STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

At a session of the Public Service Commission held in the City of Albany on October 17, 2013

COMMISSIONERS PRESENT:

Audrey Zibelman, Chair
Patricia L. Acampora
Garry A. Brown
Gregg C. Sayre
Diane X. Burman

CASE 07-M-0906 - Iberdrola, S.A., Energy East Corporation, RGS Energy Group, Inc., Greene Acquisition Capital, Inc., New York State Electric & Gas Corporation and Rochester Gas and Electric Corporation – Petition For Approval of the Acquisition of Energy East Corporation By Iberdrola, S.A. FOSSIL AUCTION TRANSACTION FILING.

# ORDER APPROVING TRANSFER, PROVIDING FOR LIGHTENED RATEMAKING REGULATION, ESTABLISHING RATE TREATMENT AND MAKING OTHER FINDINGS

(Issued and Effective October 18, 2013)

BY THE COMMISSION:

## BACKGROUND

In a petition filed on June 11, 2013, Rochester Gas and Electric Corporation (RG&E) requests approval pursuant to Public Service Law (PSL) §70 of its transfer of its 62 MW Allegany Generating Station (the Allegany facility) to Allegany Generating Station LLC, a subsidiary of Alliance Energy, New York LLC (Alliance), and for approval of other actions it took in offering the Allegany facility, and the Carthage Energy Facility, a 63 MW combined-cycle cogeneration facility (the Carthage facility) owned indirectly by Cayuga Energy, Inc. (CEI), for sale at auction. CEI is owned by Iberdrola USA, Inc. (IUSA), a subsidiary of Iberdrola, S.A. (IBE) (a utility holding company organized in Spain), that is also the indirect owner of

RG&E, affiliating it with CEI. The Carthage facility, which is a qualifying facility (QF) under PSL §2(2-a) exempt from PSL regulation to the extent provided for in PSL §2(4) and §2(13), will also be sold to Alliance.

The sales of the Allegany and Carthage facilities are made pursuant to a condition adopted in the Merger Order,[1] where IBE's indirect acquisition of RG&E and CEI through their former holding company owner was approved. Under that condition, IBE was required to sell at auction the fossil generation assets owned by its subsidiaries that operated in New York. In compliance with the condition, RG&E and CEI submitted, on November 18, 2008, a Divestiture Plan detailing a process for auctioning the fossil generation assets.

As approved on November 17, 2009,[2] the Divestiture Plan provided for a two-phase auction process, where indicative bids would be solicited and evaluated in Stage 1 and final bids would be submitted and a purchaser selected in Stage 2. Besides Allegany and Carthage, the facilities subject to the Divestiture Plan included RG&E's Stations 3 and 9, each an 18 MW gas-fired combustion turbine facility located in Monroe County, and the site of RG&E's recently-retired Russell coal-fired generation facility located in the Town of Greece. Under the Divestiture Plan, all of these assets would be auctioned as a single package, with the bidders instructed to identify a separate price for the Carthage facility. If the prices offered in the auction were below the net book value of the assets, however, the Divestiture Plan allowed RG&E to suspend the auction process

[1] Case 07-M-0906, supra, Order Authorizing Acquisition Subject to Conditions (issued January 6, 2009)(Merger Order).

[2] Case 07-M-0906, supra, Untitled Order (issued November 17, 2009)(First Auction Plan Order).

and seek guidance before moving forward with a sales transaction.

In a petition filed on December 29, 2010, RG&E reported that the auction process conducted under the Divestiture Plan had failed to elicit any conforming bids, and that the non-conforming bids which were received proffered prices amounting to less than the net book value of the assets. In the Auction Modification Order,[3] RG&E and CEI were then directed to re-auction the Allegany and Carthage facilities and Stations 3 and 9, while RG&E was authorized to proceed with demolition and environmental remediation at the Russell Station site.[4] RG&E thereafter reconfigured the Divestiture Plan in conformance with the Auction Modification Order, and the modified Plan was approved in the Second Auction Plan Order.[5]

On June 11, 2013, RG&E and CEI announced that they had completed the auction process and selected Alliance as the winning bidder that would purchase the Allegany and Carthage facilities. Neither Alliance nor anyone else, RG&E report, offered to purchase Stations 3 and 9, and RG&E proposes to commence a process for removing and salvaging the equipment located at those sites. RG&E also asks that its sale of the Allegany facility to Alliance be approved; that it be authorized to recover its expenses incurred in conducting the auction and selling the Allegany facility; that the ratemaking treatment of the sale proceeds it proposes be approved; and, that it be decided no approval of the transfer of the Carthage facility is

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[3] Case 07-M-0906, supra, Order Modifying Auction Plan and Establishing Further Procedures (issued July 25, 2011).

[4] See Case 12-E-0025, Rochester Gas & Electric Corporation, Order Accepting Plan for Filing, Authorizing a Deferral and Establishing Further Procedures (issued May 22, 2012).

[5] Case 07-M-0906, supra, Order Adopting Modified Auction Plan (issued December 20, 2011).

necessary because it is a QF. Alliance asks that it be regulated lightly once it becomes the owner of the Allegany and Carthage facilities.

In conformance with State Administrative Procedure Act (SAPA) §202(1), notice of the petition was published in the State Register on July 3, 2013. The SAPA §202(1)(a) period for submitting comments in response to that notice expired on August 19, 2013. No comments have been received.

## THE PETITION

After recounting the events that led up to the second auction, RG&E and CEI describe Alliance, the proposed purchaser of the Allegany and Carthage facilities, as a limited liability company owned indirectly by an individual investor. Alliance, they continue, already owns indirectly the 68 MW Seneca generation facility located in Batavia, the 64 MW Sterling generation facility located in Sherrill, and the 85 MW Power City generation facility located in Massena.[6] The Seneca and Sterling facilities, RG&E and CEI note, are QFs within the scope of PSL §2(2-a). Alliance also owns AG-Energy, L.P., which formerly operated an electric generation facility that has been partially dismantled; it continues to provide retail steam service as a lightly regulated steam corporation.

Alliance, RG&E and CEI elaborate, is affiliated with the owner of two gas turbine peaking units, sized at 47 MW and 42 MW, located in Hillburn and Middletown, respectively, and with the owners of two intra-state gas pipelines, an 11.2 mile line used to transport gas to the Seneca facility and a 9.5 mile line that could be used to transport gas to a location within

[6] See Case 12-E-0211, Alliance Energy, New York LLC, Order Approving Transfer Subject to Conditions and Approving Financings (issued September 17, 2012)(Power City Order).

the Syracuse University campus.[7] Outside of New York, Alliance owns the 32 MW Lowell generation facility located at Lowell, Massachusetts in the market operated by ISO New England, Inc. (ISONE).

Turning to the auction process, RG&E and CEI explain that RG&E conducted a two-stage process where indicative bids were solicited in Stage 1, followed by the submission of binding bids from qualified bidders in Stage 2. On December 17, 2012, they continue, two binding bids were received, but, subsequent to that date, an unsolicited expression of interest in purchasing the Allegany and Carthage facilities was received. The two initial bidders and the third bidder submitted binding proposals on February 15, 2013. RG&E then selected Alliance as the purchaser of the Allegany facility and CEI selected Alliance as the purchaser of the Carthage facility. RG&E and CEI note that Alliance will form a new subsidiary to own and operate the Allegany facility, while it will purchase CEI's existing subsidiary, Carthage Energy LLC (CELC), that owns the Carthage facility directly, and will insert it as a subsidiary into the Alliance corporate structure.

RG&E and CEI report that RG&E has executed an Asset Purchase Agreement (APA) with Alliance for its purchase of the Allegany facility, while CEI has executed a Membership Interest Purchase Agreement (MIPA) with Alliance for its purchase of all of the interests in the CELC subsidiary that owns the Carthage facility. The APA, RG&E continues, provides for the transfer of all the equipment, buildings, real property and permits in

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[7] Case 09-T-0489, Alliance Energy Transmissions, LLC, Order Approving Amendment and Transfer of Certificate (issued November 17, 2009); Case 11-M-0117, Alliance Energy Transmissions – Syracuse LLC, Order Approving Transfer of Ownership and Transfer of Certificate and Providing For Lightened Ratemaking Regulation (issued October 17, 2011).

effect at the Allegany site to Alliance. RG&E, however, will retain such environmental liabilities as might be present there. The APA, RG&E notes, is contingent upon receipt of all necessary regulatory approvals. The MIPA is structured as a transfer of all the ownership interests in CELC, so that all rights and liabilities residing in that CEI subsidiary will become the rights and liabilities of Alliance.

RG&E relates that it has entered into an Interconnection Agreement (IA) with Alliance governing the connection of the Allegany facility to RG&E's transmission system. Under the IA, RG&E will retain ownership of certain interconnection equipment necessary for the operation of its transmission system and will provide Alliance with interconnection service. Again, because Alliance is acquiring all of the interests in CELC instead of purchasing the Carthage facility directly, the existing interconnection arrangement between CELC and the local utility where the Carthage facility is interconnected will continue.

RG&E asks that the transfer of the Allegany facility be approved under PSL §70 as in the public interest. CEI, however, believes that no §70 finding is needed on the transfer of the Carthage facility because it is a QF.

Arguing that approval of the Allegany transfer is warranted, RG&E maintains that the approval will advance the growth and development of competitive markets for the provision of electricity within New York because it, as a fully-regulated utility, is divesting the facility to Alliance, a competitive market participant. RG&E also asserts that the value obtained for the sale of the Allegany facility was determined in an auction that was conducted in a fair and reasonable manner.

The proposed transfers, RG&E and CEI perceive, will not create any market power issues, because even after Alliance assumes ownership of both the Allegany and Carthage facilities, and thereby enhances its market share in New York by 125 MW, it will remain unable to exercise horizontal or vertical market power. After the transaction is consummated, they stress, Alliance and its affiliates will own only 429 MW of generation capacity in New York, which amounts to a share of about 1.13% of capacity available in the wholesale markets operated by the New York Independent System Operator, Inc. (NYISO). That share, they contend, is insufficient to support manipulation of those markets.

According to RG&E and CEI, the transactions will benefit the communities where the Allegany and Carthage facilities are located, since continued operation of the Allegany facility after the auction was previously uncertain and the Carthage facility was slated for retirement. Retaining the facilities in operation at their locations, RG&E and CEI contend, will promote economic development and create employment opportunities in the local communities and sustain a stream of real property tax payments to those communities.

RG&E and CEI argue that Alliance is well qualified to own and operate the Allegany and Carthage facilities, because, as noted in the Power City Order, Alliance has successfully owned and operated similar facilities at locations throughout upstate New York. They also maintain that Alliance has demonstrated its financial capability to acquire, and maintain operations at, the Allegany and Carthage facilities.

RG&E claims it will experience an estimated net loss of $3.5 million on the sale of the Allegany facility. The Divestiture Plan as approved, RG&E asserts, provides that any loss would be reflected on its books as a regulatory asset, which would earn a return and be recovered consistent with future rate determinations. RG&E argues this treatment is appropriate, because, as discussed in the Auction Modification Order, ratepayers are responsible for absorbing a loss on the sale of the facility, especially given its peculiar history. Ratepayers, RG&E explains, escaped nearly $400 million in overpayments to the Allegany facility's former owners in return for funding a loss of $120 million on RG&E's purchase of the facility from those owners. The sale of the facility now closes the books on that history. Moreover, RG&E indicates a sale of the facility avoids the risks that revenues derived from its operation will fall short of the costs and expenses of operating and maintaining the facility. Accordingly, RG&E asks that its regulatory accounting for the costs experienced in offering the facility at auction and consummating the transaction, and its ratemaking loss accounting, be approved.

Because, RG&E and CEI point out, RG&E owns the Allegany facility and the Carthage facility is a QF, neither was subject to the lightened ratemaking regulation that typically pertains to generation facilities that operate in competitive markets. Following the transaction, they note, the Allegany facility will no longer be owned by RG&E, and so should no longer be fully regulated as a utility asset, and Alliance plans to relinquish QF status at the Carthage facility, which would end its exemptions from PSL regulation. As a result, Alliance requests that both facilities be subjected to the lightened ratemaking regulation typically imposed on generation facilities that operate in competitive NYISO markets.

## DISCUSSION

The petition RG&E and CEI have submitted impels an examination of the auction process they conducted and its outcomes. As to those outcomes, RG&E's transfer of the Allegany facility to Alliance falls within the ambit of PSL §70 jurisdiction. While CEI's transfer of the Carthage facility to Alliance is outside the scope of §70 jurisdiction because the facility is a QF, CEI must show it has complied with the Merger Order requirement that its parent, IBE, divest all fossil generation in New York. That compliance is subject to review here. Following an approval of RG&E's transfer of the Allegany facility to Alliance and the making of a finding that CEI has complied with the Merger Order in transferring its Carthage facility to Alliance, both the Allegany and Carthage facilities would be subject to lightened ratemaking regulation. While the ratemaking RG&E proposes generally conforms to that expected upon the sale of utility facilities like Allegany, some adjustments to its proposals are necessary.

Environmental Quality Review

Under the State Environmental Quality Review Act (SEQRA), Article 8 of the Environmental Conservation Law, and its implementing regulations (6 NYCRR §617 and 16 NYCRR §7), we must determine whether the actions we are authorized to approve may have a significant impact on the environment. Other than our approval of the action proposed here, no additional state or local permits are required, so a coordinated review under SEQRA is not needed. We will assume Lead Agency status under SEQRA and conduct an environmental review.

SEQRA requires applicants to submit a complete EAF describing and disclosing the likely impacts of the actions they propose.[8] RG&E has submitted a narrative and a short-form EAF Part 1 that substantially comply with this requirement.[9]

The proposed action over which we have jurisdiction is the transfer of upstream ownership interests in the 63 MW

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[8] 6 NYCRR §617.6(a)(3).

[9] Consideration of CEI's compliance with the Merger Order is not an action subject to SEQRA review. See 6 NYCRR §617.2(b).

Allegany generation facility to a new owner. The proposed action does not meet the definition of Type 1 or Type 2 actions listed in 6 NYCRR §§617.4, 617.5 and 16 NYCRR §7.2, so it is classified as an "unlisted" action requiring SEQRA review. After review of the petition we conclude, based on the criteria for determining significance listed in 6 NYCRR §617.7(c), that there will be no changes to the operation of the electric generating facility underlying the proposed transfer that will result in adverse environmental impacts. Our Staff has completed the short-form EAF Part 2.

As Lead Agency, we determine that the proposed action will not have a significant impact on the environment and adopt a negative declaration pursuant to SEQRA. Because no adverse environmental impacts were found, no public notice requesting comments is required or will be issued. A negative declaration concerning this unlisted action is attached. The completed EAF will be retained in our files.

The Auction Process and Transaction Agreements

As discussed in the Auction Modification Order, it has been demonstrated repeatedly that an open and competitive auction process yields the maximum value attainable, and best furthers the public interest, upon the divestiture of generation facility assets.[10] The two-stage process RG&E and CEI deployed is consistent with prior auction practices and the auction was otherwise properly conducted in conformance with those practices and the Second Auction Plan Order. RG&E and CEI have also demonstrated that they concluded the process with the selection

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[10] See, e.g., Case 03-E-1231, Rochester Gas and Electric Corporation, Order Approving Transfer Subject to a Modification (issued May 20, 2004); Case 96-E-0909, Central Hudson Gas & Electric Corporation, Order Approving Transfer of the Danskammer and Roseton Generating Stations and Making Other Findings (issued December 20, 2000).

of the winning bidder that offered the most value for the generation facilities and otherwise best advanced the public interest.

The APA and IA, and the MIPA, that RG&E and CEI executed, respectively, are similar to the contractual agreements that have accompanied other generation facility divestitures. The APA raises one issue, in that under it RG&E retains environmental liabilities if any were present at the Allegany site prior to the time the sale is consummated. This feature, however, is but one component of the overall auction package. As RG&E points out, the benefits attending that package are substantial.

In Alliance, RG&E has found a buyer for the Allegany facility that will continue to operate the facility. As a result, it is a buyer that is willing to pay a higher price than could be obtained if the facility were instead demolished and salvaged. Besides enhancing the proceeds available to ratepayers upon the sale, continued operation benefits the local community where Allegany is located. Property taxation that reflects the value of an operational facility will proceed, and the presence of the facility enhances economic activity, avoiding the difficult issues that arise for a local community when it is necessary to shut down a generation facility.

Although RG&E will retain environmental liabilities, if any, present at the Allegany site prior to consummation of the transaction, no such environmental liabilities are known to exist at the site at this time. Moreover, since the Allegany facility was constructed in the mid-1990's when the site was a greenfield, generation operations there are of comparatively recent vintage. The risk of incurring environmental costs at such a site for liabilities currently unknown is much reduced in comparison to sites where generation or other utility activities took place over a longer period of time, especially since the facility is fueled with comparatively clean natural gas.

Therefore, we find that the auction RG&E conducted for the Allegany facility, and the APA and IA it entered into, yielded the best overall price and the least risk to ratepayers that could be obtained, notwithstanding the retention of environmental liabilities. Moreover, CEI's participation in the auction process, its selection of Alliance as the winning bidder for the Carthage facility, and its entry into the MIPA are in compliance with the Merger Order.

The Transfers

Turning to the Alliance transactions, under PSL §70, our approval is required before an electric corporation like RG&E may transfer ownership interests in electric plant to a new owner like Alliance. In conducting a review pursuant to §70 that pertains to a generation facility that will be operated by a lightly-regulated electric corporation that will participate in wholesale electric markets, we examine any affiliations with fully-regulated New York utilities or power marketers that might afford opportunities for the exercise of market power or pose the potential for other transactions detrimental to captive ratepayer interests. The same criteria adhere to a review of CEI's compliance with the Merger Order requirement that it divest the Carthage facility, consistent with our policies for promoting competitive wholesale electric markets.

RG&E and CEI have adequately addressed market power issues. The transactions do not pose the potential for the exercise of horizontal market power. Even after acquiring the Allegany and Carthage facilities, the amount of generation Alliance will own will remain de minimis, at a little more than 1% of the generation capacity available in New York. Consequently, market concentration in New York will not increase cognizably as a result of the transaction. Moreover, the size of Alliance's interests in generation operating in ISONE and other markets adjacent to New York is also de minimis and insufficient to raise market power issues within NYISO markets.

Nor does the proposed transaction pose the potential for the exercise of vertical market power. Alliance does not exercise control over electric delivery facilities (other than interconnections), or substantial influence over inputs, like fuel, into the production of generation supply within New York, and does not report an affiliation with a power marketer. While Alliance owns two gas transmission lines, each is dedicated to a single customer, and so they do not enable Alliance to influence the availability of fuel supply to its competitors generally. As a result, those avenues to the undue exercise of vertical market power are foreclosed. Consequently, the proposed transaction does not raise market power concerns.

Alliance is an experienced generation facility operator, appears sufficiently capitalized, and plans to continue the Allegany facility in operation.[11] RG&E's transfer of its Allegany facility to Alliance is therefore approved. Moreover, for the same reasons, and because Alliance intends to reverse the otherwise-planned retirement of the Carthage facility, we find that CEI's sale of CELC and its Carthage facility to Alliance complies with the Merger Order's requirements and expectations.

Lightened Ratemaking Regulation

The lightened regulatory regime that Alliance requests be applied to its wholesale electric operations is similar to

[11] As discussed in the Power City Order, Alliance is deemed a capable generation facility owner notwithstanding some issues that have been raised. See also Case 11-E-0117, Standard Power LLC, Order Approving Transfer (issued July 18, 2011).

that afforded to other comparably-situated wholesale generators participating in competitive electric markets. Its request is therefore granted, to the extent discussed below.

In interpreting the PSL, we have examined what reading best carries out the statutory intent and advances the public interest. Consequently, in the Carr Street and Wallkill Orders, it was concluded that new forms of electric service providers participating in wholesale markets would be lightly regulated.[12] Under this approach, PSL Article 1 applies to Alliance, because it meets the definition of an electric corporation under PSL §2(13) and is engaged in the manufacture of electricity under PSL §5(1)(b). It is therefore subject to provisions, such as PSL §§11, 19, 24, 25 and 26, that prevent producers of electricity from taking actions that are contrary to the public interest.[13]

All of Article 2 is restricted by its terms to the provision of service to retail residential customers, and so is inapplicable to wholesale generators like Alliance. Certain provisions of Article 4 are also inapplicable because they are restricted to retail service.[14]

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[12] Case 98-E-1670, Carr Street Generation Station, L.P., Order Providing for Lightened Regulation (issued April 23, 1999) (Carr Street Order); Case 91-E-0350, Wallkill Generating Company, Order Establishing Regulatory Regime (issued April 11, 1994)(Wallkill Order).

[13] The PSL §18-a assessment is imposed on PSL-jurisdictional gross intrastate revenues; so long as Alliance sells exclusively at wholesale, there are no PSL-jurisdictional revenues and no assessment is collected.

[14] See, e.g., PSL §§66(12) (optional tariff filings); §66(21) (retail electric corporation storm plans); §67 (inspection of meters); §72 (hearings and rate proceedings); §72-a (reporting increased fuel costs); §75 (excessive charges); and, §76 (rates charged religious bodies).

It was decided in the Carr Street and Wallkill Orders that the remaining provisions of Article 4 would pertain to wholesale generators.[15] Application of these provisions is deemed necessary to protect the public interest. The Article 4 provisions, however, are implemented in a fashion that limits their impact on the operation of competitive electric markets. Under PSL §66(6), wholesale generators satisfy Annual Report filing requirements through a format designed to accommodate their particular circumstances.[16] Filings required under other provisions of Article 4 are reviewed with the scrutiny commensurate to the level the public interest requires. This analysis of Article 4 adheres to Alliance.

Regarding PSL §69, prompt regulatory action is possible through reliance on representations concerning proposed financing transactions. Additional scrutiny is not required to protect captive New York ratepayers, who cannot be harmed by the terms arrived at for these financings because lightly-regulated participants in competitive markets bear the financial risk associated with their financial arrangements.[17]

Regarding PSL §70, it was presumed in the Carr Street and Wallkill Orders that regulation would not "adhere to transfer of ownership interests in entities upstream from the parents of a New York competitive electric generation

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[15] PSL §68 provides for certification of the construction of new plant or the retailing of electricity to customers via direct interconnections. PSL §69, §69-a and §70 provide for the review of securities issuances, reorganizations, and transfers of securities or works or systems.

[16] Case 11-M-0295, Annual Reporting Requirements, Order Adopting Annual Reporting Requirements Under Lightened Ratemaking Regulation (issued January 23, 2013).

[17] See, e.g., Case 10-E-0405, NRG Energy, Inc., Order Approving Financing (issued November 18, 2010); Case 01-E-0816, Athens Generating Company, L.P., Order Authorizing Issuance of Debt (issued July 30, 2001).

subsidiary, unless there is a potential for harm to the interests of captive utility ratepayers sufficient to override the presumption."[18] In those Orders, however, wholesale generators were also advised that the potential for the exercise of market power arising out of an upstream transfer would be sufficient to defeat the presumption and trigger PSL §70 review. Alliance may avail itself of this presumption. Under PSL §§66(9) and (10), we may require access to records sufficient to ascertain whether the presumption remains valid.

Turning to PSL Article 6, several of its provisions adhere only to the rendition of retail service. These provisions do not pertain to Alliance because it is engaged solely in the generation of electricity for wholesale.[19] Moreover, application of PSL §115, on requirements for the competitive bidding of utility purchases, is discretionary and will not be imposed on wholesale generators. In contrast, PSL §119-b, on the protection of underground facilities from damage by excavators, adheres to all persons, including wholesale generators.

The remaining provisions of Article 6 need not be imposed generally on wholesale generators.[20] These provisions were intended to prevent financial manipulation or unwise financial decisions that could adversely impact rates charged by

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[18] Carr Street Order, p. 8; Wallkill Order, p. 9.

[19] See, e.g., PSL §112 (rate order enforcement); §113 (reparations and refunds); §114 (temporary rates); §114-a (lobbying costs in rates); §117 (consumer deposits); §118 (bill payments via an agency); §119-a (use of utility poles and conduits); and §119-c (tax benefits in rates).

[20] These requirements include approval of: loans under §106; the use of utility revenues for non-utility purposes under §107; corporate merger and dissolution certificates under §108; contracts between affiliated interests under §110(3); and, water, gas and electric purchase contracts under §110(4).

monopoly providers. In comparison, so long as the wholesale generation market is effectively competitive, or market mitigation measures yield prices aligned with competitive outcomes, wholesale generators cannot raise prices even if their costs rise due to poor management. Moreover, imposing these requirements could interfere with wholesale generators' plans for structuring the financing and ownership of their facilities. This could discourage entry into the wholesale market, or overly constrain its fluid operation, to the detriment of the public interest.

As discussed in the Carr Street Order, however, market power issues may be addressed under PSL §§110(1) and (2), which afford us jurisdiction over affiliated interests. Alliance has not reported any affiliation with a power marketer, foreclosing that avenue to the exercise of market power. Consequently, we impose the requirements of §§ 110(1) and (2) on Alliance only conditionally, to the extent a future inquiry into its relationships with an affiliate becomes necessary.

Finally, notwithstanding that they are lightly regulated, Alliance and CELC are reminded that they and the entities that exercise control over the operations of the Allegany and Carthage facilities remain subject to the Public Service Law with respect to matters such as enforcement, investigation, safety, reliability, and system improvement, and the other requirements of PSL Articles 1 and 4, to the extent discussed above and in previous orders.[21] Included among these requirements are the obligations to conduct tests for stray

[21] See, e.g., Case 11-E-0351, Stony Creek Energy LLC, Order Granting Certificate of Public Convenience and Necessity, Providing for Lightened Ratemaking Regulation and Approving Financing (issued December 15, 2011).

voltage on all publicly accessible electric facilities,[22] to give notice of generation unit retirements,[23] and to report personal injury accidents pursuant to 16 NYCRR Part 125.

RG&E Ratemaking

Notwithstanding that the Allegany facility will be subject to lightened ratemaking regulation once Alliance assumes ownership and operates it in competitive New York wholesale electric markets, RG&E's ratemaking proposals remain subject to review under PSL §70 and the other provisions of PSL Article 4. Although RG&E has generally complied with the First Auction Plan Order and the Second Auction Plan Order in devising the ratemaking it proposes, some adjustments to its proposals are necessary.

A. The Sale Loss Calculation

As permitted by the Second Auction Plan Order, RG&E may establish a regulatory asset on its books for the loss experienced upon the sale of the Allegany facility, and that asset will earn a return and will be recovered over a future time period. In the petition, RG&E reports an estimated net loss of $3.5 million pre-tax ($2.1 million after tax).

RG&E's loss calculation depends upon a September 1, 2013 date for closing on the transaction with Alliance, and the utility's estimates of transaction costs. Recalculation of the loss as of the actual closing date is necessary, and RG&E is directed to provide that recalculation in the compliance filing discussed below.

[22] Case 04-M-0159, Safety of Electric Transmission and Distribution Systems, Order Instituting Safety Standards (issued January 5, 2005) and Order on Petitions for Rehearing and Waiver (issued July 21, 2005).

[23] Case 05-E-0889, Generation Unit Retirement Policies, Order Adopting Notice Requirements for Generation Unit Retirements (issued December 20, 2005).

Because RG&E conducted and supervised the auction for both the Allegany and Carthage facilities on behalf of itself and CEI, an allocation of the costs it incurred that are of common benefit to both owners of the facilities is appropriate. As the owner of the Allegany facility, however, RG&E may recover its costs from its ratepayers, while CEI, as a competitive market participant, must absorb those costs. Consequently, there is an incentive to shift costs properly borne by CEI to RG&E. In view of that incentive, a thorough examination of RG&E's allocation of costs is needed.

In response to an inquiry made during the course of such an examination, RG&E stated it did not perform an allocation of transaction costs other than simply charging service provider bills directly to either RG&E or CEI, according to the provider's selection of a payer. RG&E's direct assignment method results in it bearing 95% of the costs of conducting the auction and transferring the facilities, while CEI bears only 5% of the costs.

Under the Divestiture Plan approved in the First Auction Plan Order and the Second Auction Plan Order, however, it was expected that an allocation of the costs of services common to both facilities would be performed. RG&E's method fails to address those common costs. A review of the bills from service providers demonstrates that in many cases the services rendered to RG&E in conducting the auction were for the benefit of both RG&E and CEI, in that the services were necessary to facilitate the sale of both the Allegany and Carthage facilities. Other than occasionally billing costs directly to CEI, however, the service providers did not attempt to allocate their charges between the two facilities. As a result, the bills themselves cannot serve as the source for an allocation.

The allocation could be performed based upon the proportion of the proceeds RG&E and CEI each received to the total proceeds obtained in the auction. Such an allocation would be justified premised upon the fact that, at the conclusion of the auction, only the two facilities were actually transferred. That allocation, however, would not properly recognize the costs of the unsuccessful first auction, where RG&E's Stations 3 and 9 and its Russell site were bundled together with the Allegany and Carthage facilities. The failure of that auction to attract a buyer cannot be attributed solely to CEI.

As a result, a better method of allocation is to recognize that, at the outset of the process, there were four separate items offered for sale -- the Allegany facility, Stations 3 and 9, the Russell site, and the Carthage facility. Auction costs are best allocated proportionately to each of the four items, resulting in RG&E bearing 75% of the auction costs because it owned three of the items while CEI is allocated 25% of those costs because it owned only one of the items. After that allocation is applied, subject to adjustments for costs directly attributable to RG&E and of no benefit to CEI, the result is to reduce the transaction costs RG&E may recover by $237,474, to $1,396,926. The effect on the net loss RG&E calculates is to reduce it from $3.5 million to $3.2 million pre-tax ($1.95 million after tax), as detailed at Attachment 1. RG&E, in making its compliance filing, shall reflect that adjustment and shall apply the same allocation to any common costs incurred up to the actual closing dates for the transactions.

B. <u>Post-Transaction Ratemaking</u>

Upon consummation of the Allegany facility sales transaction, RG&E will cease earning the revenues it formerly realized from the sale of the generation the Allegany facility produced, but will also shed the costs of owning and operating the Allegany facility. The revenues were tracked in RG&E's Transition Charge -- a non-bypassable charge (NBC), and were used there to the benefit of ratepayers as a credit that offset costs also passed through the NBC. The loss of the revenues will reduce the credits available in the NBC for offset against costs, with the result that the overall NBC charge to ratepayers will increase. There is, however, currently no such mechanism in place for adjusting rates to reflect cost savings, and, absent such a mechanism, RG&E will retain the benefit of those savings.

RG&E did not include in its ratemaking proposal a mechanism for reflecting in rates the savings it will realize from shedding the depreciation, cost of capital, operation, maintenance, tax, and other costs it formerly incurred in owning and operating the Allegany facility. Those savings are substantial, amounting to $3.8 million annually on revenue requirement embedded in delivery rates. As RG&E points out, however, the real property tax expense portion of those costs will be reconciled automatically under the 2010 Rate Plan Order.[24] RG&E argues that any other cost reductions will be reflected to the benefit of ratepayers in the earnings sharing calculation provided for under that Order.

While RG&E is correct in that the real property tax reconciliation will reasonably capture for the benefit of ratepayers reductions in real property tax costs attributable to the transfer of the Allegany facility, the earnings sharing mechanism does not yield a result similarly reasonable to ratepayers. Under that mechanism, the earnings enhancement RG&E

[24] Case 09-E-0715, et al., Rochester Gas & Electric Corporation, Order Establishing Rate Plan (issued September 21, 2010).

will obtain attributable to the reduction in costs it will experience would be shared only equally with ratepayers and only after RG&E's return on equity exceeds 10.9%.  As a result, under RG&E's approach, customers would bear both the book loss on the sale of the Allegany facility and the higher NBC rate attributable to the lost revenue effect, while RG&E would retain all of the savings realized through the transaction until it earned a 10.9% ROE and even thereafter would share only 50% of the savings with ratepayers.  Moreover, since RG&E has declined to date to file for new rates that would replace those adopted in the 2010 Rate Plan Order, the sharing mechanism is likely to remain in effect for at least most or all of 2014.

This outcome is asymmetrical to the detriment of ratepayers, and also fails to comport with the practice followed in the NYSEG Seneca Order.[25]  There, the amounts to be removed from rates in recognition of a sale of assets were determined prior to the sale, and the removal and attendant rate reductions to the benefit of ratepayers were implemented promptly after the transaction was consummated.  Here, the determination of the costs to be removed has been deferred to now.[26]

Accordingly, the savings RG&E will realize upon consummation of the Allegany facility transaction shall be preserved for the benefit of ratepayers.  As a result, the $3.8 million (pre-tax) in annual savings shall be credited to ratepayers on a pro rata basis from the closing date of the sale to the effective date of new rates, subject, however, to the

[25] Case 10-M-0143, New York State Electric & Gas Corporation, Order Approving Transfers Upon Modifications and Conditions and Providing for Lightened Ratemaking Regulation (issued March 4, 2011).

[26] In conformance with this policy, RG&E shall offset any savings and salvage value resulting from the retirement of Stations 3 and 9 against the costs of retiring and removing the facilities.

offset of the $0.5 million (pre-tax) in property tax savings credited to ratepayers through the property tax reconciliation mechanism. RG&E shall apply those savings credits, on a monthly basis beginning as of the date of the consummation of the transaction, against the net loss attributable to the sale of the Allegany facility of approximately $3.2 million pre-tax, subject to update at the time of the closing. If the loss is entirely offset, the credits shall continue to accumulate for the benefit of ratepayers. The resulting net asset or liability would earn a return, and the disposition of any remaining regulatory asset or liability would be determined in RG&E's next rate proceeding.

C. The Compliance Filing

Therefore, within 60 days of the date of the closing on the transfer of the Allegany facility, RG&E shall make a compliance filing reconfiguring its net loss and other calculations and showing actual journal entries in conformance with the above discussion. The filing shall be subject to review to the extent necessary.

## CONCLUSION

Consideration of the Divestiture Plan RG&E and CEI submitted completes the reviews called for in the Merger Order. Therefore, this proceeding is closed as to further review of the administrative matters set for that review in the Merger Order.[27]

The Commission orders:

1. Rochester Gas and Electric Corporation's transfer of ownership interests in the 62 MW Allegany Generating Station

[27] Notwithstanding that Case 07-M-0906 is closed for purposes of administrative review, as is our normal practice, filings required under the Merger Order will continue to be made in Case 07-M-0906.

described in the Petition filed in this proceeding and in the body of this Order is approved, subject to the post-transaction ratemaking discussed in the body of this Order.

2. No further review will be conducted on compliance with the conditions of the Order Authorizing Acquisition Subject to Conditions issued January 6, 2009 in this proceeding regarding the divestiture of the Carthage Energy Facility.

3. Alliance Energy, New York LLC and its affiliates shall comply with the Public Service Law in conformance with the requirements set forth in the body of this Order.

4. Rochester Gas and Electric Corporation shall file, within 60 days of the closing of the transaction described in Ordering Clause No. 1, an update to its net loss calculation and journal entries in conformance with the discussion in the body of this Order.

5. The Secretary may extend the deadline set forth in Ordering Clause No. 4 upon good cause shown, provided the request for such extension is in writing and filed on a timely basis, which should be on at least one day's notice.

6. This proceeding is continued but shall be closed by receipt of the filings required by Ordering Clause No. 4 unless the Secretary finds good cause to continue the proceedings further.

By the Commission,

Kathleen H. Burgess
Digitally Signed by Secretary
New York Public Service Commission

KATHLEEN H. BURGESS
Secretary

STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

CASE 07-M-0906 - Iberdrola, S.A., Energy East Corporation, RGS Energy Group, Inc., Greene Acquisition Capital, Inc., New York State Electric & Gas Corporation and Rochester Gas and Electric Corporation – Petition For Approval of the Acquisition of Energy East Corporation By Iberdrola, S.A. FOSSIL AUCTION TRANSACTION FILING.

NOTICE OF DETERMINATION OF NON-SIGNIFICANCE

NOTICE is hereby given that an Environmental Impact Statement will not be prepared in connection with the approval by the Public Service Commission of the transfer of ownership interests in the 62 MW Allegany Generating Station from Rochester Gas and Electric Corporation to a subsidiary of Alliance Energy, New York LLC, based on our determination, in accordance with Article VIII of the Environmental Conservation Law, that such an action will not have significant adverse effects on the environment. The exercise of this approval and authorization constitute an "unlisted" action, as is defined in 6 NYCRR §617.2(ak).

Based on our review of the record, we find that the proposed approval, which will lead to the ownership and control of the Allegany facility by a new owner, will not have a significant adverse environmental impact. A change in the identity of the owner of the facility will not otherwise cause any physical alterations to it or its surroundings.

The address of the Public Service Commission, the Lead Agency for the purposes of the environmental quality review of this project, is Three Empire State Plaza, Albany, New York 12223-1350. Questions may be directed to Leonard Van Ryn at (518) 473-7136 or at the address above.

KATHLEEN H. BURGESS
Secretary

Rochester Gas & Electric Corporation
Divestiture of Allegany Generation Assets
Net Loss Calculation
Based on Estimated September 1, 2013
Closing Date

**Estimated Gain & Loss**

| | | Company Submitted | Adjustments | Staff |
|---|---|---|---|---|
| Purchase Price | | $ 1,800,000 | | $ 1,800,000 |
| Deduct Transaction Costs | | $ (1,634,400) | $ 237,474 | $ (1,396,926) |
| Proceeds Net of Transaction Costs | | $ 165,600 | $ 237,474 | $ 403,074 |
| Federal and State Income Taxes | | $ 2,215,971 | $ (94,075) | $ 2,121,896 |
| Net Proceeds Available After Income Taxes | | $ 2,381,571 | $ 143,399 | $ 2,524,970 |
| Deduct Net Book Balance of Assets Sold | | $ (2,928,874) | $ - | $ (2,928,874) |
| Deduct Accumulated Deferred Income Taxes - Depreciation | | $ (1,545,375) | $ - | $ (1,545,375) |
| After- Tax Net Loss | | $ (2,092,678) | $ 143,399 | $ (1,949,279) |
| Gross- Up for Income Taxes | 39.615% | $ (1,372,881) | $ 94,075 | $ (1,278,806) |
| Before Tax Loss | | $ (3,465,559) | $ 237,474 | $ (3,228,084) |