

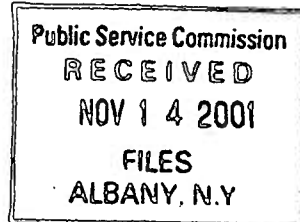
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brief



November 14, 2001

*ORIG-FILES
01-M-0075
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PER LIST*

Via e-mail and regular mail

The Honorable Joel A. Linsider
New York State Public Service Commission
Three Empire State Plaza
Albany, New York 12223

RE: Niagara Mohawk/National Grid Merger – Case No. 01-M-0075

Dear Judge Linsider:

Attached please find Petitioners' Post-Hearing Brief in the above-referenced proceeding. Pursuant to your instructions this brief is being served electronically on you and all parties of record. Hard copies of the brief also are being served on all parties and filed with the Secretary, and the original filed with Your Honor, in accordance with the Commission's Rules of Procedure.

Petitioners greatly appreciate the efforts Your Honor and the Commission have made to expedite consideration of the Joint Proposal. The sooner the Joint Proposal is approved and implemented, the sooner Niagara Mohawk's customers will see the rate cuts and the other substantial benefits that are possible because of the merger. We accordingly urge that Your Honor and the Commission continue to act expeditiously in your review of the Joint Proposal.

Respectfully submitted,

Steven J. Agresta
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cc: The Honorable Janet Hand Deixler
Active Parties List

**CASE 01-M-0075
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NIAGARA MOHAWK AND NATIONAL GRID
ACTIVE PARTY LIST
(As of November 7, 2001)**

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NEW YORK STATE
PUBLIC SERVICE COMMISSION

Joint Petition of Niagara Mohawk Holdings, Inc.,)
Niagara Mohawk Power Corporation, National Grid)
Group plc, and National Grid USA for Approval)
Of Merger and Stock Acquisition)

Case No. 01-M-0075

PETITIONERS' POST-HEARING BRIEF

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Group plc, and National Grid USA for Approval)
Of Merger and Stock Acquisition)

Case No. 01-M-0075

PETITIONERS' POST-HEARING BRIEF

Petitioners Niagara Mohawk Power Corporation ("Niagara Mohawk"), Niagara Mohawk Holdings, Inc., National Grid USA, and National Grid Group plc respectfully submit this post-hearing brief pursuant to authorization granted by the Honorable Joel A. Linsider, Presiding Administrative Law Judge in this proceeding, on November 9, 2001 (see Transcript of Proceedings ("Tr.") at 126-27). In accordance with Judge Linsider's instructions this brief will address only new issues raised at hearing; Petitioners will not address matters that already have been aired, such as the policy bases underlying the Commission's adoption and application of Rule 52 of Niagara Mohawk's retail tariff, P.S.C. No. 207 Electricity ("Rule 52").

1. Modifications to Rule 52 Should Be Approved as Recommended in the Joint Proposal.

At the evidentiary hearing the Alliance for Municipal Power ("AMP") and National Fuel Gas Distribution Corporation ("NFG") asked a series of questions challenging the scope of the modifications to Rule 52 set forth in the Joint Proposal. One such modification would exempt from Rule 52 a single customer that had disconnected from the Niagara Mohawk system and had taken power from new generation owned either by itself or by an adjacent third party that itself was isolated from the Niagara Mohawk system. In either case there is a further requirement that

100% of such new generation be used to supply the single "islanded" former customer of Niagara Mohawk. The other proposed modification to Rule 52 is an exemption for an individual customer that disconnects from Niagara Mohawk but that takes its supply from new third-party-owned generation that remains interconnected. Among several other eligibility provisions is a requirement that the third-party generator agree to pay any charges due under Niagara Mohawk's standby tariff, which currently is set forth in Rule 12 of Niagara Mohawk's retail tariff. This latter modification sometimes is referred to as the "connected generation" exemption to Rule 52.

There is ample basis in the record for approving these modifications to Rule 52 as proposed. Both are part of a comprehensive settlement and are the product of a fine balance of interests among the parties to the Joint Proposal (see Tr. at 47, line 24; Tr. at 53, lines 18-24). The exemptions were intended to have a limited potential revenue impact; expansion of the exemptions would violate the intent of the parties by jeopardizing Niagara Mohawk's ability to recover projected revenues (Tr. 73, line 15-Tr.74, line 4), and would increase the risk of cost-shifting to remaining ratepayers (Tr. 69, lines 17-22). Such cost-shifting would occur even in the case of connected customers because an aggregated group of customers would have different load characteristics, and be subject to different rates, than individual customers (see Tr. 72, line 11-Tr.73, line 14).

The exemptions also are reasonable when viewed standing alone. The exemption for single customers who, with their new supplier, are wholly disconnected from the Niagara Mohawk system represents only a modest expansion of the current exemption for self-generation. It would enable a single islanded customer to "outsource" its generation supply function (subject to several constraints) without triggering Rule 52 liability. Distribution of electricity from a new generator to more than one customer, by contrast, would raise cost

allocation and other complex regulatory issues. For example, the supplier in this situation would need to own and operate a distribution system. The new supplier would be subject to safety, customer protection, and reliability requirements that are not yet fully defined. The loads and requirements of the supply would not be Niagara Mohawk's and could create substantial costs and operating issues should the supplying generator be permanently shut down. Concerns such as these make it unlikely that many customers will avail themselves of this exemption and forgo the reliability benefits of Niagara Mohawk's standby service (Tr. 70, lines 4-11). Thus even though the "islanded generation" exemption is inconsistent with the purpose of Rule 52 (Tr. 46, lines 18-25), the inconsistency appears more theoretical than real.

The exemption for connected customers is not inconsistent with the purpose of Rule 52 because the exemption was designed to avoid cost-shifting. As Petitioners' witness Nadeau explained in response to questioning by AMP, there is no bypass in the case of a connected customer because the customer's new supplier remains subject to Niagara Mohawk's standby tariff (Tr. 49, lines 4-6).

2. Commission Precedent Amply Supports the Allowance of a Return on Stranded Costs.

At the evidentiary hearing in this case the Attorney General asked the Petitioners' Panel a number of questions about certain Commission cases cited in Petitioners' Reply Comments (see Tr. 14, line 4-Tr. 30, line 5; see also Petitioners' Reply Comments at 6). In each of those cases the Commission allowed a return on utility stranded costs, such as costs to buy out or buy down above-market purchased power contracts. The Attorney General sought to elicit from Petitioners' witnesses their views of statements in the Commission's orders in those cases to the effect that approval was not meant to be precedential (Tr. 23, lines 12-22; Tr. 24, line 25-Tr. 25, line 4).

As Petitioners' witness William F. Edwards explained, language in the Commission's approval orders concerning the non-precedential effect of determinations approving contract buy-outs and renegotiations is best interpreted as referring to the unique costs and benefits of each proposed contract modification, rather than to the principle of whether a return is allowable.

Mr. Edwards continued:

I don't believe that [the Commission's statement] indicates . . . that the financing costs associated with this type of an investment are not properly included in cost of service ratemaking.

I don't read this non-precedential nature as focusing on that element, but rather the balance that existed between what the recovery was, what the fair amount of the investment was, stacked up against the savings that would accrue to the customers by virtue of this particular contract buyout.

(Tr. 24, lines 10-19). An examination of one of the Commission orders quoted by the Attorney General (“[t]his approval is not precedential as the economic ratemaking analysis for each contract restructuring will be addressed on a case by case basis” (Tr. at 25, lines 1-4) demonstrates the correctness of Mr. Edwards' understanding. Nothing in the orders suggests that the Commission departs from the general rule that a return on prudent investments is includable in rates.

Even if the Commission in fact was signaling its intention not to establish precedent as to whether a return on investment was allowable, the cases cited by Petitioners in their reply brief still would prove the error of the Attorney General's claim that “Niagara Mohawk is not now permitted to charge customers any interest on stranded costs from whatever source.” Statement of Eliot Spitzer, Attorney General of the State of New York, Regarding Joint Proposal (“AG Statement”) at 5. As Petitioners' witness Lawrence Reilly explained, “the importance of those cases . . . was establishing . . . that it was not the Commission precedent that returns were disallowed on stranded costs.” (Tr. 29, line 24-Tr. 30, line 2). Thus, at a minimum, they

establish that there is no legal impediment to approving such a return in the context of a settlement that is otherwise just and reasonable and in the public interest.

3. **The Attorney General's Argument That Prudently Incurred Costs May Be Disallowed, So Long as They Do Not Put the Utility in Financial Jeopardy, Is Wholly Without Foundation and Should Be Rejected.**

The Attorney General argued in his Statement that the Joint Proposal should be approved only if the Commission disallows costs up to an amount that would put Niagara Mohawk in "financial jeopardy." The Attorney General leaves open the possibility of a second disallowance if Niagara Mohawk eventually is able to absorb more stranded costs than it can absorb now (AG Statement at 7). At the evidentiary hearing the Attorney General's questioning of Staff focused exclusively on the question of what level of disallowance Niagara Mohawk could sustain without facing financial jeopardy (Tr. 60, line 15-Tr. 65, line 13). Staff's answer was that it had not analyzed the issue (Tr. 65, lines 12-13).

Petitioners respectfully suggest that no such analysis has been performed because it would be legally and factually irrelevant. The Attorney General tellingly cites no authority for the proposition that ratemaking principles include a standard that would place the utility on the verge of financial jeopardy. The Commission has recognized that it is in the public interest, and not merely the interest of investors, for utilities to avoid financially troubled circumstances (see e.g., Case No. 94-E-0098 et al., Opinion and Order Approving Settlement With Modifications, Opinion No. 98-8 (issued March 20, 1998) at 19-20). The "financial jeopardy" standard advanced by the Attorney General is without legal basis and should be rejected. Moreover, the Attorney General assumes, contrary to common sense and without any record basis, that the merger would proceed even if his recommendation were accepted by the Commission.

Conclusion

For the reasons stated above and in Petitioners' Statement in Support of Joint Proposal (Exhibit 4) and Reply Comments in Support of Joint Proposal (Exhibit 5), as corrected (see Exhibit 6), Petitioners urge that the Joint Proposal be approved without modification.

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