

STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

At a session of the Public Service
Commission held in the City of
Albany on November 24, 1998

COMMISSIONERS PRESENT:

Maureen O. Helmer, Chairman
John B. Daly
Thomas J. Dunleavy
James D. Bennett

CASE 96-E-0891 - In the Matter of New York State Electric & Gas
Corporations's Plans For Electric Rate/
Restructuring Pursuant to Opinion No. 96-12.

ORDER APPROVING TRANSFER OF ELECTRIC GENERATION
FACILITIES, APPROVING CONTRACTS UPON A
CONDITION, AND MAKING OTHER FINDINGS

(Issued and Effective December 3, 1998)

BY THE COMMISSION:

BACKGROUND

One feature the rate and restructuring plan (the Plan) adopted for New York State Electric & Gas Corporation (NYSEG) in Opinion No. 98-6 is the auctioning of its coal-fired generation facilities.^{1/} The auction was intended to:

promote a more fully competitive generation marketplace, mitigate the strandable costs associated with generation plants, achieve the Commission's goals, and prudently establish the fair market value of such NYSEG generation plants for the benefit of investors and customers.^{2/}

^{1/} Case 96-E-0891, New York State Electric & Gas Corporation's Plans For Electric Rates and Restructuring, Opinion No. 98-6 (issued March 5, 1998).

^{2/} Case 96-E-0891, supra, Order Adopting Terms of Settlement Subject to Modifications and Conditions (issued January 27, 1998) (Short Order), Appendix A, p. 25.

The auction therefore effectuates the policy, stated in Opinion No. 96-12, of encouraging divestiture of generation facilities, because divestiture allays concerns about vertical market power and avoids the potential for anti-competitive behavior.^{1/}

The Auction Authorization Order

The Auction Authorization Order^{2/} modified the protocols NYSEG submitted for conducting its auction process. The utility was authorized to solicit non-binding initial bids in a Phase I, and then winnow the field to serious participants submitting binding bids in a Phase II. If more than one of the Phase II bids clustered around a particular price, the clustered bidders would compete against each other in a multiple-round ascending bid process.

NYSEG was permitted to combine the individual generation units into bundles, with each bundle offered for sale as a package. The utility proposed a bundle consisting of its 942 MW one-half share of the Homer City unit, located in Pennsylvania and operated by co-owner Pennsylvania Electric Company (Penelec), and a bundle of the six New York units -- Kintigh, Milliken, Goudey, Greenidge, Hickling and Jennison -- totalling 1,424 MW. The optimal bundling would be determined after review of the Phase I bids, where the bidders selected the bundling they preferred.

The protocols also provided for transition contracts, affording NYSEG the option to purchase electricity from the plants for a reasonable period of time after the sale was closed. The purchases would enable the utility to meet its responsibility as the provider of last resort (POLR) within its service territory. Because the Milliken plant is located in a load

^{1/} Case 94-E-0952, Competitive Opportunities Regarding Electric Service, Opinion No. 96-12 (issued May 20, 1996), mimeo pp. 59-60.

^{2/} Case 96-E-0891, supra, Order Authorizing the Process For Auctioning of Generation Plant (issued April 24, 1998) (Auction Authorization Order).

pocket,^{1/} a call contract was needed to guarantee that the plant's new owner would meet local reliability needs without charging unreasonable prices. NYSEG was directed to file these contracts following conclusion of the auction.

NYSEG was also required to implement horizontal and vertical market power guidelines. The horizontal market power guidelines generally track federal precedents on evaluating the presence of market power.^{2/} While it was suggested in the Auction Authorization Order that the potential for vertical market power had been ameliorated,^{3/} additional guidelines for evaluating that market power were adopted subsequently.^{4/}

Labor and environmental issues were also addressed. NYSEG was authorized to require the purchasers to honor all collective bargaining agreements, to offer employment to non-union personnel working at the plants, and to assume all past, present and future environmental liabilities. Consultants would be retained to assess and report on potential environmental liabilities at the plant sites. The utility, however, was required to retain ownership of dormant coal ash disposal sites not located on plant property. Other environmental issues were addressed in a Final Supplemental Generic Environmental Impact

^{1/} A "load pocket" is a small portion of a utility service territory in which load levels, at certain times, will exceed the transfer capability into the area, and so local generators must serve some of the load. Depending on the specific circumstances, the local generators may or may not possess market power.

^{2/} Horizontal market power occurs if one, or a small number, of generation entities own a percentage share of generation supply large enough to improperly raise prices above competitive market levels.

^{3/} Vertical market power occurs when an entity exercises market power at one stage of a production process and leverages that power to gain advantage over its competition in a different stage of the production process.

^{4/} Case 96-E-0900, et al., Generation Plant Auctions, Statement of Policy Regarding Vertical Market Power (issued July 17, 1998).

Statement (FSGEIS) issued on July 7, 1998 in this proceeding, which supplemented the Final Generic Environmental Impact Statement issued in connection with Opinion No. 96-12.

POSITIONS OF THE PARTIES

NYSEG's Petition

On August 17, 1998, NYSEG filed a petition under Public Service Law (PSL) §70 requesting approval of the transfer of the generation facilities to the auction winners. In the petition, NYSEG announced that AES NY, Inc. (AES) had agreed to purchase the New York facilities for a price of \$950 million, and that Mission Energy Westside, Inc. (Mission) had agreed to purchase the co-owned Homer City facility for \$1.801 billion, resulting in aggregate auction proceeds to NYSEG of \$1,850,500,000.

1. The Purchasers

AES, NYSEG relates, is fully qualified to operate the six coal-fired generation facilities located in New York.^{1/} As NYSEG describes AES, it is, when combined with its parent and affiliates, the world's largest global power company, owning 90 plants totalling more than 27,000 MW in Europe, Asia, and South America. AES has assets of more than \$9 billion, and earned total revenues of nearly \$1.5 billion in 1997. AES avers it has constructed and operates coal plants elsewhere in the U.S., and it promises to provide reliable, efficient and cost-effective electricity supply in New York.

NYSEG and Penelec will sell their joint one-half interests in the Homer City coal plant to Mission at the same time. Mission, says NYSEG, when combined with its parent and affiliates, is one of the leading global producers of electricity, and has interests in 54 projects totalling more than 11,000 MW located worldwide. Mission's parent, Edison Mission Energy, Inc., is one of the largest investor-owned utility

^{1/} AES will also acquire the Somerset Railroad Corporation, which is used to deliver coal to the Kintigh facility.

holding companies in the U.S, with an equity capitalization of over \$11 billion, total assets of over \$25 billion, and net income of \$700 million for 1997. Mission avers it has extensive experience in the construction and operation of coal-fired power plants. It asserts it has the requisite ability to successfully acquire and operate the Homer City facility.

2. The Transaction Contracts

NYSEG has entered into transaction contracts with AES and Mission, which will ensure that transmission and generation plant are properly operated by the responsible party. The transaction contracts also effectuate the other terms and conditions of the protocols, including the transition purchase and Milliken call obligations. Both AES and Mission, through their parents, executed guarantees of their performance, including the obligation to pay the sales prices.

3. Conduct of the Auction

NYSEG asserts it conducted the auction through Goldman, Sachs & Co. (Goldman), in conformance with the Auction Authorization Order. The process, it says, began in early March 1998 with solicitations directed to approximately 300 entities. Fifteen non-binding bids for the New York facilities were received on May 11, 1998. After review, it was ascertained that maximum value would be realized by requiring Phase II bidders to purchase the New York facilities as a bundle. Phase II bidders were then selected.

The Phase II bidders toured the plants, and directed more than 5,100 requests for information to Goldman. Proposed texts of the transaction contracts were sent to the bidders for comment, and revisions reflecting the comments were circulated. Phase II bids were received on July 28, 1998, accompanied by relatively few comments on the revised contracts. After evaluating the bids, and finalizing the transaction agreements, NYSEG executed the contracts for the New York plants with AES and announced it as the winner on August 4, 1998.

The process for the Homer City plant generally tracked that for the New York facilities. Twenty Phase I bids were received, and a limited number of Phase II bidders were selected. Mission was successful, and, after execution of the transaction contracts, it was announced as the winner on August 3, 1998.

4. The Public Interest

NYSEG maintains the transfer of the coal-fired facilities to AES and Mission is in the public interest. The utility stresses that its operation of its transmission and distribution (T&D) business will not be affected, and that the transition purchase power and Milliken call contracts ensure it will be able to meet its POLR responsibilities. Pointing to the experience of AES and Mission in operating plants worldwide, and the indices of their financial strength, NYSEG asserts they are fully qualified to operate the plants they will own.

Upon closing of the sale, NYSEG continues, its retail access backout credit, against which competitive suppliers match their energy sales offerings, will increase to 3.23¢ per kWh.^{1/} Moreover, since the net proceeds of the auction exceed the sum of the book value of the plants and tax consequences of the sale, NYSEG reports that it will recover all of its coal plant costs. As a result, it will not impose a competitive transition charge (CTC) for coal plant costs during the five-year term of the Plan. If a coal plant CTC had been needed, the utility relates, the net retail access credit under the Plan would have decreased in inverse proportion to increases in the magnitude of the CTC.

NYSEG compares the sales price it will receive for its plants to other auctions recently conducted elsewhere in the nation. The average price of \$782 per kW for its facilities, the utility stresses, is more than the average price for any other

^{1/} The phase-in of the backout credit is described at Opinion No. 98-6, mimeo p. 67 and at Short Order, Appendix A, pp. 22-23.

fleet of plants in the U.S. NYSEG believes that its auction is the most successful conducted in the nation to date.

5. Market Power

According to NYSEG, compliance with the market power guidelines has been achieved. AES and Mission, the utility reports, own only minor generation interests in New York, New England and Ontario. As a result, NYSEG concludes its plant sales will de-concentrate generation ownership in the New York market. Because neither Mission nor AES own transmission assets in the region, says NYSEG, there are no vertical market power issues. The utility also relates that AES and Mission are precluded from acquiring additional generation plant prior to their closings with NYSEG, if the subsequent acquisition would raise market power issues sufficient to impair those closings.

6. Accounting and Taxes

Federal income taxes, NYSEG calculates, amount to \$522 million, out of the \$1,800,500,000 purchase price. The utility also reports transaction costs of \$12,627,000, including a fee to Goldman of \$10.0 million. Excess proceeds from the auction, says NYSEG, will be used under the Plan to reduce the Nine Mile II investment. The write-down, the utility implies, should be disregarded in calculating its earnings for the purpose of determining exceedences of the 12% return on equity (ROE) cap. Earnings in excess of 12% are returned to ratepayers.^{1/}

7. EWG Status

NYSEG analyzes federal law as requiring that a state agency find new ownership of a generation facility will benefit customers, is in the public interest, and does not violate state law, before the Federal Energy Regulatory Commission (FERC) will grant Exempt Wholesale Generator (EWG) status, under the Public Utilities Holding Company Act (PUHCA), to AES and Mission on the

^{1/} Short Order, Appendix A, p. 16.

generation facilities they will own. Mission and AES seek EWG status, NYSEG discerns, so that they may operate the facilities free of burdensome federal regulation aimed at monopolies.

The new owners of the generation assets, NYSEG maintains, will participate in a wholesale competitive market for the sale of electricity. Since competition in the marketplace will set the price the generators may charge, consumers benefit and state rate regulation is not necessary. The EWG findings, says NYSEG, have been made in similar circumstances in other states,^{1/} and should also be made for Penelec, on its interest in Homer City, because that utility operates a small New York service territory in and around the Village of Waverly.

MI's Comment

In a comment filed on October 26, 1998, Multiple Intervenors (MI) notes that the net after-tax proceeds from the auction are sufficient to write-down the entire book value of the coal plant assets. According to MI, the write-down will result in over-recovery by NYSEG, because its rates will continue to reflect coal plant costs. To preclude NYSEG from improperly benefitting, MI asserts, the utility should be required to track and defer any over-recoveries resulting from the sale of the coal-fired generation assets through the term of the Plan, for future disbursement in the manner most beneficial to customers.

DISCUSSION

The auction of NYSEG's coal-fired facilities has resulted in a favorable price, obtained from experienced and financially-sound companies that are capable of properly operating the plants in a competitive environment. NYSEG also conducted the auction in substantial conformance with prior Orders. It has further ensured that the purchasers meet the

^{1/} See Docket No. 96-11-020, Pacific Gas and Electric Corporation, Interim Opinion (Cal. P.U.C., December 16, 1997), p. 5.

tests for determining that these new entrants into the wholesale electric marketplace will not be able to exercise horizontal or vertical market power. Moreover, in a companion Order Clarifying and Modifying Rate and Restructuring Plan (Order Modifying Plan) issued today in this proceeding, we adopt an earnings cap calculation and modifications to the retail access back-out credit that balance the interests of ratepayers and shareholders. With this balancing in place, the transfer of the plants to AES and Mission is in the public interest, and is approved.

1. Compliance With Prior Orders

NYSEG and Goldman managed the auction through the Phase I and Phase II process described in the Auction Authorization Order. After a broad solicitation of potential bidders, qualified bidders that executed a confidentiality agreement were provided with an offering memorandum and were invited to submit an indicative bid in Phase I. The indicative bids reflected prices with and without the obligation to enter into the transition contracts. After review of the indicative bids, the field was narrowed to a manageable number of Phase II bidders, plant bundling was finalized, and the transition and other transaction contracts were revised.

After final bids were submitted, the auctions of the two bundles were concluded in substantial compliance with the ascending bid process requirement. NYSEG also informed Staff of its progress during the course of the auction. NYSEG therefore conducted its auction in substantial conformance with the protocols adopted in the Order Authorizing Auction.

2. Market Power

In the horizontal market power guidelines, NYSEG was directed to compare the ownership concentration that would result from the sale of the coal facilities to the ownership concentration in NYSEG's hands. Since ownership of NYSEG's generation facilities will be split among NYSEG, AES and Mission after the auction, and AES and Mission have only minor interests

in existing generation facilities operating in the New York market, concentration of ownership is reduced. Moreover, NYSEG's present share of the western New York energy market is approximately 19%. After the transaction, its share will fall to about 7%, while AES and Mission would each also possess approximately a 7% share, depending upon assumptions concerning Mission's use of Homer City to participate in that market.^{1/} Consequently, no potential for horizontal market power is indicated under the guidelines; vertical market power concerns do not arise because AES and Mission do not own transmission assets in the New York market.

3. The Transaction Agreements and Reliability

NYSEG has entered into a number of contracts with the winning bidders, including an asset purchase agreement (APA), transition contracts providing for the utility's continued purchase of capacity from the generation stations it is selling, various reciprocal easement, interconnection, and transmission agreements (the separation contracts), and, with AES, the Milliken call contract. NYSEG negotiated these contracts in conformance with the Order Authorizing Auction, and their terms and prices are, for the most part, reasonable.

a. The APA and Separation Contracts

The APA contracts properly capture the real property parcels and generation asset components that will be transferred to AES and Mission. Appropriate reservations for electric substations, disconnect switches, and other electrical interface equipment are addressed. Matters individual to some of these stations, like the steam host and fly ash vendor arrangements at Goudey, are adequately identified and resolved. The future of the carbon separator facility at Kintigh, a research and

^{1/} Homer City has ready access to a number of different markets, and, because the amount of electricity Mission will choose to sell in New York is consequently unknown, its impact on the New York market is not precisely ascertainable at this time.

development project, is also provided for. Environmental and non-environmental permits are transferred, except for an Article VIII Certificate, which is the subject of a separate petition to the Board on Electric Generation Siting and the Environment.^{1/}

Safety has also been properly addressed. Compliance with various safety provisions of federal law is mandated. Moreover, since AES will be an electric corporation under New York law, it must continue to meet the safety requirements in our regulations, including 16 NYCRR Part 125.

NYSEG has also taken reasonable steps to confront the Year 2000 computer programming issue. While AES bears the liability for ensuring Year 2000 compliance, NYSEG has provided AES with a list of all software that may be affected, and other information on resolving the problem.

Reliability during the transfer of ownership and into the future is preserved under the APA and separation agreements. The structure and content of these contracts compel AES to reliably operate the plants on the date it assumes ownership. AES must conform to good utility practice, and NYSEG has preserved its authority to operate the transmission system and respond to system emergencies. The APA and separation contracts also resolve environmental and labor issues, in conformance with the Order Authorizing Auction.

b. The Transition Contracts

In the Order Authorizing Auction, it was determined that NYSEG could proceed with negotiating transition contracts, so long as the pricing did not distort the wholesale market price or the auction sales price, and the output under the contracts was appropriately matched to POLR load. At the conclusion of the auction, NYSEG entered into an agreement to purchase 1,424 MW of

^{1/} Case 98-F-1532, Joint Petition of New York State Gas & Electric Corporation and AES Corporation For Authority to Transfer the Certificate of Environmental Compatibility and Public Need For the Kintigh Generation Station to AES NY, LLP (filed in Case 80002).

installed capacity from AES through April 2001, at a fixed price. It also entered into an option agreement with Mission for the purchase of no more than 942 MW of capacity from Homer City, through the same time period as with AES, at put and call prices. While NYSEG originally envisioned the purchase of both capacity and energy, negotiations with potential purchasers persuaded it to limit the obligation to capacity.

The contract with AES sets the capacity purchase price at \$68/MW-day. The \$68 figure is reasonable, and review of the negotiations over this contract indicates it did not depress the auction price.

The Mission transition contract sets the call and put option quantity at no more than 942 MW during a first period running until May 31, 1999. Thereafter, a formula is used, and the option quantity is reduced if POLR load falls due to retail competition. When, however, the output of NYSEG's share of Nine Mile II, its independent power producer contracts, and the other generation resources it retains is summed with the AES purchase obligation and the potential put obligation under the Mission formula, the total capacity may exceed the utility's POLR load. But, at most, NYSEG has rights to the same amount of installed capacity that it owns or has rights to today. If NYSEG purchases excess capacity, it may resell it in the open market, or could apply it towards its sales contract obligations to other utilities. As a result, the purchase obligations are acceptable even though not matched exactly to POLR load.

The call price under the contract rises from \$63.30 to \$103 per MW-day over the period running from the transfer date to the termination of the contract on April 30, 2001, while the put price rises from \$49.90 to \$77.20. If the bidders believed the prices in the future competitive market would be higher than the call prices, the contract could have created an incentive to offer less for the Homer City plant in the auction.

Although the Mission call price begins at a level slightly below the market-driven \$68 price identified in the transition contract with AES, there is no indication this

transition contract depressed the prices offered for Homer City. Because the competitive wholesale electric market is in the early stages of development, the value of capacity is uncertain in the near term, and, beginning in November 1999, the call prices rise to significantly above the \$68 figure. Moreover, the bidders would have known that if the actual market price were to rise above the put price, but remain below the call price, then a profit could be earned by selling the capacity in the market.

Bidders also would have perceived the put option protection against downside risk as a significant benefit, because it ensures that there would be at least one market for the capacity, at some price. The put price also rises above the \$68 level fairly rapidly, increasing insurance against downside risk. The prices of the put and call options in this transition contract are therefore consistent with the goal of maximizing the prices bid for Homer City.

In both transition contracts, NYSEG has provided for the assignment of the contracts to any of its affiliates that have a contractual or statutory responsibility to provide capacity within its service territory. This might include NYSEG's generation subsidiary, NGE Generation, Inc., and energy services companies (ESCO) affiliated with the utility. The assignment might benefit those ESCOs, over competitors, if installed capacity is in short supply or is priced high.

If NYSEG were to make a preferential assignment to an affiliated ESCO, either directly or through NGE, it could adversely affect the functioning of both the wholesale and retail electric markets. Moreover, benefitting the affiliate could violate the intent of the Code of Conduct for affiliate transactions established in Opinion No. 98-6. As a result, we require NYSEG to obtain our prior permission before it assigns any of the capacity under these contracts, or the contracts themselves, to an affiliate.

c. The Milliken Agreement

The Milliken call contract is designed to prevent the new owner from exercising market power within the load pocket, when Milliken's generation is necessary to serve the pocket. In order to meet this goal, a call contract must provide for reasonable prices when the generation is supplied, and penalties if the generation is not provided when needed. The call prices in this contract are reasonable, and the penalties are designed to ensure that reliability will be safeguarded, without overly-burdening the new owner or depressing the auction price.

d. Conclusion

The transaction contracts were developed in conformance with the Order Authorizing Auction. The APA and separation agreements properly effectuate the sale of the plants while preserving reliability. It is more likely than not that the transition contracts enhanced the auction prices, given the value obtained for the plants. As a result, the transaction contracts are approved, subject to the condition applicable to the transition contracts discussed above.

4. Auction Proceeds and Costs

NYSEG estimates excess auction proceeds at \$379 million, which, under Opinion No. 98-6, will be used to reduce the utility's investment in Nine Mile II. The \$379 million figure, however, is preliminary and is subject to revision upon the closing of the sales transaction. NYSEG estimates its costs of conducting the auction, including the cost of preparing the environmental assessments and Goldman's fee, at \$12,627,000. The fee structure for Goldman is based on percentages of increments in the final sales price, and the resulting \$10 million figure amounts to about .5% of the approximately \$1.85 billion sales price. Given the success of the auction, this fee is reasonable, as are the other listed expenditures. NYSEG may recover these transaction costs from the auction proceeds.

NYSEG shall also update its proceeds and cost figures, and any changes shall be reviewed, after the sales transactions close. The update shall reflect the maximum \$10 million employee transition cost offset against the proceeds discussed in the companion Order Modifying Plan. NYSEG is directed to file the update within 30 days of the later of the two closings.

5. The Earnings Cap Calculation

NYSEG noted in its filing that it intended to seek approval of a proposed earnings cap calculation. One issue in devising a calculation is the means for recognizing the impact of the reduction in Nine Mile II investment funded by the excess auction proceeds above the coal plant costs.

In a filing made on November 10, 1998, NYSEG proposed an alternative method for calculating the earnings cap, by applying a pre-tax investment interest rate of 6.25% to the excess auction proceeds, and increasing the income component of the calculation by the resulting amount. Moreover, NYSEG would offset its employee transition expenses associated with the divestiture of the coal plants, up to the maximum permitted amount of \$10 million, against the auction proceeds, instead of seeking to recover those costs through the Plan as an extraordinary expense.^{1/} The offset, however, would be disregarded in the earnings cap calculation.

NYSEG also offered to accelerate the schedule for phasing-in the retail access backout credit. It would increase the credit to 3.23¢ per kWh following issuance of the Order Modifying Plan, to 3.47¢ per kWh following April 1, 1999, and to 3.71¢ per kWh following August 1, 1999, in the first available billing cycle in each instance. Under the original phase-in schedule adopted in Opinion No. 98-6, the 3.71¢ level was not reached until August 1, 2001.

As adopted in the companion Order Modifying Plan, these clarifications and modifications to the Plan properly balance the

^{1/} See Auction Authorization Order, p. 15.

interests of ratepayers and shareholders. While other approaches to calculation of the earnings cap, including recognition of a rate base reduction, are permissible under the Plan, NYSEG's integrated proposal is more advantageous. The acceleration of the backout credit phase-in should spur emergence of the retail access alternatives that, as discussed in Opinion No. 96-12, benefit ratepayers. Offsetting the employee transition costs against the auction proceeds avoids a potential rate increase to recover those costs, and the offset is not recognized in the earnings cap calculation.

With the clarifications and modifications directed in the Order Modifying Plan in place, the alternative MI proposes for the treatment of the auction impacts is inappropriate. The MI proposal is inconsistent with the Plan, which details the accounting treatment for the transfer of the coal plants.^{1/} Moreover, under the Plan, NYSEG is subject to a five-year price cap on its rates. NYSEG must fund its future wholesale purchases within the price cap rate structure that reflects the coal plant costs, even though it no longer owns the plants. MI's proposal to account for and defer the costs related to the sale of the coal-fired assets would disrupt this balancing of interests under the Plan.

Ratepayers are protected under the Plan if NYSEG proves successful in purchasing the alternative sources of generation of prices below the costs included in rates. In that event, the utility would likely earn in excess of the 12% ROE cap, and the excess earnings above that level would be captured for the benefit of ratepayers. The calculation discussed above is sufficient to ensure that ratepayers receive, through the ROE cap mechanism, the benefits from the success of the auction envisioned for them under the Plan. As a result, the provisions of the Plan are sufficient to protect ratepayers interests, without the additional deferral that MI proposes.

^{1/} Short Order, Appendix A, Article V(1)(g).

6. The Public Interest

Under PSL §70, our consent is required before an electric corporation may transfer any of its assets to a new owner. The consent is furnished if the transfer is in the public interest. In making the public interest determination, a review is conducted of the qualifications of the purchaser to provide the utility service; the impact of the sale on the rates customers pay; and, the other details of the transaction.^{1/}

The new owners of the facilities are affiliates of two of the world's largest independent power plant operators. These companies have demonstrated that they are financially sound, that they have extensive experience in operating power plants (including coal-fueled), and are already participating in competitive marketplaces elsewhere in the world. Moreover, both companies have affirmed that they will operate the plants in a responsible and cost-effective manner. These purchasers are, therefore, capable of operating these facilities efficiently and reliably, either directly or indirectly through wholly-owned affiliates.

The price paid for the purchase of the facilities is sufficient to satisfy the public interest. Since the auction was conducted in conformance with the Order Authorizing Auction, the outcome was a price determined by participants in an open and fair market. The price that a free market generates is presumably reasonable.^{2/}

Moreover, while differences in plant fuels, vintages, regional market prices and other variables make comparisons among fleet auctions difficult, NYSEG's auction produced the highest per-MW price paid for a fleet of utility-owned power plants in the U.S. This price was also substantially above the book value

^{1/} Springbrook Water Co. v. Village of Hudson Falls, 269 A.D. 515 (1945), app. den. 269 A.D. 913.

^{2/} See Auction Authorization Order, pp. 13-14.

of the plants.^{1/} The success of the auction ensures that a CTC for coal plant costs will not be imposed on NYSEG's ratepayers, and that the back-out credits provided for in the Plan will not be diminished to reflect that type of CTC.

The impact of the generation assets sale on existing NYSEG customers is beneficial, with the clarifications and modifications to the Plan described in the companion Order Modifying Plan. Approval of the auction is contingent upon these arrangements. Sharing the benefits of the excess auction proceeds with ratepayers through the earnings cap mechanism, and spurring development of the retail market through accelerating the backout credit phase-in, result in the just and reasonable rates and conditions of service after transfer of the plants that justify the approval.

None of the other details of the transaction countermand the conclusion that it is in the public interest. NYSEG's divestiture of its facilities through its auction benefits ratepayers; contributes to the creation of a fully-functional wholesale market for electricity where none of the participants can exercise market power; and, brings companies with a good record of responsible plant operation into the New York market. As a result, it is approved.

7. SEQRA Compliance

Approval of the transaction requires compliance with the State Environmental Quality Review Act (SEQRA). Upon review of the auction protocols, however, the impacts of the auction on the environment were analyzed in the July 7, 1998 FSGEIS. There, it was decided that the change of ownership from NYSEG to the winning bidders could affect existing informal land use agreements or rights of access at property appurtenant to the

^{1/} Milliken and Kintigh had comparatively high book values, because Kintigh is a relatively new plant, and state-of-the-art pollution control devices were recently installed at Milliken.

coal facilities. As a result, the sale of the plants was conditioned upon NYSEG's compliance with the following conditions:

1. NYSEG should inform the new owners of all informal land uses at each of its facilities;
2. The new owners should perform a cost/benefit analysis for each land use identified and consider continuing every reasonable land use for which the benefits outweigh the costs; and,
3. Prior to changing or terminating any land uses, the new owner should identify all affected individuals or communities, either directly or by publication, and provide a forum at which reasonable alternatives can be discussed.

NYSEG and the new owner(s) must continue to comply with the FSGEIS.

In an Environmental Assessment Form (EAF) filed on September 30, 1998, NYSEG evaluated environmental impacts associated with the approval of the sale of the facilities under §70. The utility reported that all environmental permits, and certain other certificates, will be transferred to the new owners. NYSEG also consented to implement the appropriate mitigation measures in the FSGEIS, where applicable.

A review of the conditions of sale and the EAF demonstrates that there are no further significant environmental impacts beyond those addressed in the FSGEIS. As a result, no additional conditions are needed upon approval of the transfer, and no revisions need be made to the FSGEIS.

8. EWG Status and State Regulation

NYSEG asks that findings be made for it and Penelec sufficient to justify a FERC decision that the facilities may be awarded EWG status in the hands of AES and Mission. Operating under the EWG rubric, says the utility, will avoid unnecessary federal regulation and will permit AES and Mission to more efficiently participate in the wholesale electric market.

Accordingly, in conformance with PUHCA and FERC's regulations,^{1/} we find that allowing Homer City and the New York coal plants to become eligible facilities, with Mission and AES, respectively, owning the plants either directly or indirectly through one or more affiliates as defined under federal law:^{2/} 1) will benefit New York consumers (including those currently served by either NYSEG or Penelec); 2) is in the public interest; and, 3) does not violate New York law.

Making these findings is appropriate on the same basis as finding that the transaction is in the public interest under §70. It was previously determined in Opinion No. 96-12 that a competitive marketplace for the provision of electricity supply would benefit all of New York's consumers, and these transactions are directed towards that goal. Moreover, there is no violation of New York law in transferring the plants to the new owners.

While AES would become an electric corporation under New York law, it qualifies for a lightened regulatory regime in conformance with the Public Service Law. This approach to regulation has previously been approved for generators that intend to participate entirely or primarily in the wholesale market.^{3/} AES, however, is advised that it must apply for that status, under the procedures set forth in the State Administrative Procedure Act,^{4/} and that, as discussed above, it will still be subject to state safety regulation.

^{1/} 15 U.S.C.A. §79z-5a; 18 C.F.R. §365.

^{2/} 15 U.S.C.A. §79b(a)(11); 18 C.F.R. §365.3(a)(1)(i).

^{3/} Case 93-E-0272, Regulatory Regime For Sithe/Independence Power Partners Proposed By Niagara Mohawk Power Corporation, Order Establishing Regulatory Regime For Sithe/Independence Power Partners (issued April 19, 1994); Case 91-E-0350, Wallkill Generating Company - Regulatory Regime, Order Establishing Regulatory Regime (issued April 11, 1994).

^{4/} AES need not apply for a Certificate of Public Convenience and Necessity, unless it intends to establish a service territory by directly interconnecting with retail customers. See Case 93-E-0999, Regulation of Grumman Aerospace Corporation, Declaratory Ruling (issued January 26, 1994).

Mission, as the owner of Homer City, would not be regulated under New York law. Mission would merely own a generator located in Pennsylvania, selling into the wholesale market, and so would be outside the purview of New York regulation. Although Mission must meet its obligations under the transaction contracts, there is no reason to treat Mission any differently than any other out-of-state generation owner.^{1/}

The Commission orders:

1. New York State Electric & Gas Corporation's sale of its electric generation facilities to AES NY, LLP and Mission Energy Westside, Inc. is approved, subject to the conditions discussed in the body of this Order.

2. The transaction contracts New York State Electric & Gas Corporation entered into with AES NY, LLP and Mission Energy Westside, Inc. are approved, subject to the condition described in the body of this Order.

3. New York State Electric & Gas Corporation shall make a filing setting forth the amount of proceeds it earned and the costs it incurred in conducting the auction, in conformance with the discussion in the body of this Order, within 30 days of the later of its two closings with AES NY, LLP and Mission Energy Westside, Inc.

4. The findings on Exempt Wholesale Generator status under the Public Utility Holding Company Act described in the body of this Order are made.

5. The findings under the State Environmental Quality Review Act described in the body of this Order are made.

6. This proceeding is continued.

By the Commission,

(SIGNED)

DEBRA RENNER
Acting Secretary

^{1/} NYSEG will continue to own any transmission assets located in New York, but used to deliver power from Homer City.