BEFORE THE
STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

In the Matter of

NEW YORK STATE ELECTRIC AND GAS CORPORATION
ROCHESTER GAS AND ELECTRIC CORPORATION

CASES 09-E-0082, 09-G-0083, 09-E-0084, AND 09-G-0085

FEBRUARY 2009

Prepared Testimony of:

STAFF FINANCIAL PANEL
OFFICE OF ACCOUNTING AND FINANCE

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INTRODUCTION OF WITNESSES

Q. Please state your names and business addresses.

A. Our names are Thomas A. D'Ambrosia and Patrick J. Barry. We are the members of the Staff Financial Panel (SFP). Our business address is Three Empire State Plaza, Albany, New York 12223-1350.

Q. Mr. D'Ambrosia, by whom are you employed and in what capacity?

A. I am employed by the New York State Department of Public Service as a Supervisor in the Office of Accounting and Finance.

Q. Please outline your educational background and professional background.

A. I graduated in 1980 from Saint John Fisher College in Rochester, New York with a Bachelor of Science degree in Accounting. I joined the Department of Public Service in September 1980 as a Public Utility Auditor Trainee and advanced to my current position through competitive examinations.

As a supervisor of Accounting and Finance, I am responsible for managing the activities of a unit of auditors, accountants, and financial analysts located throughout New York State on a variety of projects, including their participation in major proceedings before the Public Service Commission.

Between 2002 and 2007, my main responsibilities consisted of the two Energy East affiliates operating in New York State, New York Electric and Gas Corporation (NYSEG or the company) and Rochester Gas & Electric Corporation (RG&E). Since 2008, my responsibilities changed to include just NYSEG and numerous telecommunications entities. In addition, I directly participate in proceedings before the Public Service Commission involving NYSEG.

Activities that I or my Staff have been involved in include examinations of accounts, records, documentation, policies and procedures of regulated utilities to develop issues for electric, gas, and telecommunications rate proceedings, settlements, financing approvals, fuel and gas adjustment clause reviews, rate of return reviews, asset sales (including RG&E's sale of its Ginna nuclear plant and its share of the Nine Mile Point #2 Nuclear Plant), use of revenues cases, mergers and acquisitions, reorganizations and restructurings, Article VII transmission reviews, and other general accounting and financial investigations. I have also previously testified on the determination of the overall utility cost of capital (including estimating the cost of equity) and capital structure.

Q. Mr. D'Ambrosia do you hold any professional licenses?

A. Yes. I am a Certified Public Accountant.

Q. Have you previously testified before the New York Public Service Commission?

A. Yes, I have testified in numerous proceedings, including in the recent Energy East/Iberdrola Merger Proceeding (see In the Matter of Joint Petition of Iberdrola, S.A., Energy East Corporation, RGS Energy Group, Inc., Green Acquisition Capital, Inc., New York State Electric & Gas Corporation and Rochester Gas and Electric Corporation for Approval of the Acquisition of Energy East Corporation by Iberdrola, S.A., Case 08-M-0906, the Merger

Order).

I also testified in NYSEG’s last rate case (see New York State Electric and Gas, Order Adopting Recommended Decision with Modifications, issued August 23, 2006, NYSEG 2005 Rate Order), as well all of RG&E’s rate cases over the last two decades. A summary listing of the testimony I have given is included in Exhibit___(SFP-1).

Most recently, I testified as the co-lead Staff witness on the Energy East/Iberdrola Staff Policy Panel. In the above NYSEG rate case I was a member of three panels concerning NYSEG’s electric revenue requirements; electric commodity options; and on its embedded cost of service.

Q. Mr. D'Ambrosia, as part of your activities in your role as a Supervisor of Accounting and Finance have you participated in other ways in NYSEG's and RG&E’s formal proceedings?

A. Yes. Recently, among other things, I was extensively involved in the review of NYSEG’s and RG&E's compliance filings establishing its electric fixed prices (FPO) and fixed non-bypassable wires charges (NBC) for the 2005-2009 commodity options periods. I was also involved in Case 06-M-1413-Proceeding on Motion of the Commission Concerning New York State Electric & Gas Corporation's Accounting Practices for Other Post Employment Benefits and the Company's Use of the Interest Earned on the OPEB Reserve Account (see Order Adopting the Terms of a Joint Proposal, issued and effective September 20, 2007, the NYSEG OPEB case).

Q. Mr. Barry, please summarize your educational and professional background.

A. I graduated from the State University of New York at Albany in 1986 with a Masters Degree in Business Administration with a course concentration in finance. Prior to that, I received a Bachelor of Business Administration from Siena College with a course concentration in accounting. In March 1987, I joined the Department as a Senior Utility Financial Analyst. Currently, I am employed as a Principal Utility Financial Analyst in the Office of Accounting and Finance.

Q. Please describe your duties for the Office of

Accounting and Finance.

A. As a Principal Utility Financial Analyst my responsibilities include processing financing petitions, testifying in rate proceedings, analyzing merger and acquisition petitions, and performing financial forecasting, economic analysis, audits, and other investigations and studies. Regarding financings, I make recommendations to the Commission concerning petitions to issue debt and equity securities. The focus of these recommendations is on the appropriateness of the mode of financing selected and the cost of securities issued. In rate proceedings, my recommendations are made concerning matters that related to fair rate of return, cash flow considerations, ratemaking policy issues, and cost of service adjustments. Additionally, I have performed financial forecasts and economic analyses that were made in light of proposed actions by various utilities.

Q. Have you previously testified before the New York Public Service Commission?

A. Yes. I have testified numerous times before the

New York State Public Service Commission and I have also presented testimony in several cases before the Federal Energy Regulatory Commission. I have filed testimony in proceedings involving the following companies: KeySpan Energy Delivery New York, KeySpan Energy Delivery Long Island, New York State Electric & Gas Corporation, Tennessee Gas Pipeline Company, Transcontinental Gas Pipe Line Corporation, CNG Transmission Corporation, Corning Natural Gas Company, St. Lawrence Natural Gas Company, Consolidated Edison Company of New York, Inc., Long Island Lighting Company, Niagara Mohawk Power Company, Central Hudson Gas & Electric Corporation, National Fuel Gas Corporation, Spring Valley Water Company, New York Water Service Corporation, Shorewood Water Company, Citizen's Water Company, and New Rochelle Water Company. Generally, my testimony has addressed rate of return and other financial issues. Most recently, I testified in the Iberdrola Energy East Acquisition proceeding as the co-lead Staff witness on the Staff Policy Panel.

Q. Panel, did you prepare exhibits supporting this testimony?

A. Yes, we prepared 15 Exhibits, referenced throughout this testimony as Exhibit ___(SFP-1) through Exhibit__ (SFP-15).

Q. In your testimony, will you refer to, or otherwise rely upon, any information produced during the discovery phase of this and other proceedings?

A. Yes. We relied upon a number of Petitioner’s responses to Staff Information Requests. These are attached as Exhibit ___(SFP-2).

PURPOSE OF TESTIMONY

Q. What is the purpose of your testimony?

A. The purpose of this testimony is to support the motion to dismiss the rate cases filed by New York State Electric & Gas (NYSEG) and Rochester Gas & Electric (RG&E, collectively the Companies). Our testimony will demonstrate that NYSEG and RG&E have access to capital despite the recent turbulence in the financial markets. Our analysis indicates that the reliability and service functions of the Companies will not be affected by delaying the rate requests until after the stay out period the Commission required and the Companies unconditionally agreed to. We will also describe other bases for dismissing the filing or, at a minimum placing these cases on a regular 11-month rate case schedule once the Companies' filing is complete.

OVERVIEW

Q. Please describe the rate filings in this proceeding.

A. On January 27, 2009 the Companies filed for a $278 million increase in their gas and electric delivery rates. The effective date requested for these new rates is July 1, 2009, which is approximately five months after the date these filings were made. These increases represent approximately 25% of the Companies' delivery revenues.

Further, the Companies indicated that if the above increases were not granted by July 1, 2009, they would seek an additional $44 million or 4% increases in delivery rates. Typical residential customers using 600 kWh of electricity and 100 therms of gas could see increases amounting to $211-254 per year should the filings be approved.

Through these filings, the Companies are seeking to be allowed a return on equity (ROE) of 12-12.2% based on an equity ratio of 47-48%. The filings utilize an historic test year based on the twelve months ending September 30, 2008. Interestingly, this date is only approximately two weeks after the closing of the Iberdrola acquisition of Energy East, the Companies' parent company.

Q. How do the Companies define the economic conditions facing its customers?

A. On page 2 of the January 15, 2009 Comments of New York State Electric & Gas Corporation and Rochester Gas and Electric Corporation in Case 08-M-1312-Proceeding on Motion of the Commission to Consider the Financial Impacts on New York State's Energy Utilities of Changes in Uncollectible Expense and Arrearages in the Current Economic Environment to the Commission, the Companies stated: "the weak economy, with its rising unemployment rate, housing industry woes, credit market meltdown and the rising cost of energy is impacting the Companies' customers' ability to pay their utility bills. RG&E and NYSEG are both experiencing increased write-off expense as a direct result of these difficult economic circumstances”.

Q. Do you have any reaction to these comments?

A. If the Companies’ assessment of the conditions of its customers is accurate, these rate filings will only exacerbate the difficult conditions faced by many of its customers. Moreover, the Companies’ approach to correcting their alleged difficulties is all wrong. Instead of relying on rate increases to improve its financial condition, the Companies’ focus should be to embark on a vigorous cost reduction program to alleviate the need to increase rates.

Q. Why have the Companies filed for expedited rate treatment at this time?

A. The Companies claim that they are experiencing severe financial difficulties since the global financial crisis began last September. They claim the effect of the crisis on the Companies is compounded by their “BBB+/Baa1” credit ratings from Standard & Poor’s and Moody’s, respectively. The Companies claim that they require expedited rate relief to alleviate liquidity and cash flow issues. Absent this rate relief, the Companies worry that their credit ratings will be subject to costly downgrades. NYSEG and RG&E also suggest the purported liquidity crisis impairs their ability to provide safe and reliable service to customers.

Q. What are the reasons given for the Companies' rate relief request?

A. The Policy Panel states that the rate increases that NYSEG and RG&E seek are necessary to recover costs related to previous deferrals and adjustments to reserve targets, operations and reliability, pension expense, and low income assistance.

Q. Is the recovery of these costs, in and of itself, a basis for expedited rate treatment?

A. No. These are ordinary issues that have been dealt with in almost all recent rate filings.

Q. Do you believe expedited rate treatment is necessary?

A. No. The Companies' claim that they face a liquidity crisis does not withstand scrutiny.

Q. What do the Companies describe as one of the primary reason for the alleged liquidity crisis?

A. The Companies' claim that their liquidity crisis was brought on by the world-wide financial crisis.

Q. How does the Policy Panel claim that NYSEG and RG&E have been affected by the current financial crisis?

A. The Companies' Policy Panel claims that NYSEG and RG&E are experiencing difficulties as a result of the financial crisis. The Policy Panel claims that a "perfect storm" of negative events, driven in part by the financial crisis with a resultant recession and NYSEG's and RG&E's "BBB" level credit ratings, have led to severely constrained liquidity, higher costs of capital, higher costs, and reduced sales. The Policy Panel testifies that these factors have led to deterioration in NYSEG and RG&E's financial performance necessitating their rate filings. The Companies claim that their financial deterioration is so severe that waiting eight months to file rate cases, and another eleven months until new rates become effective would jeopardize the Companies' ability to obtain capital needed to provide safe and reliable service.

Q. What effects do the Companies claim that the current financial situation is having on the operations of NYSEG and RG&E?

A. The Companies claim that the financial situation has impacted the operations of NYSEG and RG&E in the following ways: 1) the cost of capital for NYSEG and RG&E has risen and this has been exacerbated by each Company's "BBB+/Baa1" credit rating from S&P and Moody's, respectively; 2) the Companies' financial performance has deteriorated; 3) the Companies do not have adequate access to liquidity and this creates reliability and customer service issues.

Q. Is there a clear and significant linkage between these rate filings and the global financial crisis?

A. No. While the global financial crisis could affect liquidity and the cost of future debt issuances, it does not seem to have a significant impact on the Companies' revenue requirements at this time. This being the case, we conclude that the rate filings are not driven to a large degree by the global financial crisis.

Q. Please explain why the global financial situation does not have a significant effect on the Companies' revenue requirements.

A. First, the impact of the global crisis will not significantly affect the cost of debt since the Companies are not expected to issue a significant amount of debt during 2009-2010. Also, the revenue requirement elements that one would expect to be affected by macro economic factors such as property taxes, uncollectibles, and sales, to a large degree are embedded in the historical results. As we show later on, the historical results are satisfactory.

Q. Are there other external factors that are more likely causes of any alleged deterioration of the Companies' financial performance?

A. Yes. It was well known that the United States was in or was on the verge of a recession during early 2008 and oil prices spiked. Further, the stock markets had declined substantially over 2008. Those well known external factors probably had more to do with the alleged deterioration of the Companies financial performance than the crisis in the financial markets that occurred later in 2008. More importantly, those economic factors were known to Energy East and Iberdrola at the time both companies completely and unconditionally accepted the merger condition to refrain from seeking rate increases until September 2009.

<u>ACCESS TO CAPITAL</u>

Q. What factors do the Policy Panel blame for their perception that NYSEG and RG&E do not have access to capital?

A. The Policy Panel blames the "perfect storm" of the financial crisis, the “BBB+/Baa1” bond ratings of the Company, and the “low returns” authorized by the Commission for causing the Companies not to have access to capital.

Q. According to the Policy Panel, how has the financial crisis affected NYSEG and RG&E's access to capital?

A. The Policy Panel testimony notes the failures of fifteen United States banks in 2008, including the seminal bankruptcy of Lehman Brothers filed on September 15, 2008. They claim that immediately afterwards, the credit markets froze, and credit was unavailable for nearly a two-week period – particularly for “BBB” level rated companies.

Q. Did utilities have access to capital markets during this time period?

A. Yes. Actual data during the period shown on Exhibit __(SFP-3) indicates that Laclede Gas Company accessed the capital markets during the two week period subsequent to the September 15, 2008 Lehman Brothers bankruptcy. In the next week alone, six utilities accessed the capital markets.

Q. Were there other periods in 2008, prior to the Lehman Brothers bankruptcy, where only one utility issuance occurred?

A. Yes, as shown on Exhibit __(SFP-3), there was only one issuance between August 22 and September 7. There was only one issuance between July 18 and August 17. There was only one issuance between April 18 and May 5. Finally, there was only one issuance between January 25 and March 2, a period of over five weeks. There have been no claims that utilities did not have access to capital during those periods.

Q. Does the Policy Panel believe that the capital markets have improved?

A. It does not appear they do. The Policy Panel indicates that the changes on Wall Street appear to be permanent.

Q. Do you agree with their assessment?

A. No. There has been a 100 basis point drop in Public Utility Bond interest rates during the month of December as shown on Exhibit __(SFP-4). This demonstrates that the capital markets have improved significantly since November. In fact, just this past week El Paso Corporation issued $500 million of non-investment grade debt that was only rated “Ba3”/”BB-“ with a yield to maturity of 8.5% and there were “BBB” rated issuances in the last week of January (January 23-30) totaling an aggregate $1.2 billion with yields ranging from 6.0% to 7.8%.

Q. Have you found evidence to support the Policy Panel's assertion that changes in the way the US financial markets operate means that the remaining firms will have less capital available in both the debt and equity markets for companies seeking debt and equity investment?

A. No. There appears to have been plenty of capital available for utilities in the period since the Lehman Brothers bankruptcy. Exhibit __(SFP-3) indicates there were 50 public and private offerings of utility debt during this period that raised $15.7 billion in capital since the Lehman Brothers bankruptcy. We are not aware of any failed offerings during this time and it appears to us that capital was available to utilities that needed it during this period.

Q. The Policy Panel makes the assertion that “BBB” level rated utilities are experiencing significant difficulties in accessing the capital markets. Have you found any evidence of this?

A. No. We are not aware of any “BBB” rated utility that was unable to access the market. Exhibit __(SFP-3) demonstrates that 21 utilities rated in the "BBB" category by at least one credit agency accessed the capital markets for nearly

$7.8 billion since the Lehman Brothers bankruptcy.

Q. The Policy Panel indicates that the capital markets have been completely closed to “BBB” level rated utilities during certain periods in late 2008 and particularly points to the period late September through October of 2008 when it claims there were virtually no utility issuances of “BBB” long-term debt. Do you agree?

Q. No. As shown on Exhibit __(SPP-3), 14 utilities, rated by at least one credit agency in the "BBB" category, issued an aggregate of over $5 billion of long-term debt during the period in 2008 after the Lehman Brothers bankruptcy. Moreover, the Policy Panel’s own Exhibit __ (PP-2), belies the notion that capital has been inaccessible to “BBB” level rated utilities since September 15, 2008. We have found no evidence of any failed offerings of utility debt during this period.

Q. How do you view the current viability of capital markets for long-term debt?

A. We believe the capital markets for long-term debt are a viable option for any investment grade utility that needs funding. As evidence of this on the front page of the February 10, 2009 edition of the Wall Street Journal was the article “Bond Market in Winter Thaw.”, attached as Exhibit __(SFP-5). The article stated, “A growing number of big companies are taking advantage of the thawing credit markets to raise large sums of money at low interest rates, with Cisco Systems Inc. Monday selling $4 billion in bonds to bolster its war chest for acquisitions.” The article states that since the beginning of the year, U.S. companies have sold $78.3 billion of investment-grade corporate bonds that are not guaranteed through a government program, according to research firm Dealogic. The article attributed the easing in the bond market to governments and central banks lowering interest rates and guaranteeing billions in debt, restoring confidence to the market.

Q. Have the credit agencies reported on the availability of long-term debt for utilities?

A. Yes. As shown on Exhibit __(SFP-6), S&P states on page 2 of its December 16, 2008 article entitled "Industry Report Card: U.S. Electric Utility Credit Quality Remains Strong Amid Continuing Economic Downturn" that “regulated electric issuers continued to access debt markets during the fourth quarter of 2008 at rates in line with the 10-year average of about 8% for five-year notes, not the abnormally low interest rate environment of the 2000's which is a distant memory. Standard & Poor's will be carefully watching issuers who delay needed financings due to reluctance to accept the reality of higher-coupon debt. This strategy would likely precipitate lower ratings and/or negative outlooks given the uncertain capital market picture and the heightened potential of constrained liquidity in 2009.” We note that this is consistent with our findings that, nationwide, utilities have accessed the capital markets many times since the Lehman Brothers bankruptcy.

Q. Have NYSEG or RG&E accessed the capital markets since the onset of the financial crisis?

A. During 2008 and so far in 2009, NYSEG did not need to access the capital markets. RG&E needed to access the capital markets and was able to issue debt on December 19, 2008, a time of year considered by many to be a difficult time to access the capital markets even under good conditions. Based upon our analysis, we see no evidence that NYSEG or RG&E was denied access to capital. Moreover, given the recent improvements in the capital markets, as evidenced by the general decline in utility interest rates since November 2008, there is no reason to believe the Companies will be denied access to capital in the foreseeable future.

Q. What were the terms of RG&E's debt issuance?

A. As shown in Exhibit ___ (SFP-3), RG&E issued $150 million of secured debt, maturing in 25 years with an 8% coupon. The debt was issued privately as a Section 144A issuance, and was not registered with the SEC. It was rated "A/A3".

Q. Did the Policy Panel claim that RG&E experienced difficulties in accessing the capital markets in December 2008?

A. Yes. The Company claims its underwriters needed two full days of marketing before the Company was able to price $150 million of 25-year first mortgage bonds on December 19, 2008. They also claim this issuance was attributable to one investor’s purchase of over one-third of the bonds.

Q. Do you have any comments on their statement.

A. Many factors could have contributed to the length of time it took to market RG&E’s issuance. In the late 1980s and early 1990s, when Staff participated in the non-abrogation process then authorized by the Commission, there were several issuances that took two days to market. First, issuing at the end of the year, during the December holidays is considered a difficult time to market debt even the best economic climates. Second, the terms of RG&E’s issue, which had a longer maturity than most debt being issued at the time, may have slowed investor response. Third, the relatively small size of the issuance might have actually kept larger investors out of the market. In an email correspondence provided in response to NYRGE-0008, attached in Exhibit __(SFP-2), Thomas C. Croft of Bank of America indicated that the company actually would have saved 25-50 basis points if $250 million had been issued. Fourth, the unregistered private placement nature of the debt may have played a role. If there were difficulties in marketing the RG&E debt, it might well be due, in part, to the fact that the company is no longer registered at the Securities and Exchange Commission and therefore public financial reports are not available to investors.

Q. The Policy Panel makes the point that Moody’s recently reported in a January 16, 2009 article that dramatic changes in the financial markets have materially changed the banking environment for utilities. What is your view of the Moody's article?

A. We believe Moody's assessment that upcoming credit facility renewals will be more challenging and "constrained in both their ability and inclination to provide traditional credit, especially at the relatively low pricing levels and on the liberal terms and conditions that prevailed prior to mid-2008.” is correct. The Policy Panel is correct that investors, and we believe this particularly applies to investors in banks that were severely hurt by lax lending standards, are more carefully evaluating and assessing risk. We are not so sure about whether the cost of this debt will increase since much of the emphasis behind the federal bailout plans is to assure that banks have capital available to lend at reasonable costs. Nevertheless, whether the costs of bank facilities rise or not, we believe that this form of capital will remain available to NYSEG and RG&E as it will to other utilities in New York.

Q. What has been NYSEG and RG&E's experience in accessing the capital markets under the current financial conditions?

A. As noted previously, RG&E issued $150 million of long-term debt. Besides that issuance, we observed that Energy East affiliate Southern Connecticut Gas Company also accessed the capital markets in December 2008. As stated in response to Exhibit _(SFP-2), NYRGE-0008, "Neither the NY utilities nor Energy East sought or were denied additional credit or loans since

September 1, 2008. Neither Energy East nor NYSEG contemplated any long-term debt or equity financings since September 1, 2008. RG&E was awaiting the issuance of a new financing order and was planning a long-term debt issuance since early 2008."

Q. Do you have any observations about the Companies response to NYRGE-0008?

A. Yes. The premise behind these rate requests is that the Companies are in the midst of a “liquidity crisis.” We wonder how severe a “liquidity crisis” the Companies were facing if they did not seek loans of any kind since the financial crisis unfolded. If there is any “liquidity crisis” at NYSEG and RG&E, it appears to be a self-inflicted one.

Second, response to NYRGE-0008 seems to indicate that RG&E had to wait to issue debt until a new Commission financing order was issued. In fact, RG&E had $127 million of remaining authority available under its existing Commission financing order. That RG&E waited to issue debt again was a self-imposed action.

Q. What obligations does Iberdrola have concerning the Companies?

A. In the merger proceeding, Iberdrola touted its strong financial position as a benefit of the merger. The Commission considered Iberdrola's statements when approving the merger. Therefore, Iberdrola, as the owners of public service providing companies, should avail the Companies of its financial strength in order to ensure safe and reliable service.

Q. Have you performed any analysis to determine if the Policy Panel is correct in claiming that cost of capital for utilities like NYSEG and RG&E has risen?

A. Yes. While we have found that the cost of some investment vehicles such as Treasury Bills and Bonds have fallen since the onset of the financial crisis, the relevant financial instruments for NYSEG and RG&E, utility stocks and bonds, have seen their costs increase. The Mergent Bond Record indicates that the cost of Public Utility Bonds had risen steadily throughout most of 2008 and that the rate of increase in the cost accelerated in the first few months after the onset of the current financial situation. However, it is equally important to note that the market for utility debt appears to be stabilizing. In December 2008, the cost of debt for Public Utilities dropped from 8.98% to 8.13% for “BBB”-rated utilities and from 7.60% to 6.54% for “A”-rated utilities. See Exhibit __(SFP-4) which shows Public Utility Bond Yield Averages as reported by the Mergent Bond Record.

Q. Is it unusual for capital costs for utilities to rise and fall?

A. No. Capital costs for utilities continually rise and fall. Evidence of this can be gleaned from the changing Public Utility Bond Yields shown on Exhibit __(SFP-4).

Q. Are utilities more challenged by increases in interest rates than non-regulated corporations?

A. No. The Policy Panel is wrong when it states that increased capital costs are of particular concern to the utility industry. In fact, utilities are unique in that they can pass the increased costs of their borrowings directly on to its customers once these costs have been factored into the utility’s tariff. Therefore, they are less challenged than non-regulated corporate entities who must try to cover these increased costs either through increases in the price of their goods in services, which may prove detrimental to their sales revenues, or seek to offset the increase in their borrowing costs by attempting to reduce their other expenses.

Q. Do you believe the financial position of NYSEG and RG&E is impaired by increases in their costs of borrowing?

A. No. Obviously, increases in capital costs do not benefit the Companies or their ratepayers. However, these costs should be manageable by NYSEG and RG&E, as they are by any competent utility. Increased capital costs in debt issuances are readily quantifiable and can be recovered in the utility’s next rate case. Waiting until the next rate case for recovering increased debt costs, however, does not constitute a financial crisis.

Q. Have or will the Companies experience significantly increased borrowing costs?

A. We have not seen any evidence that the Companies will experience significantly increased borrowing costs in the near term. In fact, RG&E issuance at 8% only raised its embedded cost of debt by 23 basis points, and NYSEG's embedded cost of debt is unaffected since it has not issued any debt recently. More importantly, besides a $100 million refunding scheduled in 2009 for RG&E, the Companies are not expecting to issue long term debt in the next two years.

Q. The Policy Panel claims that NYSEG and RG&E are facing higher costs in part because of their "BBB" level credit ratings. How do you respond to that statement?

A. First, RG&E has generally issued first mortgage debt at an "A/A3" rating, so the Companies are overplaying the "BBB" rating card. Still, NYSEG's unsecured debt is rated "BBB+/Baa1", and RG&E's overall corporate rating is in that category. Compared to an "A" rated utility, the capital costs of "BBB+/Baa1"-rated NYSEG are higher. It is also true that the costs of "A"-rated debt has increased at a lesser rate than "BBB" rated debt. However, this in and of itself does not precipitate a financial crisis.

These costs are identifiable and recoverable in rates.

Q. The Policy Panel compared the cost of RG&E’s debt issuance to an issuance by Consolidated Edison (Con Ed) and concluded that RG&E paid an 87.5 basis point higher price for its debt than did Con Ed. Could you please comment on this comparison?

A. First, as mentioned above, RG&E was able to issue with an “A” rating which would seemingly make moot much of the Companies’ arguments regarding the cost of “BBB” rated debt. Second, RG&E’s issuance was rated “A” and Con Ed’s issuance carried an “A-” rating from S&P. Moody’s rates Con Ed’s debt as “A1” and RG&E’s as “A3” with a negative outlook, respectively.

Q. Why did these two issuances carry different yields?

A. In addition to the differences in debt rating, the most obvious answer is that RG&E issued for a longer term which, given the term structure of interest rates at that time, caused them to issue at a higher cost of debt. On December 19, 2008, RG&E issued 25-year debt at 8%. On

December 4, 2008, Con Ed issued 10-year debt at a coupon rate of 7.125%. The extra fifteen years maturity of the RG&E is the most likely primary difference in the rating of the two securities. Generally, there is a difference in yield between issuances with a five to ten year maturity and issuances with a 25 year maturity. Another probable contributor to the difference in interest rates is the difference in rates and spreads between the time Con Ed and RG&E issued. The difference in 10 year treasury rates at these two dates was 40 basis points. The small size of the issue, as noted above, cost RG&E approximately 25-50 basis points. Finally, as discussed above, RG&E placed its debt privately, as compared to Con Ed’s public issuance. Rule 144A private placements are less liquid and can only be traded amongst institutional investors, thus they generally pay a higher interest rate compared to other securities of comparable terms.

Q. The Policy Panel claims that there are no indications that cost of capital will return to the low levels that were experienced over the past three to five years. In fact, the Companies state that the current cost of capital should not be seen as a short-term phenomenon, but rather as a permanent shift in the costs of capital to reflect the true risk of investment. Does the Panel have an opinion on this?

A. The Policy Panel's belief that current cost of capital is static and will not change is a rather naïve view to be taken by the financial leadership of a multi-national billion dollar corporation. The notion that cost of capital is in anyway permanent or even predictable in the future is precisely the thinking that caused the $100 million hedging loss referred to by the Policy Panel on page 21. Exhibit __(SFP-4) demonstrates that the Mergent Bond Record shows approximately a one percentage point decline in the cost of utility debt. The evidence suggested by Exhibit __(SFP-4) indicates that cost of capital is always changing. Moreover, Exhibit __(SFP-7) demonstrates that as of February 11, 2009 Moody’s indicates that “A” rated debt has fallen an additional 44 basis points since December and “BBB” rated debt has fallen an additional 54 basis points

Q. Please summarize how the increase in cost of capital has affected RG&E and NYSEG?

A. At this point in time, the world-wide financial climate has raised capital cost from the levels they were at pre-September 15, 2008. The increase in the cost of capital has consequences for NYSEG, RG&E and their ratepayers. However, these are not dire. The cost of capital goes up and down for any business. Utilities are not unusual in this regard. In the current environment it appears that the Companies may require higher capital costs in their next rate cases. However, the increase in capital costs we have seen here does not create the urgency needed to allow these cases to be submitted early, especially on an expedited basis, since the utilities have access to the capital markets and any increase in interest expense does not materially impair the Companies' credit profile and can be recovered in the course of their next rate filing.

Q. How does the Policy Panel describe how the financial situation is affecting NYSEG's and

RG&E’s credit ratings?

A. The Policy Panel states that the combination of poor liquidity, deteriorating financial condition, limited access to capital, and weakened balance sheets pose a risk of adverse credit rating opinions for NYSEG and RG&E. We note that Moody’s had already placed a negative outlook on NYSEG’s and RG&E’s ratings prior to the financial crisis. Moody’s stated before the merger even took place that they were concerned about some of the Companies’ financial ratios being at the low end of the metrics for their current bond rating. We also note Moody's view that the Companies’ regulatory risk profile has weakened from recent standards and that the return on equity given NYSEG recently was low.

Q. Have the rate filings of NYSEG and RG&E caught the attention of the credit rating agencies?

A. Yes, but probably not in the manner the Companies might have wanted. S&P immediately put the ratings of Energy East and all of its subsidiaries on review for a downgrade. Moody's, already having NYSEG and RG&E on a review for downgrade, has been silent to date since the filing.

Q. What were S&P’s stated reasons for the downgrade review?

A. S&P in its February 9, 2009 article entitled, “Summary: Energy East Corp.”, attached as Exhibit __(SFP-8), states that Energy East‘s 'BBB+' Credit Rating is currently on CreditWatch Negative. The article states that while Iberdrola has demonstrated its support for Energy East by suspending dividends and extending liquidity to the company, it is reviewing the current ratings on Energy East and its utility subsidiaries and would likely lower these ratings if Standard & Poor's were to view Iberdrola's strategic and financial commitment to have weakened since acquiring Energy East in 2008. When the Companies were initially placed on CreditWatch on January 29, 2009, S&P called the primary reason for review a change in Iberdrola’s support for the Energy East companies. That article stated that “the recent filing with the New York Public Service Commission suggests that the ultimate level of support and commitment of parent Iberdrola S.A.

to Energy East may differ from what is reflected in the current rating. The company's filing with the Commission states it is experiencing ‘severe financial difficulties’ that have produced a deteriorated liquidity position, particularly at its New York subsidiaries which have fully drawn their bank facilities. Standard & Poor's is reviewing Energy East's plans to meet its liquidity requirements including refinancing needs and capital budget items. Of particular importance in resolving this CreditWatch listing will be our assessment of the depth of Iberdrola's commitment to Energy East.” Clearly, S&P believes that Iberdrola may not be committed to the financial health of the Companies. This is troubling, to say the least.

Q. What is your view of the Moody’s credit ratings situation at NYSEG and RG&E?

A. NYSEG and RG&E are on review for a downgrade at Moody's. While one of the factors in Moody's downgrade was its perception of low allowed returns in New York which it claims contributes to its weak overall financial metrics, there were other factors that caused the ratings review, including the substantial amount of debt at Energy East and the possibility that Iberdrola's dividend policy could become an adverse factor for the Companies.

Q. Would a downgrade from the credit agencies cause NYSEG or RG&E to lose access to the capital markets?

A. No. A downgrade would not cause a result that drastic, but it could, all else equal, raise the cost of capital for the Companies.

<u>THE ALLEGED “LIQUIDITY CRISIS”</u>

Q. Why does the Policy Panel say there is a liquidity crisis at NYSEG and RG&E?

A. The Policy Panel states that both NYSEG and RG&E have fully utilized their available revolving credit facilities. In addition to that, the Policy Panel indicates that RG&E and NYSEG have temporarily borrowed over $90 million and almost $20 million, respectively, from their parent company. Moreover, the Companies claim that operating cash flows at the Companies are expected to be insufficient to meet prospective cash requirements through 2010 by approximately $500 million at RG&E and approximately $390 million at NYSEG.

Q. What caused the purported liquidity shortfall at the Companies according to the Policy Panel?

A. The Policy Panel blames the liquidity shortfall at the Companies on several factors: 1) the use of liquidity to minimize the costs related to the collapse of the auction rate markets which temporarily caused the cost of auction rate tax exempt debt to skyrocket; 2) a derivative transaction in the swaps market turned against the Companies created a loss approximating $100 million on a position related to the bond financing completed in December 2008; 3) the impact of the Positive Benefits Adjustment (PBAs) arising from Iberdrola's acceptance of the merger order and 4) the deteriorating financial position of NYSEG and RG&E.

Q. Was all of this foreseeable by Iberdrola when they purchased Energy East?

A. Yes. The collapse of the auction rate debt market certainly was known, the risk of an open derivative position should have been known and the rates allowed by the Commission and the PBAs were known by Iberdrola when it unconditionally accepted the Commission’s merger conditions and closed on the acquisition transaction.

Q. Is there a reason why the Companies have fully extended their lines of credit?

A. Yes. An attachment sent with Response NYRGE-0007 as shown on Exhibit __(SFP-2) is an e-mail from K. Powers to B. Kump and H. Coon of the Company dated November 21, 2008. This suggests that the Companies chose to draw on their lines of credit because this mode of financing was cheaper than issuing long-term debt.

Q. Why did the Companies not remedy their problem by seeking capital from either its ultimate parent or the capital markets?

A. It is the Companies' contention that the capital markets were closed to it and it is apparent that Iberdrola would not provide cash flow relief. We discuss this in detail below.

Q. How do the credit ratings of NYSEG and RG&E compare with utilities throughout the country?

A. According to a story in the Times Union of Albany, a January 5, 2009 report by Standard & Poor’s said NYSEG’s financial position puts it in the top 35 percent of all utilities in the country, and that its business profile is called "excellent." The S&P report is shown as Exhibit __(SFP-9).

Q. Despite this reasonable ranking nationwide, the Companies claim that a potential credit rating downgrade would further exacerbate the financial issues that they see as threatening the Companies' ability to provide safe and reliable service. Do you agree with that statement?

A. No, a downgrade to a "Baa2/BBB" credit rating should not have an immediate significant negative effect on the ratepayers of NYSEG and RG&E.

Q. The Companies indicate that they believe it is in ratepayers' best interests for the Companies to achieve an "A" level credit rating within the next few years. Moreover, the Companies note the Commission's stated goals of supporting and maintaining "A" level credit ratings for New York utilities. Is this a reasonable goal?

A. From a long-term perspective, this is a reasonable goal, but, as even the Companies concede, this cannot be achieved overnight. While maintaining a "BBB" level credit rating is likely more costly at the moment than maintaining an “A” rating, it is not an adequate reason to go to extraordinary lengths to nudge the Companies toward an “A” rating by reneging on their unconditional acceptance to refrain from filing for rates until September 2009.

Q. Please describe your position on the pursuit of an “A” rating for the Companies?

A. As we said, we find the “A” rating to be an admirable long–term goal for the Companies, but do not believe that an expedited rate proceeding is necessary or even desirable to achieve these goals. Nor is it necessary to remedy the alleged short-term financial concerns raised by the Companies. The Companies should be proactive in taking steps to increase their credit quality: specifically implementing a golden share (a limited voting junior preferred stock) mechanism as discussed in the Merger Order and preparing an RDM for its next rate case.

Q. What statements have the Companies made in their filing that would raise concerns with S&P about Iberdrola’s commitment to the financial condition of NYSEG and RG&E?

A. The Policy Panel testimony at pages 30-31 states: “Energy East has not received any dividends from RG&E since April 2008, or from NYSEG since August 2008, and Iberdrola has not been paid any dividend from Energy East since the closing of the merger transaction. In that sense, Iberdrola has not earned any return on its equity investment in the Companies since closing. This is not sustainable as Energy East and Iberdrola have their own liquidity needs, and investors in public utilities (both debt and equity) must receive a reasonable return on their investment to ensure the utilities have future access to capital for the provision of safe and reliable service.”

Q. What is the implication of this statement?

A. This statement implies to us, and apparently to S&P as well, that Iberdrola is threatening to withhold capital from NYSEG and RG&E if what it views as a “reasonable” return on equity is not allowed by the Commission.

Q. Does this suggest that Iberdrola is not interested in investing in the Companies?

A. Yes. It appears that Iberdrola will invest within its system where it will achieve the highest returns among competing investments. For example, it would invest in nuclear generation in Europe where it recently formed a venture with other companies. Their strategy is summed up by their CEO who stated, “We can be part of the solution or we can make more problems. If we will not get a proper return, we will not make the investment," when announcing reduced capital expenditure plans for 2009 compared with 2008. The article containing this quote is attached as Exhibit __(SFP-10).

Q. Why does that concern you?

A. Iberdrola committed to support and invest in the Companies in the merger proceeding. In fact, Iberdrola insisted that its acquisition of Energy East would improve the Companies’ access to capital. This new and undisclosed hurdle for investment in NY directly contradicts Iberdrola’s public assertions of financial support.

Q. Did this type of hurdle on investment exist when Energy East was the sole owner of the Companies?

A. No. Energy East only had investment opportunities in distribution and transmission. Iberdrola's investment opportunities are much broader and include, wind, hydro, and nuclear generation. This new hurdle suggests that the acquisition has actually impaired the Companies access to its parent's capital.

Q. Are there any other statements in the filing that appear to indicate that Iberdrola will withhold financial support if the returns on equity allowed to the Companies are not reasonable?

A. The cover letter sent with the filing states that, "Failing to permit returns at reasonable levels would be confiscatory and would result in cash flows insufficient to support future capital investment."

The testimony of Companies' Witness Makholm states that, "All utilities compete in the market for capital, regardless of who owns their stock at the moment. It is unreasonable as a practical matter to expect capital markets to support necessary and ongoing utility capital expenditures unless they compete effectively with other investment opportunities. The incentive on the part of the capital markets to commit funds to operating utilities is no different for an independent company than it is for the operating subsidiary of a holding company. This is always true, but the effect is particularly visible in difficult economic times when capital funds are tight." Makholm's statement in particular is troubling. When Iberdrola sought approval of its merger with Energy East, the acquirer emphasized to the Commission its commitment to provide capital to the New York utilities.

Q. What positive assertions did Iberdrola make to the Commission?

A. The merger case is littered with positive assertions made by Iberdrola to use its financial strength for the benefit of NYSEG and RG&E and their ratepayers. Page 3 of the Joint Petitioner's Initial Brief in the Merger Case states that, "As a larger, stronger and more diversified holding company with 'A' category credit ratings from all major ratings agencies, Iberdrola will bring financial strength and stability to Energy East and its operating subsidiaries NYSEG and RG&E, which have credit ratings in the 'BBB' category. Iberdrola's financial strength should in the future provide NYSEG and RG&E with greater access to capital at lower costs, ultimately benefiting ratepayers."

Iberdrola also touted its ability to provide safe and high quality service saying, "IBERDROLA is a leading global utility and energy company with a market capitalization of approximately $70 billion...It has the financial, technological and managerial capabilities, honed by over 100 years of utility experience, to acquire control of Energy East while ensuring that NYSEG and RG&E continue to provide high quality, safe, and reliable service to their customers;"

In a theme it trumpeted throughout the case, Iberdrola proclaimed it had greater access to capital for NYSEG and RG&E than Energy East saying that, "the Proposed Transaction will provide Energy East (and thus RG&E and NYSEG) with greater access to both U.S. and global financial markets than they would have in the absence of the Proposed Transaction” and “IBERDROLA's ability to quickly sell 85 million new shares of common stock through a fully-subscribed accelerated private placement shows how access to capital can be a benefit of IBERDROLA’s financial strength. By providing enhanced access to capital, the Proposed Transaction will allow NYSEG and RG&E to continue to provide high quality, safe and reliable service.”

Q. Has Iberdrola delivered on its “promise” of financial strength for the Companies?

A. No. The financial strength of Iberdrola has not been apparent to us. Both Moody’s and S&P have placed the Companies on a review for downgrade. The financial strength of Iberdrola also appears to be withheld as demonstrated by this filing in lieu of an equity infusion from the parent.

Q. The financial crisis has been a compelling story over the past four months. Has Iberdrola’s ability to access capital been infirmed by this global event?

. Iberdrola was able to issue a debt of 3.1 billion euros ($3.9 billion US) for its capital expenditure needs and recently restructured a $7.955 pound ($11.67 billion) loan. Moreover in a February 9, 2009 article posted by Reuters, Iberdrola was quoted as saying, "with this deal, Iberdrola reinforces its financial solvency and lengthens the average maturity of the debt, which is 5.9 years, at the same time as it increases its liquidity to 8 billion euros" ($10.2 billion US). Thus, while the Companies claim an inability to access capital, Iberdrola, their parent, claimed it has 8 billion euros ($10.4 billion) in liquidity available to it. This article is attached as Exhibit __(SFP-10).

Q. Is Iberdrola currently achieving any other benefits from this acquisition besides dividends?

A. Yes. As Staff testified in the merger, Iberdrola will receive significant domestic and foreign tax benefits as a result of this merger, exceeding $100 million annually and amounting to over $1 billion lifetime. Furthermore, the Commission allowed Iberdrola the unique opportunity to invest in wind generation in New York even though it owned two New York distribution utilities. So it is not fair to suggest that Iberdrola is not benefiting directly due to this merger.

Q. Has Iberdrola delivered on its promise to bring $2 billion of wind investment to New York?

A. We are not aware of any incremental investment in wind that Iberdrola has made in New York since the merger closed.

Q. Please summarize your view of Iberdrola’s financial support for NYSEG and RG&E.

A. We are concerned that Iberdrola is unwilling to make the necessary financial commitments to NYSEG and RG&E to ensure that these utilities fulfill their duties as public service companies to provide safe and reliable service. Conjuring a liquidity crisis at the Companies in an attempt to generate an expedited rate increase is unconscionable. Amazingly, the proposed rate increases do very little to fund capital expenditures. The Policy Panel Exhibit PP-6 shows that for 2009-2010, very little additional cash is generated for capital expenditures after $400 million in dividends are paid out.

<u>FINANCIAL PERFORMANCE OF THE COMPANIES</u>

Q. Have the Companies' claimed that their cash flows and earnings will be inadequate?

A. Yes. The Companies allege that cash flows and earnings will be inadequate in 2009.

Q. Have you examined the Companies' claimed inadequate cash flows and earnings assertions?

A. We have made a preliminary review of the Companies' earnings and cash flows in an extremely compressed amount of time and without having the benefit of the substantial details that are lacking in the filings.

Q. What do you conclude from your preliminary review?

A. The earnings and cash flow deterioration alleged by the Companies is based on flawed assumptions, suffers from material omissions, and is not supported by evidence. In fact, we find that opposite is true. The Companies' cash flows and earnings are and will continue to be adequate for 2009 without rate increases. In summary, we conclude that any effect of the world-wide financial crisis on the utilities as alleged by the Companies is materially over stated and largely manufactured.

Q. How did you determine that the claimed effect of crisis on these utilities is materially over stated and manufactured?

A. Based on information provided in Response NYRGE-0005, we are certain that NYSEG’s and RG&E’s current earnings for the year 2008 exceed a 10% return on equity. A return on equity, exceeding 10%, all things considered, is reasonable especially since the Commission (Long Merger Order, page 141) established an earning sharing threshold of 10.1% reflecting the financial conditions at the date of the abbreviated Order Approving the Acquisition. In contrast, the Companies’ projected deficiency in earnings and the cash flows was created by future projections of substantial spending increases, an unreasonably high ROE (12.0%-12.2%), and the use of a stand alone capital structure.

Q. The Companies rate filings are seeking ROEs exceeding 12% for 2009-2010. Why is that unreasonable?

A. Iberdrola unconditionally accepted a 10.1% ROE as one of the conditions of the merger. In Staff’s view the 10.1% ROE accepted by Iberdrola and Energy East is tantamount to and the equivalent of an ROE established in a multi year rate plan, therefore the 12.2% ROE request at issue here is invalid until rates are reset in late 2010. The same can be said for the lower equity ratio used for setting the Companies rates. The use of a lower equity ratio is also tantamount to and the equivalent of an equity ratio established in a multi year rate plan.

Q. Do the Companies' earnings or cash flows for 2009 suggest that they will not be able to have the financial resources necessary to provide safe and adequate service?

A. No. As shown in Staff's exhibits, the Companies stand alone earnings, Exhibit __(SFP-11), and cash flows, Exhibit __(SFP-12), for 2009-2010 will provide the financial resources necessary to provide safe and adequate service even without financial assistance from Iberdrola.

Q. What is the Panel's observation about the disparity between the Companies current level of earnings and the projected earnings erosion?

A. Past experience has demonstrated that the Companies are very unlikely to sustain the magnitude of the projected earnings erosion when the current level of earnings is sufficient. This situation has been confirmed in both NYSEG’s and RG&E’s most recent rate cases, where current earnings were adequate but pro-forma earnings were alleged to be deficient.

Q. What was the outcome of these rate cases?

A. Both NYSEG and RG&E largely failed at their attempts to project earnings erosion and the Commission found that the delivery rate increases it sought were not justified. The rates in those cases ultimately were either frozen at current levels or reduced. A similar result should be expected here.

Q. What do you base your conclusion on?

A. It is based on the most recent rate filings of the Companies. In 2002, RG&E sought electric and gas rate increases of $59 million and $18.7 million, respectively. The Commission denied RG&E’s electric rate increase and granted RG&E a $5.5 million gas rate increase. In 2003, RG&E sought electric and gas rate increases of $105.5 million and $25.3 million, respectively. The Commission ultimately approved a joint proposal which froze RG&E's electric and gas delivery rates for five years, and adopted $7.4 million and $7.2 million in electric and gas surcharges, respectively.

Similarly, in 2005, NYSEG sought an electric delivery rate increase of $91.6 million, which it subsequently updated to over $100 million. In its 2006 Rate Order the Commission adopted a $36.2 decrease in NYSEG's electric delivery rates.

Q. What are the projected earnings of the utilities for 2009?

A. The Companies allege that they will earn at or below 7% for 2009 without rate relief and before regulatory adjustments (Policy Panel, page 25).

Q. Do you have any comments on this assertion?

A. Yes, as the Policy Panel admits, these pro-forma returns are for delivery operations only and omit substantial earnings from its respective electric commodity programs (Policy Panel, page 9, footnote 3). When an estimate of those regulated tariffed commodity earnings are added back, we estimate that the Companies' projected 2009 ROE will rise to over 11%.

Q. Is it reasonable or proper for the utilities to omit tariffed electric commodity profits for purposes of meeting the merger condition of financial deterioration?

A. No. In the ordinary course of reviewing a delivery rate filing we would not necessarily reflect commodity earnings, however, the Companies are seeking extraordinary consideration of rate relief on the basis of financial deterioration. This is only allowed if the Companies can demonstrate that their overall financial performance has fallen to levels that jeopardize safe and reliable service. Further, the investment community analyzes the overall operations of a corporation when evaluating the financial condition of a corporation. The commodity and delivery operations are not segregated when the Companies' finances are evaluated. As a result, it is proper to include the Companies' commodity operations when evaluating whether the utilities are experiencing a financial crisis. Also, the Merger Long Order referenced the Companies' financial condition as a whole and did not explicitly exclude commodity earnings from the determination of the utilities financial performance. In fact, the Companies’ filing distorts its financial situation by including certain earnings (delivery) that are allegedly inadequate while ignoring other earnings that are adequate.

Q. Do you have any other observations on the Companies’ 2009 pro-forma earnings?

A. Yes. The 2009 pro-forma earnings projections presented by the Companies are flawed in other ways. For example, the utilities have failed to address merger-best practices or austerity savings in its projections, even though it was under order to do so. Further, the utilities have projected certain costs for 2009 that are questionable. For example, the Companies have projected approximately $8 million of increased legal expenses, largely due to rate case costs even though the utilities committed to a merger condition that prohibited rate cases. Also, when many businesses are freezing wages, laying off employees, or asking for employee give-backs, the utilities have projected discretionary 3% payroll increases for all its employees, including those who are not contractually entitled to increases, even though it claims that it is in financial distress.

In addition, it appears the Companies continue to award their employees incentive compensation and allow executives to collect a supplemental employee retirement plan. A rigorous cost reduction program would have re-examined these employee compensation packages before the Companies requested a rate increase.

Q. Are there any other concerns about the utilities expense projections?

A. Yes. In the Merger Order, the Commission expressed a concern that expenses caused by the merger might distort historic expenses in the Companies next rate filings. The Commission stated that “rates set on the basis of such costs would be excessive” (Merger Long Order, page 139). The Commission indicated that the twelve month rate stay-out would help to ensure that such costs were not embedded in the Companies' future rate levels. However, the Companies’ filings do not explicitly show the removal of any expenses caused by the merger even though the historic test year ending September 2008 covered the period in which most of the merger expenses were incurred.

Q. Have you made an estimate of the Companies' pro-forma 2009 earnings?

A. Yes. We estimate the Companies' 2009 pro-forma delivery earnings will exceed 10%, without rate relief or any further austerity or best practice savings, on a regulatory basis. Further, when $17 million of commodity earnings are added, those earnings could easily exceed 11%. This estimate is contained in Exhibit___(SFP-13).

Q. According to the Companies' rate filings, it seeks $278 million in delivery rate increases effective July 1, 2009. What level of ROE was projected by the Companies for 2009 in developing these rate increases?

A. The Revenue Requirements Panel's exhibits allege that the 2009 ROE for the Companies will fall from approximately 7% to below 4% after the new spending increases, discretionary program costs, and recovery of prior period regulatory costs are added. The Companies also allege that the

ROE required is 12.0%-12.2%. The shortfall between the projected ROE of 4% and the desired ROE of 12% produces the aggregate $278 million of rate relief calculated by the Companies.

Q.   The Policy Panel alleges that the 2009 ROE will fall below 7%, but the revenue requirement produced by the Revenue Requirements Panels is based on a 2009 ROE below 4%. How did that occur?

A.   The Revenue Requirements Panels adopt numerous “regulatory adjustments” to 2009 pro-forma earnings to produce a further deterioration in earnings. Among those adjustments are massive increases in capital and operating expenses and the implementation of significant new discretionary spending on existing programs. Further, the filings seek the recovery of substantial deferred costs from prior and existing rate agreements.

Q.   Do you have any general reaction to these regulatory adjustments?

A.   Yes. It seems particularly disturbing and contradictory for a company that is supposedly in “financial distress” and that is facing a "liquidity crisis" to engage in such a massive spending binge.

Q. Did these spending increases in capital and operating expenses, the implementation of significant new discretionary spending on existing programs, and the alleged build up of deferrals occur after the merger condition to keep rates at existing levels was unconditionally accepted by the Companies?

A. No. These cost increases were largely known to the Companies prior to the acceptance of the conditions.

Q. What is this conclusion based on?

A. The spending increases in capital and operational programs were largely presented by the Companies' respective Capital Expenditure, Reliability, and Operations Panels (CEROP). We examined these proposals and conclude that many have been known for several years (e.g., Ithaca Transmission Project), others are not new requirements (Electric Reliability Organization), some are requirements of the merger (Municipal Cooperatives Task Force), while other programs must have been in the planning stages since they are extensions of existing programs (TDIRP). These requirements should have been foreseen by the Companies at the time they unconditionally accepted the condition to refrain from filing rate cases for twelve months. We have prepared Exhibit___(SFP-14) which provide the basis for our conclusions.

Q. What is the magnitude of the new capital spending proposed by the CERO Panels?

A. As shown in Companies Exhibit___(PP-4) pages 1-2, the Companies' capital expenditures are projected to exceed $816 million over 2009-2010. This proposed level of expenditures is 51% or $276 million more than the $540 million amount of capital expenditures the Commission ordered as a merger condition to ensure safe and reliable service.

Q. Do you have any other observations about the level of expenditure increases, both capital and operating, projected by the Companies for 2009 and 2010?

A. Yes. Proposed incremental investments and expenses are routinely encountered by management and assigned greater or lesser priority to existing expenditures within resource constraints. At this time, that procedure is even more appropriate given the promise and commitment made to ratepayers to hold rates constant through 2010. Management cannot be allowed to abandon its managerial duties by simply asking for higher rate levels. It is even more troubling for a company that is in “financial distress” and that is facing a “liquidity crisis” to propose and seek recovery of substantial spending increases on discretionary programs.

Q. Can you provide an example of spending increases proposed in discretionary programs?

A. Yes. We note that the filings contain proposed increases in discretionary program spending such as depreciation changes ($4 million), low-income ($20 million), and rate case expenses ($8 million). Also, the Companies are expediting funding on environmental remediation programs (to $51 million) whose timing appears to be discretionary.

Q. Do you have any further comments on this new discretionary spending?

A. With perhaps the exception of depreciation changes, the new discretionary spending, if approved by the Commission, will do nothing to alleviate either the company's "financial distress" or its "liquidity crisis" which are the alleged basis for these rate filings.

Q. You have mentioned in several places that current earnings are above 10% for the Companies. Please elaborate.

A. Based on Response NYRGE-0005, Staff has estimated the 2008 actual ROE for the Companies to be 10.3%. This estimate is provided in Exhibit___(SFP-11).

Q. Has the achieved ROE fallen dramatically for the Companies between 2008 and 2007?

A. No. As shown in the exhibit, we estimate that the Companies achieved a 10.9% ROE in 2007.

Q. Has the ROE achieved in 2008 deviated significantly from the expectations in its 2008 Budgets?

A. No. As shown in Exhibit___(SFP-15) the ROE achieved in 2008 was reasonably comparable to its budgeted expectation of 11%.

Q. Did Staff observe anything unusual in its review of monthly data for 2008 concerning the Companies earnings?

A. Yes. We observed some unusual activity in the months of July and September through November for RG&E's electric operations. Reported earnings were unusually low for those months, although they rebounded somewhat in December 2008. RG&E's gas earnings appeared to be up and NYSEG's earnings were not substantially different from the prior year's amounts.

Q. In the short time you had to review this filing, did Staff try to develop an understanding of RG&E's electric earnings erosion?

A. Yes. We reviewed data obtained from RG&E and found that there was a very large and unusual reduction to its ROE and in the net electric sales margins (revenues less commodity costs) in those months.

Q. Does a drastic reduction in net margins and ROE make sense?

A. No. The net margin on sales is mostly reconciled for RG&E via its non-bypassable wires charge. While timing and estimation discrepancies could impact the level of earnings in between months, over the year the net margin should not be materially impacted. Also, the reduction in net margins was negatively impacting RG&E's ROE. This too did not make sense since we expected to see offsetting expense reductions due to the closure of Russell Station in May 2008.

Q. Did you seek information on the volatility of RG&E's electric earnings, in particular its dramatic net electric margin erosion?

A. Yes, during December 2008, we inquired of several senior management personnel and no one could provide an adequate explanation.

Q. Do you have any concerns about RG&E's electric earnings erosion?

A. Yes. The net margin erosion concerns Staff. First, it appears to be negatively influencing the company's own view of its earnings. Second, to the extent that sales margin erosion exists because of the non-bypassable wires charge, it will be largely reconciled in subsequent months. As a result, the utility will be made whole for any margin erosion that may have occurred in 2008.

Further, and most importantly, this earnings erosion is embedded in its historic test year. This may be artificially increasing the rate increases sought by RG&E. Therefore, a full review of this issue should be conducted before any rate relief is considered.

Q. You stated previously that cash flow deterioration alleged by the Companies is based on flawed assumptions, suffers from material omissions, and is unsupported. You also concluded that the opposite is true--the Companies' cash flows are and will continue to be adequate for 2009. How do you support these conclusions?

A. Staff prepared a high level cash flow statement based on the information in the filings. This statement is contained in Exhibit___(SFP-12). This exhibit shows that the Companies' cash flows for 2009-2010 are adequate. The Companies will have over $100 million of free cash flow in the aggregate over the years 2009-2010.

Q. Did the Policy Panel present a similar cash flow statement?

A. Yes, the Policy Panel provided a similar cash flow statement in Exhibit___(PP-4) pages 1-2 but the results shown were quite the opposite.

Q. What does the Companies' cash flow Exhibit___(PP-4) show?

A. Exhibit___(PP-4) shows that the Companies' cash flow will be -$693 million during the 2009-2010 periods (-$366 million in 2009 and -$327 million in 2010).

Q. What does Staff's cash flow analysis show?

A. For the same period, Staff's cash flow analysis shows that the Companies will achieve positive cash flows of approximately $100 million.

Q. Explain how and why Staff's cash flows differ from the Companies by almost $800 million.

A. There are several assumption differences that cause the large discrepancy in 2009-2010 cash flows. First, the Companies assume that approximately $201 million in dividends are paid to the parent. The assumption that the Companies will pay dividends is questionable at a time of alleged "financial distress." Further, should the Companies' credit ratings deteriorate as they suggest they will, the Commission could impose a dividend restriction.

Q. Are there any other differences between Staff's and the Companies' cash flows?

A. Yes. The Companies have assumed capital expenditures of over $815 million in 2009-2010. Staff has assumed that the level of capital expenditures necessary to provide safe and adequate service amount to $540 million, or a difference of $276 million.

Q. How did you arrive at Staff's assumed level of capital expenditures?

A. These capital expenditure levels were the amounts approved by the Commission recently in the Iberdrola merger order.

Q. Are there any other significant cash flow differences?

A. Yes. There is a $236 million difference in working capital, $10 million in non-cash pension costs, and $37 million in deferred taxes. Finally, Staff added commodity earnings to our cash flows.

Q. Explain the difference in working capital.

A. The amount of working capital requirements shown by the Companies (-$151 million) is lacking support. On the other hand Staff is aware of several major cash flow working capital enhancements that will be implemented in 2009-2010.

Q. Please itemize the Staff working capital assumptions.

A. Staff observed that $57 million of non-cash Asset Sale Gain Account (ASGA) credits currently flowing through RG&E’s non-bypassable charge (NBC) are expected by RG&E to expire in 2010 (see RG&&E Revenue Requirements Panel, page 27). The expiration of that non-cash credit will increase RG&E’s cash flow by $57 million in 2010. Also, Staff notes that NYSEG’s NBC for 2009 will collect $24.7 million of deferred under-collections from 2008 and this too will increase NYSEG’s cash flow in 2009.

Q. Before you continue, can you comment on the impact of the projected expiration of RG&E’s ASGA credits on RG&E electric delivery customer’s bills?

A. Yes. Currently, there is approximately $57 million of ASGA credits embedded in RG&E’s electric delivery rates. The expiration of RG&E’s ASGA credits will mean that RG&E electric delivery customer’s bills will rise another $57 million (22%) annually. This increase, together with the 25% delivery rate increase sought by RG&E, will lead to a 47% increase in its electric delivery revenues by 2010.

Q. Getting back to cash flows, you made two other adjustments to cash flows, one for pension expense and the other for commodity income. Can you explain these?

A. Yes. The cash flow projections used by the Companies use delivery income and ignore commodity earnings. That omission is not reasonable or explained. Also, the Companies project a sizable increase in pension expenses during the 2009-2010 periods. Pension expenses are reflected as a reduction in income but are not a cash flow item. Therefore, we added pension expense back to cash flow.

Q. Do the Companies have other means to enhance their cash flows?

A. Yes. Besides withholding dividends to the parent, the Companies should also consider withholding certain payments to its parent holding company and its service company until its alleged financial and liquidity issues subside.

Q. Which payments should the Companies consider withholding to further improve cash flows?

A. The Companies should consider withholding payments to the parent to reimburse it for stand alone federal income taxes and other inter-company payables.

Q. Why should the Companies consider withholding of federal income taxes to improve its cash flows?

A. As debated at length in the merger proceeding, Staff found that the acquisition of the Companies’ taxable income would enable Iberdrola to utilize federal production tax credits (PTCs) that otherwise would not be utilized due to Iberdrola’s lack of taxable income in the United States. Because of the merger Iberdrola could now utilize PTCs to offset Iberdrola’s domestic federal income taxes.

Q. How much PTCs were estimated by Staff in the merger proceeding?

A. Staff estimated that Iberdrola could generate between $100-$150 million of PTCs per year for the next ten years or over $1 billion (Merger

Long Order, page 121).

Q. How much of federal stand alone income taxes are estimated by the Companies during 2009?

A. The Companies estimate the payment of $34 million of stand alone federal income taxes in 2009, without rate relief. A similar level of payments could be expected for 2010. Therefore, the withholding of these tax payments will free up almost $70 million of cash flow to the Companies over two years.

Q. You also mentioned that the Companies should consider delaying payments of affiliates inter-company payables until the alleged crisis recedes. What are inter-company payables?

A. The Companies receive a variety of services from the holding and service company affiliates. These services range from executive support to information technology services. According to page 302 of their respective 2007 FERC Form 60 Reports, in 2007, the holding (EEMC) and service (USSC) company affiliates billed the Companies $27 million and $50 million ,respectively, for their services. Delaying payments of these reimbursements to the affiliates could free up over $77 million of cash flows per year.

Q. Why would it be reasonable for the Companies to delay these payments until the alleged crisis is resolved?

A. In the case of PTCs, Iberdrola will not actually pay the taxes the Companies remit to it to the federal government. Rather, Iberdrola will utilize PTCs to offset the taxes owed on the utility income. Therefore, the dollars paid by the Companies to Iberdrola representing federal taxes will actually flow to Iberdrola. Further, in the case of PTCs and the payment of inter-company payables, Iberdrola is not alleging its own financial distress or lack of access to capital, in fact based on recent press reports, the opposite seems to be true. Therefore, it would be fair and prudent for the Companies to delay these inter-company payments until its alleged cash flow troubles subside.

Q. The Policy Panel at page 30 claims that “the Companies are taking aggressive measures to help conserve liquidity in the current financial crisis, including restricting hiring (including delaying line worker classes), travel restrictions, reducing operating expenses, delay of vendor payments to the greatest extent possible and other cash conservation measures." Is this response to an alleged financial crisis adequate?

A. No. The Companies' purported attempts at austerity are weak. In addition, the Companies have not sought to adopt system wide best practices or potential merger savings.

Q. Does the Policy Panel present any estimate of savings from their alleged austerity measures?

A. No. The amount of savings arising from these measures was not presented in the Companies' testimony.

Q. What obligations do the Companies have with respect to any costs or savings related to operational changes resulting from their merger with Iberdrola?

A. Pursuant to the Merger Order, the Companies must provide "all studies, analyses and related work papers prepared by Iberdrola, its subsidiaries, affiliates, or agents that identify or quantify the costs and savings related to merger synergies, efficiency gains, and the adoption of utility best practices that in any way affect the management, operation and underlying costs of NYSEG's and RG&E's utility business."

Q. Have any merger savings been identified?

A. No. According to the Policy Panel testimony at page 44 "the merger was not intended to create any merger savings, and no such merger savings have been identified. In fact, because the Companies have determined that no such savings were likely, no studies or analyses were performed."

Q. Is this a reasonable response?

A. No. This response is unreasonable for two main reasons. First, given the current circumstances in which the Companies are alleging financial distress, the pursuit of best practices should commence immediately. Second, the response given is contradicted by assertions made by Energy East in a December 2008 presentation to its ratings agencies.

Q. Has Staff identified any areas in which best practices or consolidations could be achieved?

A. Yes, in the Iberdrola merger proceeding, Staff identified ways in which best practices and consolidations could be achieved. In fact, the Companies’ witness agreed that best practice and perhaps synergy savings could be achieved (see Tr. 957, Case 07-M-0906).

Q. Did the Commission acknowledge that savings could be achieved?

A. Yes. The Merger Long Order (page 140) states “Staff testified that such savings are likely and Companies ultimately conceded on rebuttal that savings are possible.”

Q. Do the Companies address austerity measures that can be achieved?

A. Yes. The Policy Panel, on page 44, mention austerity, but they do not elaborate, nor do they consider several other austerity measures aimed at improving earnings and cash flows.

Q. What additional austerity measures could be implemented to improve earnings and cash flows?

A. To improve earnings and cash flows, the Companies could implement additional austerity measures such as: reducing overtime, cutting the workweek, eliminating bonuses, offering unpaid vacations or furloughs, implementing salary, wage, or merit freezes, reducing part-time workers or contractors, or voluntary severance programs.

In addition, the Companies could improve cash flows, by reducing the over $200 million in dividends they expect to pay to the parent during the period 2009-2010. The payment of dividends at a time in which they allege that they are in a financial and liquidity crisis is particularly egregious.

Q. Are these unusual or extraordinary austerity measures?

A. No. Businesses all over the world are implementing just such measures in response to the current financial crisis.

Q. Are there any other means to achieve earnings improvements in lieu of rate increases?

A. Yes. The Companies can and have sought earnings relief through regulatory mechanisms. For example, the Companies have recently sought expedited recovery of almost $14 million in increased uncollectible expenses expected to be incurred in 2009. In addition, the Companies always have the option of seeking deferral treatment of material or extraordinary unforeseen cost increases if they can be justified.

Q. It was reported in the Albany Times-Union on January 14-16, 2009 that the Companies were considering filing requests for temporary rate increases. Were you aware of these press reports?

A. Yes. Press reports indicated that the Companies were considering a request for temporary rates and furthermore they desired that such temporary rates be implemented on an “emergency” basis. That is, they wanted the increase to take place immediately, without a vote of the full Commission via a one Commissioner order.

Q. What is the procedure for implementing temporary rates?

A. According to Public Service Law §114, “The commission may, in any such proceeding, brought either on its own motion or upon complaint, upon notice and after hearing, if it be of opinion that the public interest so requires, immediately fix, determine and prescribe temporary rates to be charged by said utility company pending the final determination of said rate proceeding. Said temporary rates so fixed, determined and prescribed shall be sufficient to provide a return of not less than five per centum upon the original cost, less accrued depreciation, of the physical property of said public utility company used and useful in the public service, and if the duly verified reports of said utility company to the commission do not show the original cost, less accrued depreciation, of said property, the commission may estimate said cost less depreciation and fix, determine and prescribe rates as hereinbefore provided."

Q. Are emergency temporary rate filings commonly seen in New York?

A. No. Not only are temporary rate filings rare, the fact that the Companies desired the increases without a full Commission vote, required financial support documentation, or hearings is extremely rare.

Q. Did the Companies request temporary rates?

A. No.

Q. What else did Staff review at this time?

A. As discussed above, Staff reviewed the

Companies' access to capital markets as reflected in its RG&E debt issuance and other capital market trends and found sufficient liquidity and access to funds. Thus, Staff concludes that the Companies could not have met the requirements for temporary rate increases.

Q. What is the basis for this conclusion?

A. The Companies and other similarly situated utilities have access to capital. Further, even by their own admissions, the Companies cannot meet the statutory minimum 5% return threshold for temporary rates. Also, as noted above the utilities have adequate cash flows.

Q. You indicate that you have reviewed the rate case filings submitted by the Companies. Do you have any observations about these filings?

A. Yes. The filings are deficient in many ways. They are deficient in that they do not comply with traditional rate case filing requirements, as discussed above they do not comply with the Merger Long Order, they omit critical electric commodity rate issues, and they omit some filing requirements imposed by the Commission in the 2006 NYSEG rate order.

Q. How do the filings lack compliance with the Merger Long Order?

A. As the Policy Panel readily admits, the filings omit any studies of merger or best practice savings. These studies were required to be filed in the Companies next rate cases by the Merger Long Order. Second, the Companies fail to address the removal of merger related transaction or integration costs as required by the same order. Third, the starting point for the utilities’ forecast cannot readily be tied to the accounting records because commodity operations were removed from the presentation. The utilities provided no workpapers showing a reconciliation between the companies’ accounting records and the rate case presentation.

Q. Why did the Companies omit any discussion on electric commodity issues?

A. According to the Policy Panel, page 9, footnote 3, “the Companies’ commodity programs are not addressed in this filing. The Companies will address such programs in a March 1, 2009 filing in compliance with the Commission's January 20, 2009 Order Establishing Filing Requirements in

Cases 07-E-0479 and 03-E-0765.”

Q. Is that a fair and reasonable omission given that the Commission’s January order required such a review of the Companies electric commodity programs commence in March 2009?

A. No. The Commission’s January order predated these rate filings and was made on the heels of the Merger Long Order, which ordered a delay in the overall rate filings until September 2009, at the earliest. The Commission sought to consolidate the RG&E commodity review which was required to be filed by March 1, 2009 with a review of NYSEG’s commodity program (which was to be reviewed in 2010) in the January Commodity Order. This was done to “conserve both administrative resources and the resources of parties interested in retail access issues” (January Commodity Order, page 2).

Q. Should NYSEG’s electric commodity programs be reviewed prior to 2010?

A. Yes. Pursuant to the July 10, 2007 Joint Proposal establishing NYSEG’s electric commodity program “the three-year term shall be reopened if NYSEG files a major electric delivery rate case with the Commission.” Therefore, since NYSEG has filed the delivery rate cases, its commodity program has been reopened.

Q. How does the omission of electric commodity issues impact these filings?

A. The omission impacts these rate filings in two critical ways. First, the filings omit the favorable impacts of commodity income and cash flows from the Companies’ analysis of its earnings and cash flows. Second, specifically for RG&E, the omission of the electric merchant function charge (MFC) related to electric commodity programs, could distort the level of its electric delivery revenue requirements.

Q. What did RG&E say about the omission of the MFC from its electric rate filing?

A. According to the RG&E Delivery Rate Design Panel testimony at page 21 “the Company intend[s] to address an MFC in the non-revenue requirement portion of this proceeding.” This suggests that the implementation of an MFC does not impact its electric revenue requirements.

Q. Would the implementation of an MFC impact RG&E’s electric delivery revenue requirements?

A. Yes. Based on past experience with the
implementation of NYSEG's electric MFC, its
implementation could significantly impact the
delivery revenue requirement and customer bills.
Q. Explain how the implementation of an electric
MFC will impact RG&E's electric revenue
requirements?
A. The implementation of an MFC is typically
revenue neutral overall because it is expected
to reduce delivery revenue requirements and
increase commodity revenue requirements by
comparable amounts. However, since RG&E's
electric delivery revenue requirements are at
issue in the instant filings, the MFC must be
addressed in these filings or the impacts on
delivery revenue requirements cannot be
implemented.
Q. How would the implementation of an MFC impact
RG&E's electric delivery revenue requirement?
A. It could reduce the delivery revenue requirement
through the addition of electric merchant
function charge revenues, offset by the loss of
the retail access surcharge. Overall, it should
reduce the net delivery revenue requirements.

Q. You stated that these rate filings omit some filing requirements imposed on NYSEG by the Commission in the 2006 NYSEG rate order. Please explain.

A. In NYSEG's 2006 rate order the Commission at page 90 states "In future rate proceedings, NYSEG is required to provide, and included in any rate filing it submits, information equivalent to the information Staff was able to obtain from the Securities and Exchange U5S and U-9 reports that were available during this proceeding." This information was not provided in the rate filings.

Q. What information is contained in these reports?

A. These reports contain detailed information on the parent's consolidated capital structure and financing as well as consolidated income statements and balance sheets.

Q. Why did the Commission require this information be provided in NYSEG's rate cases?

A. This information is required to evaluate the use of a consolidated capital structure for ratemaking purposes.

Q. What did the Commission state in the 2006 NYSEG

Rate Order concerning the use of a stand alone capital structure for NYSEG?

A. The 2006 NYSEG Rate Order stated, at pages 89 through 90, “we are prepared to re-evaluate NYSEG's capital structure if and when Energy East provides its criteria to fully insulate the subsidiary's capital structure and financial standing in a manner that the credit rating agencies would recognize NYSEG's credit worthiness separate and apart from Energy East's. Until such ‘ring fencing’ provisions are in place, the consolidated capital structure will be used for ratemaking purposes.”

Q. Is the Company now arguing that a stand alone capital structure should be used because ring fencing measures are in place, thus obviating the need to file the information contained in these reports?

A. Yes. However, to the best of our knowledge, the credit rating agencies have not recognized NYSEG's credit worthiness separate and apart from Energy East's. Therefore, the required information should have been filed.

Q. What other omissions are you aware of that are typically found in traditional rate filings?

A. The filings seem less detailed than in the past. The volume of normalizing adjustments to the historic test year data were less than in the past filings. Further, support workpapers were not provided. We noted in the RG&E filings, an earnings base/capitalization (EBCAP) adjustment was not made (an EBCAP adjustment was made by NYSEG).

Q. Please summarize the results of your analysis.

A. The Companies' filing that claims a financial crisis exists at NYSEG and RG&E is extremely exaggerated. While capital cost have risen for the Companies, we have found no evidence that they would be precluded from accessing the capital markets. Moreover, we have found Iberdrola's financial support of the Companies, or lack thereof, to be in complete contradiction to the assertions made to the Commission in the merger proceeding and a major contributing factor to Companies' financial condition.

Q. The Companies are concerned that they have inadequate access to short-term capital to manage emergency situations. What is your position on this?

A. We do not believe this should be a concern. As discussed previously, the Companies have choices to make on how to effectively manage cash whether it chooses dividends, austerity measures or various financing decisions. The Companies chose to borrow under existing short-term facilities and proceeded to draw them down to their limit rather than issuing long-term debt, which the Companies may do now to reimburse their short-term borrowings. The Companies chose not to issue long term earlier under existing financing authority and waited for a second commission order. The Companies chose to enter, extend and hold its hedge which ultimately cost them $100 million. The Companies chose to issue only $150 million when they did issue even though a larger issue might have been less costly.

We believe the Companies have access to both long term and short term financing. While the cost of this financing may more costly than in the recent past, in part because the Companies have created this crisis, that cost is manageable. Furthermore, that cost is not higher than the utilities have ever seen and it is a normal part of running a business subject to regulatory lag and commitments under the Merger Order not to file for rates for a fixed time. The higher costs are a risk that the Companies took and these costs have not caused financial performance to decline to a point that would jeopardize safe and reliable service.

Q. Does this conclude your testimony, at this time?

A. Yes.