hold the CEO and the Chairman of the Board positions at NYSEG, RG&E, Networks, or IUSA.	
12) Standards of Conduct	Following the Reorganization, the Standards of Conduct, as amended, will be updated to reflect the Reorganization entities, with the updates included in the 90 day compliance filing.	
13) Financial Reporting/ Books and Records	<p>I. The Companies shall continue to provide financial reports for NYSEG, RG&amp;E and Networks under GAAP, and shall provide financial reports for IUSA under IFRS.</p> <p>II. The Companies shall continue to locate NYSEG and RG&amp;E books and records in New York.</p> <p>III. The Companies shall make available to Staff access to all books and records for:</p> <ul style="list-style-type: none"> <li>a) all service and holding companies that have transactions with the New York utilities;</li> <li>b) all tax related records related to IRHI;</li> <li>c) all other entities that have significant transactions with the New York utilities.</li> </ul>	

14) Interlocks	<p>I. The Standards of Conduct currently prohibit certain officers and directors of NYSEG and RG&amp;E from being officers and directors of certain other affiliates. This aspect of the Code of Conduct shall be revised to reflect Networks as the additional intermediate holding company. With respect to interlocking officers and directors and the composition of the utility Boards, a majority of the utility Board of Directors shall be Eligible Directors.</p> <p>II. An Eligible Director is any individual who is not:</p> <ul style="list-style-type: none"> <li>a) an officer or director of HoldCo (other than Networks only); or</li> <li>b) an officer or director of any of IBE's non-utility Affiliates; or</li> <li>c) an officer or director of any Competitive Energy Affiliate or Unregulated Affiliate.</li> </ul> <p>The revisions to the interlocking director matrix shall be provided in the 90 day compliance filing.</p>	
15) Cost Allocation Guidelines	Staff is authorized to propose in the future modifications to the Standards of Conduct, the related Cost Allocation Guidelines, and any other related guidelines to reflect continuation of the use of IEP, if permitted, and any other transactions not reviewed upon the Reorganization.	
16) Conflicts of Interest	The Standards of Conduct shall be updated to include provisions prohibiting the members on the Board of Directors at NYSEG, RG&E and Networks from having interests, financial or otherwise, in competitors to the regulated entity or in unregulated affiliates. The revisions shall be provided in the 90 day compliance filing.	
17) Conflicts of Interest	The Companies shall adopt a policy at NYSEG, RG&E and Networks that requires disclosure if a Board member has an interest in an unaffiliated entity adverse to, or that conducts significant business with, NYSEG, RG&E or Networks.	
18) Stand Alone Treatment	NYSEG and RG&E shall agree to be treated on a stand-alone basis for rate purposes, including tax issues.	
19) Headquarters	<p>I. NYSEG and RG&amp;E shall maintain their headquarters in the service territories of NYSEG or RG&amp;E. The majority of the NY utility executives (officers and Vice-Presidents) shall have their work locations in the service territories of NYSEG or RG&amp;E.</p> <p>II. The Companies shall commit that, for local emergencies, channels of communication and field operations will be coordinated from local emergency command centers that would be centrally located in NYSEG's and RG&amp;E's service territories, and that, for emergencies of wider company impact, the system Area Command Planning Section located in the service territory (formerly referred to as the "Emergency Operations Center") may be activated, as appropriate.</p>	
20) Imputed Credit Ratings	NYSEG and RG&E shall hold customers harmless for any increase in NYSEG's or RG&E's cost of subsequently issued debt caused by reductions in NYSEG's or RG&E's credit ratings, due to actions by or against an affiliate. In such an event, the cost of debt for NYSEG and RG&E would be imputed based upon the cost of debt attributable to entities with a rating equivalent to the Company's rating prior to the downgrade. This requirement applies to debt issuances made during any	

	<p>applicable downgrade period. The starting point for any comparison would be to the then current ratings of NYSEG and RG&amp;E, unless a rating change occurs other than due to a rating action taken against an affiliate, in which case the starting point would be the credit rating in effect immediately prior to any rating change of NYSEG and RG&amp;E. This imputation requirement applies only to debt issuances made during any applicable downgrade period.</p>	
21) Credit Rating Objectives	<p>NYSEG and RG&amp;E will each seek to obtain and maintain an “A-/BBB+” rating.</p>	
22) Independent Audit Committee	<p>I. At least two-thirds* of the directors on the Networks A&amp;CC will be independent directors, one of which shall be the Chair of the Networks A&amp;CC.</p> <p>II. All members of the Networks A&amp;CC will be “financially literate,” as such term is used in NYSE Rule 303A.07 and explained in the commentary to NYSE Listed Company Manual Section 303A.07, and that at least one member of the Networks A&amp;CC must have “accounting or related financial management expertise”, as such term is used in NYSE Rule 303A.07 and explained in the commentary to NYSE Listed Company Manual Section 303A.07.**</p>	<p><i>*In comparison, SOX requires that all directors on an ACC be independent; this condition therefore strikes a balance between effective Board governance and burdens on company management that the Commission may wish to consider further.</i></p>
23) Rate Case Information	<p>If, following the initiation of the next rate case for NYSEG or RG&amp;E, Staff requests that NYSEG and RG&amp;E provide information on the capital structure for Networks or IUSA, the Companies shall provide such information.</p>	
24) IUSA Merger Obligations	<p>The Petitioners shall have Networks assume the following financial and corporate protection conditions in the Merger Order in Case 07-M-0906, such that Networks, and not IUSA, would be subject to the following obligations.</p> <p>I. With respect to financial transparency and reporting conditions: the financial statements of IBE’s regulated U.S. electric and gas utilities, including NYSEG and RG&amp;E, will be consolidated at the Networks level after the Internal Reorganization. Accordingly, the Companies shall have Networks (and not IUSA) assume IUSA’s commitments, pursuant to Merger Order Appendix 1, §5(c) and (d):</p> <ul style="list-style-type: none"> <li>a) use U.S. Generally Accepted Accounting Principles (“GAAP”);</li> <li>b) comply with the provisions of the Sarbanes-Oxley Act (“SOX”) as if it were still bound directly by the provisions of the SOX; and</li> <li>c) remain subject to annual attestation audits by independent auditors.</li> </ul> <p>II. No changes are proposed with respect to other Merger Order Appendix 1 conditions as they apply to affiliates of IBE or IUSA.</p>	

25) IEP Relationship	<p>Temporary measures preventing a further embedment of IEP within NYSEG/RG&amp;E operations shall be implemented ,as follows:</p> <ul style="list-style-type: none"> <li>a) NYSEG and RG&amp;E shall not to increase the embedment of IEP beyond the current levels. Until such time as the engineering resource plan associated with Management Audit Recommendation 11.1 has been reviewed by the Commission, the utilization of IEP on an average monthly dollar basis shall not exceed 105% of the most recently reviewed monthly average run rate for dollars spent on IEP support. This most recently reviewed run rate is \$1.07 million for the 6 months ending October 2012;</li> <li>b) NYSEG and RG&amp;E shall increase existing internal engineering resources for NYSEG and RG&amp;E beyond the October 31, 2012 level by filling the 25 internal vacancies in existence as of November 20, 2012 by June 30, 2013; and</li> <li>c) IEP resources shall be available to the Companies in the event that additional resources are needed because of an emergency situation, after first consulting with Staff concerning the nature of the emergency, the additional services needed and their cost.</li> </ul>	<p><i>Issues related to the Companies' use of IEP services, beyond this condition replacing Management Audit Recommendation 2.1, shall be decided later the context of a review of the Companies' Engineering Resource Plan filed on February 4, 2013 in response to Audit Recommendation 11.1.</i></p>
26) Gas Executive	<p>The Companies shall demonstrate in the 90 day compliance filing that the Gas Strategic Planning Committee (GSPC) has been created, does meet on a regular basis, discusses strategic gas issues and develops long-term plans accordingly. The Companies also shall submit to the Secretary, copied to the Director of Electric, Gas and Water, the meeting notes from the GSPC within 30 days of the meeting.</p>	<p><i>With this condition, the Companies have, adequately addressed management of gas operations issues, per Management Audit Recommendation 2.2.</i></p>
27) Consolidation	<p>This issue will be addressed subsequently in another more appropriate proceeding</p>	

CASE 12-M-0066/CASE 10-M-0551 – PETITION FOR APPROVAL OF A REORGANIZATION/MANAGEMENT AUDIT  
AUDIT RECOMMENDATIONS COMPLIANCE

Recommendation Number	IUSA Response to Liberty Recommendation	Status
2.1 Suspend Use of Iberdrola Engineering Projects, Inc. (IEP).	<b>Modified:</b> Cost-effective balance of internal and external (including both affiliate and contractor) resources will be examined in response to Recommendation 11.1 in Case 10-M-0551.	Addressed in Reorganization Condition #25; issues related to the Companies' use of IEP services, beyond Condition 25 (which replaces Audit Recommendation 2.1), shall be decided later the context of a review of the Companies' Engineering Resource Plan filed on February 4, 2013 in response to Audit Recommendation 11.1.
2.2: Consolidate the gas business under a single executive reporting to the COO.	Modified: Determine appropriate business changes.	Addressed in Reorganization Condition #26
2.3: Streamline executive communications and empower IUSA CEO.	<b>Adopted and already implemented-</b> The IUSA CEO is fully empowered and, as can be seen in the Iberdrola USA Board of Director records and the Iberdrola USA and Iberdrola Group Network communications, provides the leadership and executive management for Iberdrola USA and its New York utilities (NYSEG and RG&E). The IUSA CEO will remain fully empowered, leading, managing, and responsible for the communications and performance of IUSA and its New York utilities.	The filings to date appear to meet the spirit of this Recommendation. Staff will continue to monitor implementation to ensure that the Recommendation's intent is met.
2.4 Institute formal IUSA board evaluations of CEO performance and review of CEO evaluations of other top management incumbents.	<b>Adopted-</b> IUSA Board will conduct performance review for in 2013 of CEO's 2012 performance, and review CEO evaluations of other top management.	The filings to date appear to meet the spirit of this Recommendation, subject to a prohibition, implemented in the audit compliance process, preventing directors who report to the officer being evaluated from participating in the evaluation or deciding the compensation for that officer. Staff will continue to monitor implementation to ensure that the Recommendation's intent is met.

<p>2.5: Governance gap— The gaps between IBE governance and what one would expect for a company with the breadth of operations of IUSA do not lend themselves to concrete, executable change recommendations.</p>	<p><b>NO ACTION-</b> Liberty’s opinion that a governance structure without majority independence (at Iberdrola USA) fails to ensure a convergence of shareholder and customer interests is unsupported. Despite explicit and binding IBE internal regulations and evidence of improving operational and regulatory results, faced with a different board composition, Liberty elevates independence above experience and performance. While Liberty had no recommendation, their opinion is unsupported and contradicted by major findings in the Report. The Report makes many positive findings regarding governance and executive management. Nevertheless, the Governance section of the Report makes a number of findings that are fundamentally incorrect and unsupported.</p>	<p>When the adoption of, and compliance with, the Reorganization Conditions is coupled with the filings made to date, the spirit of this Recommendation is met. Staff will continue to monitor implementation to ensure that the Recommendation’s intent is met.</p>
<p>2.6 Make IUSA personnel a more central voice in communicating regulatory requirements, expectations, decisions, guidance and other matters to senior Spanish executives and the parent board and establish vehicles to make those audiences more aware of U.S. regulatory issues.</p>	<p>Adopted and already implemented- IUSA personnel (CEO, President of NYSEG and RG&amp;E, General Counsel and VP-Regulatory) will communicate NY regulatory requirements to other Iberdrola executives on a regular basis.</p>	<p>Additional compliance efforts are required to improve communication between U.S. Companies and Iberdrola. Concrete mechanisms shall be created, for submission and review in the audit compliance process, providing for the regularly scheduled preparation and transmission of written communications from IUSA to IBE executives and the IBE Board, with confirmation from IBE executives that the communications were received and listing of the communications on IBE Board agendas when they are considered.</p>
<p>2.7 Institute yearly self-assessments of board performance</p>	<p><b>Adopted-</b>IUSA Board and IUSA Board Audit and Compliance Committee (ACC) to review annual external and independent assessment. IUSA Board, assisted by IUSA Board Secretary, to review and discuss the annual external and independent assessment and results. IUSA Board ACC, assisted by IUSA Board ACC Secretary, to review and discuss annual external and independent assessment and results.</p>	<p>The filings to date appear to meet the spirit of this Recommendation. Staff will continue to monitor implementation to ensure that the Recommendation’s intent is met</p>

10.3 Enhance the IUSA Board's role in overseeing capital budget formation and monitoring.	<b>Adopted and already implemented</b> -Provide Board with a review of CAPEX principles, process, and schedule. Solicit feedback from Board to ensure that the Board has the information and opportunities to establish priorities, approve budgets, monitor and intervene as appropriate. Review will consider short, medium, and long-term CAPEX formation and monitoring.	The filings to date appear to meet the spirit of this Recommendation. Staff will continue to monitor implementation to ensure that the Recommendation's intent is met
14.2 Subject prior and future changes in SOX compliance structure, responsibilities, procedures, practices, and components (e.g. key controls) to a focused analysis of potential impacts on utility regulatory processes and proceedings	<b>Adopted and already implemented</b> -Assure that regulatory experts have been and will continue to be involved in reviewing SOX 404(b) changes	The filings to date appear to meet the spirit of this Recommendation. Staff will continue to monitor implementation to ensure that the Recommendation's intent is met
14.4 Incorporate into the IUSA Code of Conduct specific statements of IUSA values and principles regarding affiliate relationships and transactions, and summarize and make references to applicable policies, procedures, and guidance	<b>Adopted and already implemented</b> -The Code of Ethics adopted by the IUSA Board in January 2012 includes specific statements of IUSA values and principles regarding affiliate relationships.	The filings to date appear to meet the spirit of this Recommendation. Staff will continue to monitor implementation to ensure that the Recommendation's intent is met
14.5 Make the reporting of the IUSA chief ethics and compliance lead organizationally separate from the general counsel's organization, establish a direct reporting organizational relationship to the IUSA CEO, and provide for regular and confidential reporting to the IUSA board's audit committee	<b>Adopted</b> -Clarify existing corporate compliance organizational structure, including reporting relationship. Review legal and regulatory basis for structure and best practices.	The filings to date appear to meet the spirit of this Recommendation, subject to a demonstration in the audit compliance process that the means and provisions for direct and immediate access of the Compliance Officer to the CEO and other high lever officers are in place and are adequate to ensure the requisite access. Staff will continue to monitor implementation to ensure that the Recommendation's intent is met.

<p>14.8 Give the IUSA board the full power to design and determine the compensation of IUSA employees.</p>	<p><b>Adopted and already implemented-</b>IUSA Board has the full power to design and determine the compensation of IUSA employees. Under its direction, the IUSA Board relies on IUSA Executives to develop and implement IUSA Total Rewards Program, including compensation and benefits.</p>	<p>The filings to date appear to meet the spirit of this Recommendation. Staff will continue to monitor implementation to ensure that the Recommendation’s intent is met.</p>
<p>14.9 Make the IUSA board the sole authority for establishing and measuring IUSA incentive compensation and assure the creation of all goals by the start of the period they address.</p>	<p><b>Adopted and already implemented-</b>IUSA Board reviews and sets IUSA incentive compensation and ensures the communication of goals for the period they address. Consistent with the Performance Management and Incentive programs, IUSA Executives will develop IUSA incentive plans and results for IUSA Board review and approval.</p>	<p>The filings to date appear to meet the spirit of this Recommendation. Staff will continue to monitor implementation to ensure that the Recommendation’s intent is met.</p>

## FINANCIAL AND CORPORATE PROTECTION CONDITIONS

1. Goodwill and Acquisition Cost Conditions

(a) No goodwill, implementation, or transaction costs associated with any merger, acquisition or restructuring may be reflected on the books maintained by New York State Electric & Gas Corporation (NYSEG), Rochester Gas and Electric Corporation (RG&E), RGS Energy Group, Inc. (RGS), Iberdrola USA Networks, Inc. (Networks), or Iberdrola USA, Inc. (IUSA) after the closing of the corporate holding company reorganization by Iberdrola, S.A. (Iberdrola), whether related to the reorganization or any prior acquisition.

(b) Goodwill, implementation, and transaction costs must be excluded from rate base, expenses, and capitalization in the determination of NYSEG's and RG&E's rates and earned returns for New York State regulatory reporting purposes.

(c) If at any time any analysis determines that goodwill on Iberdrola's books from this reorganization, or goodwill already on the books of IUSA or RGS from prior transactions, is impaired to any extent, Petitioners must submit that analysis to the Commission within five business days after the determination has been made.

2. Credit Quality and Dividend Restriction Conditions

(a) Copies of all presentations made to credit rating agencies by Iberdrola or any of its affiliates that relate to NYSEG, RG&E, RGS, IUSA or Networks, together with supporting materials (work papers, assumptions, and underlying calculations), must be provided, within ten business days of the presentation, to Department of Public Service Staff on a continuing basis.

(b)(i) Iberdrola, IUSA, Networks, NYSEG, and RG&E must register with the two major nationally and internationally recognized bond rating agencies, Standard & Poor's and Moody's Investor Service, and

intend to maintain at least an investment grade credit rating at each entity.

- (ii) NYSEG and RG&E shall maintain a minimum common equity ratio (measured using a trailing 13-month average) at the same equity ratio used to set rates. At each month-end, NYSEG and RG&E shall maintain a minimum equity ratio of no less than 300 basis points below the equity ratio used to set rates. If gas and electric equity ratios for ratemaking purposes differ within a particular Company (either NYSEG or RG&E) then, the Company shall use a weighted average of the equity ratios for purposes of this provision. In the event that NYSEG, RG&E, Networks, ISA, or IUSA ratings are downgraded to the lowest investment grade with a negative watch, or ratings are downgraded to noninvestment grade, NYSEG and RG&E shall be prohibited from issuing dividends that would result in a trailing 13-month average common equity less than the maximum equity ratio utilized for the Companies' earnings sharing mechanism (e.g., currently 200 basis points above the equity ratio used to set rates). At each month-end, NYSEG and RG&E shall maintain a minimum equity ratio of no less than the equity ratio used to set rates. Subject to this condition, NYSEG and RG&E, respectively, are permitted to pay dividends in any year up to an amount equal to the sum of: (i) income available for common dividends generated in that year; (ii) the cumulative amount of retained earnings accrued in prior years, starting with the closing date of this restructuring; and (iii) that portion of paid-in capital that was recorded on the books of NYSEG or RG&E, respectively, as unappropriated retained

earnings, unappropriated undistributed earnings, and accumulated other comprehensive income immediately prior to the closing date of this restructuring, to the extent that those earnings have not already been paid out as dividends in years following the closing date of this acquisition.

(c) To the extent that NYSEG or RG&E desires, for the purposes of this provision, to exclude from the calculation of "income available for common dividends" non-cash charges to income resulting from accounting changes or charges to income resulting from significant, unanticipated events, NYSEG or RG&E, respectively, must first notify the Commission of its intent to do so and provide an explanation for that action. NYSEG or RG&E, respectively, may exclude the items identified in the notification if the Commission or its designee has not, within 30 days from the date of its receipt of notification, notified the company that additional review is necessary. Under no circumstances may the balance of retained earnings become negative as a result of a dividend payment.

(d) If: (i) a credit rating agency's bond rating on the least secure form of debt issued by NYSEG or RG&E falls as a result of action by or against an affiliate, the cost of debt for NYSEG and RG&E will be imputed based upon the lower cost of debt attributable to that entity with a rating equivalent to the Company's rating prior to the downgrade. This requirement applies to debt issuances made during any applicable downgrade period. The starting point for any comparison would be to the then current ratings of NYSEG and RG&E, unless a rating change occurs other than due to a rating action taken against an affiliate, in which case the starting point would be the credit rating in effect immediately prior to any rating change of NYSEG and RG&E. This imputation requirement applies to debt issuances made only during any applicable downgrade period.; or

(ii) the bond rating on the least secure form of debt issued by Iberdrola, IUSA, or Networks falls to the lowest investment grade rating and there is a negative watch or review downgrade notice for Iberdrola, IUSA, or Networks as determined by any nationally recognized rating agency or, alternatively, if the bond rating for Iberdrola, IUSA, or Networks immediately falls to non-investment grade without such a notice, see subparagraph (e).

(e) If a ratings event described in clause (i) of subparagraph (d) above occurs with respect to NYSEG or RG&E, the company affected by that ratings event may not transfer, lease, or lend any moneys, assets, rights, or other items of value to any affiliate without first obtaining Commission approval. If a ratings event described in clause (ii) of subparagraph (d) above occurs, neither NYSEG nor RG&E may transfer, lease, or lend any moneys, assets, rights, or other items of value to any affiliate without first obtaining Commission approval. These provisions exclude payments for goods, services, and assets related to reasonable commitments made 180 days or more before the triggering event, routine transactions required in the regular course of business pursuant to contracts or other arrangements in existence 180 days or more before the triggering event, corporate taxes, and payments, if not accelerated, of principal or interest on loans.

(f) If a ratings event described in subparagraph (d) above occurs, Iberdrola, IUSA, Networks, NYSEG, and RG&E must file a plan with the Secretary to the Commission within 60 days explaining the actions that are planned to address and rectify the situation. The dividend payment and value transfer provisions in subparagraph (d)-(e) above end when the relevant credit rating is restored, the negative watch or review notice is removed with no negative action taken, or the Commission or

its designee specifically approves the payment of dividends or transfer of items of value.

### 3. Money Pooling Conditions

(a) NYSEG and RG&E may participate in a money pool only if all other participants, with the exception of Iberdrola, IUSA, Networks, and RGS, are regulated utilities operating within the U.S., in which case NYSEG or RG&E may participate as either a borrower or a lender. Iberdrola, IUSA, Networks and RGS may participate only as lenders in money pools involving NYSEG or RG&E. Neither NYSEG, nor RG&E may participate in any money pool in which any participant directly or indirectly loans or transfers funds to IUSA, Networks, or Iberdrola.

(b) Neither Iberdrola, IUSA, Networks, nor any of their affiliates may have any cross default provision at closing of the approved restructuring that affects NYSEG or RG&E in any manner. Neither Iberdrola, IUSA, Networks, nor any of their affiliates may enter into any cross default provision that affects NYSEG or RG&E in any manner. To the extent that any cross default provision that might affect NYSEG or RG&E already exists, Iberdrola, IUSA, and Networks must use their best efforts to eliminate that provision within six months of closing. If any cross default provision remains in effect at the end of that period, Iberdrola must obtain indemnification from an investment grade entity, at a cost not borne by ratepayers, that fully protects NYSEG and RG&E from the effects of any cross default provision.

### 4. Special Class of Preferred Stock Conditions

(a) The voting right as previously accepted by the Commission preventing a bankruptcy, liquidation, receivership, or similar proceedings ("bankruptcy") of NYSEG or RG&E, respectively, from being caused by a bankruptcy of Iberdrola applies to IUSA, Networks, or any other affiliate.

### 5. Financial Transparency and Reporting Conditions

- (a) Networks, NYSEG, and RG&E must continue to use U.S. Generally Accepted Accounting Principles (GAAP) for all financial reporting purposes.
- (b) NYSEG and RG&E must continue to satisfy all reporting requirements that currently apply to them.
- (c) After the closing of the reorganization, Networks must continue to comply with the provisions of the Sarbanes-Oxley Act (SOX) as if it were still bound directly by the provisions of the SOX. Network's periodic statutory financial reports must continue to include certifications provided by its officers concerning compliance with SOX requirements as if still bound directly by the provisions of SOX.
- (d) Networks, NYSEG, and RG&E shall remain subject to annual attestation audits by independent auditors.
- (e) Iberdrola, IUSA, Networks, NYSEG, and RG&E must provide Staff access to the books and records, including, but not limited to, consolidated tax returns, the tax records of any affiliate participating in the consolidated return, of Iberdrola and all of its affiliates to the extent necessary for Staff to determine whether the rates and charges of NYSEG and RG&E are just and reasonable. Among other things, such access must be sufficient to provide Department of Public Service Staff the opportunity to ensure that costs are allocated equitably among affiliates and that intercompany transactions involving either NYSEG or RG&E are priced reasonably compared to transactions involving similarly situated Iberdrola affiliates. That access must include, but not be limited to, all information supporting the underlying costs and the basis for any factor that determines the allocation of those costs.
- (f) (i) Iberdrola must file annually with the Commission financial statements, including balance sheets, income statements, and cash flow statements for Iberdrola and its major regulated and unregulated

energy company subsidiaries in the United States. Domestic business entities with annual revenues less than five percent of total domestic U.S. revenues may be aggregated, provided that each entity included is fully identified. Energy utility information must be fully consistent with former Securities and Exchange Commission (SEC) Form U-9C-3.

- (ii) Iberdrola must file annually with the Commission historical consolidating balance sheets, income statements, and cash flow statements in a format similar to former SEC Form U-5S. These statements must specifically show financial results for IUSA, Networks, RGS, NYSEG, and RG&E and must link the specific IUSA, Networks, RGS, NYSEG, and RG&E account balances to the overall consolidated results. Although individual statements for individual business entities other than IUSA, Networks, RGS, NYSEG, and RG&E are not required, Iberdrola's consolidating statements must show the aggregate results for both its unregulated and its regulated subsidiaries separately.
- (iii) To the extent that information required by clause (i) or clause (ii) of this subparagraph is presented in an IFRS format, Iberdrola must provide answers within 10 business days to any question raised by the Commission or Department of Public Service Staff concerning the format or the content of the financial statements.
- (iv) Following the initiation of the next rate case for NYSEG or RG&E, if Staff requests that NYSEG and RG&E provide information on the capital structure for Networks or IUSA, the Companies shall provide such information.

(g) All information required by the financial transparency and reporting requirements in subparagraphs (a) through (f) above must be provided in English and stated in U.S. dollars and shall be publicly available.

(h) The Companies shall provide to the Secretary a quarterly governance report to notify the Commission of the following:

(i) a list of changes in directors, committee members, officers or executives at NYSEG, RG&E, RGS, Networks, and IUSA; (ii) a list of completed major transactions (i.e., at least 5% of IUSA net assets) that relate to or affect NYSEG, RG&E, RGS, Networks or IUSA; and (iii) Significant changes in capitalization at NYSEG, RG&E, RGS, Networks, and IUSA.

6. Affiliate Transactions, Cost Allocations, and Code of Conduct

(a) Iberdrola shall be subject to the rules, practices, and procedures in the existing code of conduct, and as that code of conduct is revised, governing relations among Networks and its subsidiaries, including, but not limited to, NYSEG and RG&E, in the same manner as they apply to Networks.

(b) NYSEG and RG&E Companies shall continue to comply with both the Standards of Conduct and PSL § 110 (which requires the filing of contracts with affiliates). The Companies shall file with the Secretary, copied to the Director of the Office of Accounting, Audits, and Finance, or its successor Office, all amendments and supplements to the Standards of Conduct and related guidelines, thirty (30) days prior to making such change(s). The Companies shall also notify in advance the Secretary, copied to the Director of the Office of Accounting, Audits, and Finance, of any services that Management Corp. (as defined in the Standards of Conduct) provides to IRHI or other companies that are not subsidiaries of Networks in excess of 5% of the respective net incomes of NYSEG or RG&E.

(c) Following the Reorganization, the Standards of Conduct, as amended, will be updated to reflect the Reorganization entities. Staff is authorized to propose subsequent to the reorganization modifications to the Standards of Conduct, the related Cost Allocation Guidelines, and any other related guidelines.

(d) NYSEG and RG&E shall issue debt only through fully registered SEC securities.

#### 8. Governance Provisions

(a) NYSEG and RG&E shall maintain their headquarters, and shall continue to locate their utility books and records, in their respective New York service territories. The majority of the NYSEG and RG&E executives (Officers and Vice-Presidents) shall have their work locations in the service territories. The Companies shall commit that, for local emergencies, channels of communication and field operations will be coordinated from local emergency command centers that would be centrally located in the respective NYSEG and RG&E service territories, and that, for emergencies of wider company impact, the system Area Command Planning Section located in the service territory (formerly referred to as the "Emergency Operations Center") may be activated, as appropriate.

(b) At least one-third of the directors at Networks shall be "independent directors," as defined in SEC Rule 4200(a)(15). At least half of the independent directors must either live or work in the service territories of NYSEG or RG&E or have more than 10 years of relevant work experience in the regulated utility or energy industry, but in all cases, the Board must have at least one member who meets the residency requirement. The Companies shall report on progress in implementing this condition in the 90 day compliance filing. Staff and Commissioners may submit written communications to the Secretary of the Networks Board of Directors, and receipt of a

communication will be confirmed in writing. The Board Secretary shall then provide such written communications to the Networks Board of Directors.

(c) A majority of the Utility Board of Directors shall be Eligible Directors. An Eligible Director is any individual who is not: (i) an officer or director of HoldCo (other than Networks only); or (ii) an officer or director of any of Iberdrola's non-utility Affiliates; or (iii) an officer or director of any Competitive Energy Affiliate or Unregulated Affiliate. The revisions to the interlocking director matrix shall be provided in the 90 day compliance filing.

(d) The Networks Board shall designate a lead independent director. The Board of Directors shall authorize an independent director, to request the chairman of the Board of directors to call a meeting of the Board of Directors whenever such independent Director deems appropriate, to request the inclusion of matters on the agenda for Board of Directors Meetings, and to act as a liaison and communicate any issues to the Chairman brought to the lead director if requested by the other independent directors. The lead independent director shall rotate every year.

(e) At least two-thirds of the directors on the Networks Audit and Compliance Committee (ACC) will be independent directors, one of which shall be the Chair of the Networks ACC. All members of the Networks ACC will be "financially literate," as such term is used in NYSE Rule 303A.07 and explained in the commentary to NYSE Listed Company Manual Section 303A.07, and that at least one member of the Networks ACC must have "accounting or related financial management expertise", as such term is used in NYSE Rule 303A.07 and explained in the commentary to NYSE Listed Company Manual Section 303A.07.

(f) The same person shall not hold the CEO and the Chairman of the Board positions at NYSEG, RG&E, Networks, or IUSA.

(g) The Companies shall provide access to board agendas for Networks, IUSA, IEP, IRHI, and ISA. With respect to IUSA, IEP, and Networks, the Companies shall provide access to all board and committee minutes and related materials. With respect to ISA, the Companies shall provide access to board and committee minutes and related materials, to the extent related to the U.S. businesses or transactions (including common services) between affiliates and the New York utilities. With respect to IRHI, the Companies shall provide access to board and committee minutes and related materials to the extent related to U.S. income tax matters or transactions between affiliates and the New York utilities. The Companies shall also provide additional board and/or committee minutes and/or related materials from ISA upon reasonable and specific request. Notwithstanding the foregoing, the Companies shall not be required to provide minutes and related materials for transactions involving operating companies that are unrelated to U.S. utilities or their holding companies.

(h) During management or operations audits conducted pursuant to the Public Service Law, the companies shall provide full and complete access to all board and committee minutes and related materials.

#### 8. Consolidated Tax Provisions

(a) After the Reorganization is completed, the consolidated U.S. taxpayer for the U.S. subsidiaries will be IUSA. A Tax Sharing Agreement will be used to allocate tax benefits and obligations among the companies participating in the consolidated tax return. NYSEG and RG&E shall submit the Tax Sharing Agreement within 90 days following the closing of the Reorganization.

(b) The Petitioners commit to have IUSA indemnify NYSEG and RG&E customers for tax obligations other than those that would have been incurred by NYSEG or RG&E on a stand-alone basis.

The contractual mechanism for implementing the tax indemnification would be set forth in the Tax Sharing Agreement referenced below and shall be included for review in the compliance filing that shall be made 90 days following the closing of the Reorganization.

(c) For ratemaking purposes, NYSEG and RG&E customers shall be held harmless from any adverse tax consequences that may occur through affiliated companies. Income tax expense charged to customers will be computed treated as if they were able to receive the benefits of any NYSEG or RG&E losses, credits or deductions that would have been attributable to NYSEG or RG&E on a stand-alone basis and, subject to the normalization rules applicable to NYSEG and RG&E. NYSEG and RG&E shall be treated on a stand-alone basis for rate purposes, including tax issues.

## Capital IQ Fixed Income Screening Report

Maturity Date	Issuer	Public/P		Coupon Rate (%)	Coupon Type	Offering Date	Offering Amount (\$USDmm, Historical rate)	Amount Outstanding (\$USDmm, Historical rate)	S&P Security Rating - Issue Credit Rating -	
		rivate	Fixed Income Security Type						Long-Term Local Currency [Latest] (Rating)	Numeric Rating
Feb-15-2042	Boston Gas Co.	144A	Corporate Debentures	4.49	Fixed	Feb-14-2012	500.0	500.0	A-	3
Sep-15-2042	Northern Natural Gas Company	144A	Corporate Debentures	4.10	Fixed	Aug-22-2012	250.0	250.0	A	2
Feb-15-2042	Boston Gas Co.	Private	Corporate Debentures	4.49	Fixed	Feb-14-2012	500.0	500.0	A-	3
Sep-15-2042	Northern Natural Gas Company	Private	Corporate Debentures	4.10	Fixed	Aug-22-2012	250.0	250.0	A	2
<b>Median Interest Rate</b>				<b>4.29</b>					<b>Average Rating</b>	<b>2.50</b>
Feb-15-2023	Nisource Finance Corp.	Public	Corporate Debentures	3.85	Fixed	Jun-11-2012	250.0	250.0	BBB-	6
Jul-01-2023	Entergy Mississippi, Inc.	Public	Corporate Debentures	3.10	Fixed	Dec-05-2012	250.0	250.0	BBB	5
Dec-01-2041	Oncor Electric Delivery Company LLC	Public	Corporate Debentures	4.55	Fixed	Jul-26-2012	299.6	299.58	A-	3
Jan-15-2042	Alabama Power Co.	Public	Corporate Debentures	4.10	Fixed	Jan-10-2012	250.0	250.0	A	2
Feb-01-2042	PacifiCorp	Public	Corporate Debentures	4.10	Fixed	Jan-03-2012	300.0	300.0	A	2
Feb-01-2042	South Carolina Electric & Gas Company	Public	Corporate Debentures	4.35	Fixed	Jan-23-2012	250.0	500.0	A	2
Mar-01-2042	Westar Energy, Inc. (NYSE:WR)	Public	Corporate Debentures	4.13	Fixed	Feb-27-2012	250.0	550.0	BBB	5
Mar-15-2042	Georgia Power Co.	Public	Corporate Debentures	4.30	Fixed	Feb-29-2012	750.0	1,100.0	A	2
Mar-15-2042	Mississippi Power Co.	Public	Corporate Debentures	4.25	Fixed	Mar-05-2012	250.0	450.0	A	2
Mar-15-2042	Consolidated Edison Co. of New York Inc.	Public	Corporate Debentures	4.20	Fixed	Mar-08-2012	400.0	400.0	A-	3
Mar-15-2042	Southern California Edison Company	Public	Corporate Debentures	4.05	Fixed	Mar-08-2012	400.0	400.0	BBB+	4
Mar-15-2042	Duke Energy Indiana, Inc.	Public	Corporate Debentures	4.20	Fixed	Mar-12-2012	250.0	250.0	A	2
Apr-01-2042	Arizona Public Service Co.	Public	Corporate Debentures	4.50	Fixed	Jan-10-2012	325.0	325.0	BBB+	4
Apr-01-2042	San Diego Gas & Electric Company	Public	Corporate Debentures	4.30	Fixed	Mar-19-2012	250.0	250.0	A	2
Apr-15-2042	Pacific Gas & Electric Co.	Public	Corporate Debentures	4.45	Fixed	Apr-11-2012	400.0	400.0	BBB	5
May-15-2042	Carolina Power & Light Company	Public	Corporate Debentures	4.10	Fixed	May-15-2012	500.0	500.0	BBB+	4
Jun-01-2042	Florida Power & Light Company	Public	Corporate Debentures	4.05	Fixed	May-10-2012	600.0	600.0	A-	3
Jun-01-2042	Delmarva Power & Light Co.	Public	Corporate Debentures	4.00	Fixed	Jun-19-2012	250.0	250.0	BBB+	4
Jun-15-2042	Tampa Electric Company	Public	Corporate Debentures	4.10	Fixed	May-31-2012	300.0	300.0	BBB+	4
Jun-15-2042	The Detroit Edison Company	Public	Corporate Debentures	3.95	Fixed	Jun-19-2012	250.0	250.0	BBB+	4
Aug-01-2042	Centerpoint Energy Houston Electric, LLC	Public	Corporate Debentures	3.55	Fixed	Aug-07-2012	500.0	500.0	BBB+	4
Aug-15-2042	Northern States Power Company	Public	Corporate Debentures	3.40	Fixed	Aug-06-2012	500.0	500.0	A-	3
Aug-15-2042	Pacific Gas & Electric Co.	Public	Corporate Debentures	3.75	Fixed	Aug-13-2012	350.0	350.0	BBB	5
Sep-15-2042	Public Service Co. of Colorado	Public	Corporate Debentures	3.60	Fixed	Sep-04-2012	500.0	500.0	A-	3
Sep-15-2042	Dominion Resources, Inc. (NYSE:D)	Public	Corporate Debentures	4.05	Fixed	Sep-10-2012	350.0	350.0	A-	3
Sep-15-2042	Southern California Gas Co.	Public	Corporate Debentures	3.75	Fixed	Sep-18-2012	350.0	350.0	A	2
Sep-30-2042	Duke Energy Carolinas, LLC	Public	Corporate Debentures	4.00	Fixed	Sep-18-2012	650.0	650.0	BBB+	4
Oct-01-2042	Commonwealth Edison Company	Public	Corporate Debentures	3.80	Fixed	Sep-24-2012	350.0	350.0	BBB	5
Oct-01-2042	Northern States Power Company-Wisconsin	Public	Corporate Debentures	3.70	Fixed	Oct-02-2012	100.0	100.0	A-	3
Nov-15-2042	Florida Power Corporation	Public	Corporate Debentures	3.85	Fixed	Nov-15-2012	400.0	400.0	BBB+	4
Dec-01-2042	Wisconsin Public Service Corporation	Public	Corporate Debentures	3.67	Fixed	Nov-26-2012	300.0	300.0	A-	3
Dec-01-2042	Alabama Power Co.	Public	Corporate Debentures	3.85	Fixed	Nov-27-2012	350.0	350.0	A	2
Dec-01-2042	Oglethorpe Power Corp.	Public	Corporate Debentures	4.20	Fixed	Nov-27-2012	250.0	250.0	A	2
Dec-15-2042	Wisconsin Electric Power Company	Public	Corporate Debentures	3.65	Fixed	Dec-05-2012	250.0	250.0	A-	3
Dec-15-2042	Florida Power & Light Company	Public	Corporate Debentures	3.80	Fixed	Dec-17-2012	400.0	400.0	A-	3
<b>Median Interest Rate</b>				<b>4.08</b>					<b>Average Rating</b>	<b>3.34</b>
<b>Differential</b>				<b>0.21</b>					<b>66% A-/34% BBB+</b>	

**Credit Quality Adjustment**

2012 Long Term Utility Bond Yield \*  
Credit Structure of Interest Rates

	A	BBB	Implied A-	Implied BBB+
January	4.34%	5.06%	4.58%	4.82%
February	4.36%	5.02%	4.58%	4.80%
March	4.48%	5.13%	4.70%	4.91%
April	4.40%	5.11%	4.64%	4.87%
May	4.20%	4.97%	4.46%	4.71%
June	4.08%	4.91%	4.36%	4.63%
July	3.93%	4.85%	4.24%	4.54%
August	4%	4.88%	4.29%	4.59%
September	4.02%	4.81%	4.28%	4.55%
October	3.91%	4.54%	4.12%	4.33%
November	3.84%	4.42%	4.03%	4.23%
December	4%	4.56%	4.19%	4.37%
Average	4.13%	4.86%	4.37%	4.61%
Private Debt Rate	4.29%			
Public Debt Rate	<u>4.08%</u>			
Differential	0.21%			
Credit Quality Adjustment				
Implied Yield on Private Credit Rating	4.25%			
Implied Yied on Public Credit Rating	<u>4.45%</u>			
Differential	<u>0.20%</u>			
Credit Adjusted Yield Difference	0.41%			

\* From Mergent Bond Record January 2012



**Issuance Comparison 2008 - Present****2008 Rochester Gas & Electric Issuance**

<u>Offering Date</u>	<u>Company</u>	Issuer <u>Rating</u>	Security <u>Rating</u>	<u>Coupon Rate</u>	<u>Offering Amount</u>	<u>Term</u>
1/5/2009	Pacificorp	A-	A+	6.00%	\$300 M	30
12/3/2008	Potomac Electric	BBB	A-	7.90%	\$350 M	30
Average		BBB+	A	6.95%		
12/19/2008	Rochester Gas & Electric	BBB+	A	8.00%	\$150 M	25

Difference: 105 basis points

**2009 Rochester Gas & Electric Issuance**

<u>Offering Date</u>	<u>Company</u>	Issuer <u>Rating</u>	Security <u>Rating</u>	<u>Coupon Rate</u>	<u>Offering Amount</u>	<u>Term</u>
6/23/2009	Virginia Electric	A-	A-	5%	\$350 M	10
6/24/2009	Rochester Gas & Electric	BBB	A-	5.90%	\$150 M	10

Difference: 90 basis points

**2011 Rochester Gas & Electric Issuance**

<u>Offering Date</u>	<u>Company</u>	Issuer <u>Rating</u>	Security <u>Rating</u>	<u>Coupon Rate</u>	<u>Offering Amount</u>	<u>Term</u>
8/15/2011	Florida Power	BBB+	A-	3.10%	\$300 M	10
8/30/2011	Commonwealth Edison	BBB	A-	3.40%	\$350 M	10
Average				3.25%		
7/29/2011	Rochester Gas & Electric	BBB+	A-	4.10%	\$125 M	10

Difference: 85 basis points

**2012 New York State Electric & Gas Issuance**

<u>Offering Date</u>	<u>Company</u>	Issuer <u>Rating</u>	Security <u>Rating</u>	<u>Coupon Rate</u>	<u>Offering Amount</u>	<u>Term</u>
9/4/2012	Public Service Colorado	A-	A+	2.25%	\$300 M	10
9/10/2012	PECO Energy	BBB	A-	2.38%	\$350 M	10
9/19/2012	Tampa Electric	BBB+	BBB+	2.60%	\$250 M	10
Average		BBB+	A-/A	2.41%		
9/13/2012	New York State Electric & Gas	BBB+	BBB+	3.24%	\$75 M	10

Difference: 83 basis points

**2012 New York State Electric & Gas Issuance**

<u>Offering Date</u>	<u>Company</u>	Issuer <u>Rating</u>	Security <u>Rating</u>	<u>Coupon Rate</u>	<u>Offering Amount</u>	<u>Term</u>
9/4/2012	Public Service Colorado	A-	A+	3.60%	\$300 M	30
9/6/2012	Union Electric	BBB	A-	3.90%	\$485 M	30
9/10/2012	Public Service Electric & Gas	BBB	A-	3.65%	\$350 M	30
9/18/2012	Southern California Gas	A	AA-	3.75%	\$350 M	30
9/19/2012	Duke Energy Carolinas	BBB+	A	4.00%	\$650 M	30
Average		BBB+	A	3.78%		
9/13/2012	New York State Electric & Gas	BBB+	BBB+	4.55%	\$75 M	30

Difference: 72 basis points

**Source Capital IQ and Company finance Compliances**