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THOMAS J. FLAHERTY III

EXECUTIVE SUMMARY

Mr. Flaherty is a Senior Vice President in Booz & Company's Energy & Utilities Practice, based in the Firm's Dallas, Texas office. Mr. Flaherty has more than 35 years of consulting experience in assisting clients in the Energy Industry and has directed numerous engagements in the areas of strategy development, mergers and acquisitions, corporate growth, organizational restructuring, operational improvement, financial management and capital allocation and, regulatory strategy and assistance.

He has been involved in the majority of the power and gas mergers above $1 billion in the United States, as well as, a number of cross-border transactions involving companies in the United Kingdom, Canada, Australia and, New Zealand. He has also worked with a number of private equity participants on the assessment, modeling and operations transfer of acquisitions related to generation, transmission and distribution assets or segments.

Mr. Flaherty has recently focused on leading enterprise wide cost reduction programs at several major utilities and on financial management process improvement. He is a frequent speaker at industry conferences on topics such as enterprise strategy, M&A strategy, and industry evolution and has recently published articles on business model innovation, M&A, strategic flexibility and, financial management.

RELEVANT EXPERIENCE

Mergers and Acquisitions: Directed over 350 merger, acquisition, carve-out, spin, and sell-side assistance projects related to mergers of equals, unsolicited tenders, buy-side investment assistance, joint ventures and, alliances. The related scope of activities included identification of potential targets, quantification of operational cost synergies, development of revenue enhancement opportunities, financial modeling, development of potential regulatory alternatives, evaluation of customer and shareholder impacts, bid assistance and development of negotiation strategies.

Post-Merger Integration: Directed numerous post-merger integration planning assignments, including developing the strategic framework, defining the integration process, managing integration teams, establishing the governance processes, capturing or meeting revenue targets, managing boundary issues across function and processes, and guidance through the regulatory approval process.

Business Transformation: Directed numerous analyses of operating model and organizational redesign efforts focused on strategic positioning, performance improvement and cost excellence. This focus has been on all aspects of the value chain including corporate/shared services, delivery, customer care, generation, and non-regulated businesses. Activities included operating and organizational model alignment, capabilities assessment, performance improvement, process redesign and alignment, service level agreement development, program management assistance, and executive alignment.

C**orporate Strategy:** Directed multiple corporate strategy projects focused on identifying growth strategies and opportunities consistent with existing portfolio businesses and client capabilities and competencies. Analysis has included evaluation of target segments, assessment of business model requirements, financial feasibility, shareholder value impacts, and implementation strategies.

Financial Management: Directed a number of assignments related to improving financial management processes and performance execution. These assignments have addressed capital allocation, planning, budgeting and forecasting, performance measurement and reporting, and other stewardship activities. The focus of this involvement has been to reshape the role of the CFO and to transform financial operations including organizational redesign and corporate business unit interfaces.

Capital Project Management: Directed several projects focused on redefining capital management processes, including portfolio allocation, capital budgeting, project management and, project evaluation. Led over 20 prudence analyses of regulated utilities in the areas of nuclear and fossil power plant construction and operations, fuel acquisition, capital investment, management performance and, inter-company cost transfers. These assessments have focused on various corporate and project level processes including: planning, project management, construction, start-up, cost and schedule control, contracting, pricing and, financial management.

Shared Services: Led multiple assignments related to creating, redesigning or improving shared services within utility companies. These projects have focused on organizational modeling, activity responsibility and location, performance target establishment, service and cost level improvement and SLA design.

PRIOR EXPERIENCE

Prior to joining Booz Allen Hamilton, Mr. Flaherty was a senior partner and led the Deloitte Consulting Utilities strategy and operations practice area.

EDUCATION

Mr. Flaherty received a B.B.A in Accounting from the University of Oklahoma. He is a member of the Institute of Management Consultants.

SUMMARY OF REGULATED UTILITY EXPERIENCE

Alaska Public Utilities Commission

- Anchorage Sewer Utility

Arizona Corporation Commission

- U S WEST Communications - Docket No. E-1051-88-146

Arkansas Public Service Commission

- FPL Group, Entergy Corporation, WCB Holding corp. and Entergy Arkansas, Inc. – Docket No. 00-329U
- Beaumont, Texas
- Entex, Inc.
- Gulf States Utilities Company

California Public Utilities Commission

- The Washington Water Power Company and Sierra Pacific Power Company - Application No. 94-08-043
- Pacific Enterprises and ENOVA Corporation - Application No. A-96-10-038

Clark County, Washington

- Washington Public Power Supply

District of Columbia, Public Service Commissions

- Baltimore Gas and Electric Company and Potomac Electric Power Company - Formal Case No. 951

Colorado Public Utilities Commission

- Public Service Company of Colorado and Southwestern Public Service Company - Docket No. 95A-513EG

Delaware Public Service Commission

- Atlantic City Electric Company and Delmarva Power & Light Company - Docket No. 97-65

Federal Energy Regulatory Commission

- Baltimore Gas and Electric Company and Potomac Electric Power Company - Docket No. EC96-10-000
- IES Utilities Inc., Interstate Power Company, Wisconsin Power & Light Company, South Beloit Water, Gas & Electric Company, Heartland Energy Services and Industrial Energy Applications, Inc. - Docket No. EC96-13-000
- Trans-Alaska Pipeline System - Docket No. OR78-1
- Middle South Energy, Inc. - Docket No. ER-82-483-000
- Middle South Energy, Inc. - Docket No. ER-82-616-000
- Kansas Power and Light Company and Kansas Gas and Electric Company - Docket No. EC91-2-000
- Southwestern Public Service Company and Public Service Company of Colorado - Docket No. EC96-2-000
- The Washington Water Power Company and Sierra Pacific Power Company - Docket No. EC94-23-000
- Northern States Power Company and Wisconsin Energy Corporation - Docket Nos. EC95-16-000 and ER95-1357-000
- Midwest Power Systems Inc. and Iowa-Illinois Gas and Electric Company – EC95-4
- Ohio Edison Company, Pennsylvania Power Company, The Cleveland Electric Illuminating Company, and The Toledo Edison Company – ER97-412-000
- Atlantic City Electric Company and Delmarva Power & Light Company – EC97-7
- Union Electric and Central Illinois Public Service Company – EC-96-7-000

Federal Power Commission

- Organization and Operations Review

Florida Public Service Commission

- Florida Power & Light Company and Entergy Corporation – Docket No. 001148

City of Garland, Texas

- General Telephone Company of the Southwest
- Lone Star Gas Company

Georgia Public Service Commission

- Georgia Power Company - Docket No. 3673-U

City of Houston, Texas

- Houston Lighting & Power Company

Idaho Public Utilities Commission

- The Washington Water Power Company and Sierra Pacific Power Company - Case Nos. WWP-E-94-7 and WWP-G-94-4

Illinois Commerce Commission

- Illinois Power - Docket No. 84-0055
- Iowa-Illinois Gas and Electric Company and Mid-American Company Energy - Docket No. 94-0439
- Central Illinois Public Service Company, CIPSCO Incorporated and Union Electric Company - Docket No. 95-0551

Indiana Utility Regulatory Commission

- IPALCO and PSI Resources

Iowa Utilities Board

- Midwest Resources Inc., Midwest Power Systems Inc. and Iowa-Illinois Gas and Electric Company - Docket No. SPU-94-14
- IES Industries Inc., Interstate Power Company, WPL Holdings, Inc. – Docket No. SPU-96-6

Iowa Electric Light and Power

- Organization and Operations Review

Kansas Corporation Commission

- Southwestern Bell Telephone Company - Docket Nos. 117,220-U and 123,773-U
- Kansas Gas & Electric - Docket No. 120,924-U
- Kansas Power and Light Company and Kansas Gas and Electric Company - Docket No. 174,155-U
- Western Resources and Kansas City Power and Light - Docket No. 190,362-U
- Western Resources, Inc. and Kansas City Power and Light - Docket No. 97-WSRE-676-MER

Kentucky Public Service Commission

- Louisville Gas & Electric Company - Case Nos. 5982, 6220, 7799, 8284, 8616 and 8924
- South Central Bell Telephone Company - Case Nos. 6848, 7774 and 8150
- Kentucky-American Water Company - Case No. 8571
- Duke Energy Corporation – Case No. 2005-00228

Louisiana Public Service Commission

- American Electric Power Company, Inc., Southwestern Electric Power Company and Central and South West Corporation – Docket No. U-23327
- Entergy Louisiana, Inc. and Entergy Gulf States, Inc. Merger with FPL Group, Inc. – Docket No. U-25354

Maryland Public Service Commission of

- Baltimore Gas and Electric Company and Potomac Electric Power Company – Order No. 73405, Case No. 8725

Massachusetts Department of Telecommunications and Energy

- Boston Edison, Cambridge Electric Light Company, Commonwealth Electric Company and Commonwealth Gas Company – Docket D.T.E. 99-19

Michigan Public Service Commission

- Wisconsin Electric Power Company and Northern States Power Company - Case No. U-10913

Minnesota Public Service Commission

- Continental Telephone Company - Docket No. PR-121-1
- Northern States Power Company - Docket No. E002/GR-89-865
- Northern States Power Company and Wisconsin Energy Corporation - Docket No. E, G002/PA-95-500

Mississippi Public Service Commission

- Mississippi Power & Light Company - Docket No. U-4285
- Entergy Mississippi, Inc., Entergy Corporation, FPL Group, Inc. and WCB Holding Corporation – Docket No. 2000-UA-925

Missouri Public Service Commission

- Union Electric Company - Case Nos. ER-84-168 and EO-85-17
- Union Electric Company and Central Illinois Public Service Company - Case No. EM-96-149
- Kansas City Power & Light Company - Case Nos. ER-85-128 and EO-85-185
- Kansas Power and Light Company and Kansas Gas and Electric Company - Case No. EM-91-213
- Southwestern Bell Telephone - Case No. TC-93-224
- Western Resources and Kansas City Power and Light – EM 97-515

Nevada Public Service Commission

- Bell Telephone Company of Nevada - Docket No. 425
- Central Telephone Company - Docket No. 91-7026
- The Washington Water Power Company and Sierra Pacific Power Company - Docket No. 94-8024

New Jersey Board of Public Utilities

- Atlantic City Electric Company and Delmarva Power & Light Company - Docket No. EM-97-020103

New Mexico Public Service Commission

- Public Service Company of New Mexico
- Southwestern Public Service Company and Public Service Company of Colorado - Case

No. 2678

New Mexico State Corporation Commission

- Continental Telephone of the West - Docket No. 942
- General Telephone Company of the Southwest - Docket Nos. 937 and 990
- Mountain States Telephone and Telegraph Company - Docket Nos. 943, 1052, and 1142
- U S WEST Communications - Docket No. 92-227-TC

City of New Orleans, Louisiana

- New Orleans Public Service Company

New York, State of, Public Service Commission

- Long Island Lighting Company and Brooklyn Union Gas Company - Case 95-G-0761

North Carolina Utilities Commission

- Duke Energy Corporation – Docket No. E-7, Sub 795

Ohio Public Utilities Commission

- Ohio Bell Telephone Company - Case No. 79-1184-TP-AIR
- Cleveland Electric Illuminating Company
- Cinergy Corporation – Case No. 05-732-EL-MER and Case No. 05-733-EL-AAM

Oklahoma Corporation Commission

- Organization and Operations Review
- Southwestern Bell Telephone Company - Cause No. 26755
- Public Service Company of Oklahoma - Cause Nos. 27068 and 27639
- Southwestern Bell Telephone Company - Cause No. 000662
- American Electric Power Company, Inc., Public Service Company of Oklahoma and Central and South West Corporation – Cause No. PUD-980000444

Oregon, Public Utility Commission of

- Pacific Power and Light Company - Revenue Requirements Study
- Portland General Electric Company - Revenue Requirements Study
- The Washington Water Power Company and Sierra Pacific Power Company - Docket

No. UM-696

City of Riverside California

- San Onofre Nuclear Generating Station

City of Sherman, Texas

- General Telephone Company of the Southwest

Tennessee Public Service Commission

- United Inter-Mountain Telephone Company - Docket Nos. U-6640, U-6988 and U-7117

Texas Attorney General

- Southwestern Bell Telephone Company

Texas, Public Utility Commission

- Texas Power & Light Company - Docket Nos. 178 and 3006
- Southwestern Bell Telephone Company - Docket Nos. 2672, 3340, 4545 and 8585
- Houston Lighting & Power Company - Docket Nos. 2448, 5779 and 6668
- Lower Colorado River Authority - Docket No. 2503
- Gulf States Utilities Company - Docket No. 2677
- General Telephone Company of the Southwest - Docket Nos. 3094, 3690 and 5610
- Central Telephone Company - Docket No. 9981
- Southwestern Public Service Company and Public Service Company of Colorado Docket No. 14980
- FPL Group, Inc. and Entergy Corporation – Docket No. 23335
- Reliant Energy HL&P – Docket No. 22355
- PNM Resources – Texas-New Mexico Power – Docket No. 30172
- Entergy Gulf States – Docket No. 30123
- AEP – Central and SouthWest – Docket No. 19265
- Entergy Gulf States – Docket No. 34800
- Oncor Electric Delivery – Docket No. 35717
- PNM Resources – Texas-New Mexico Power – Docket No. 36025
- Southwestern Electric Power Company – Docket No. 37364

Utah Public Service Commission

- Utah Power and Light Company - Docket No. 76-035-06

Vermont Public Service Board

- New England Telephone and Telegraph Company - Docket Nos. 3806 and 4546

City of Waco, Texas

- Texas Power & Light Company

Washington Utilities and Transportation Commission

- The Washington Water Power Company and Sierra Pacific Power Company - Docket No. UE-94-1053 and UE-94-1054
- Puget Sound Power and Light Company and Washington Natural Gas Company – UE-960195

Washington D.C. Metropolitan Area Transit Authority

- D.C. Transit

Wisconsin Public Service Commission

- Northern States Power Company and Wisconsin Energy Corporation – 6630-UM-100 and 4220-UM-101
- WPL Holdings, IES Industries Inc., Interstate Power Company, Inc. - Docket No. 6680-UM-100

Wyoming Public Service Commission

- Cheyenne Light, Fuel and Power Company (Southwestern Public Service Company and Public Service Company of Colorado) - Docket Nos. 20003-EA-95-40 and 30005-GA-95-39
- Mountain States Telephone and Telegraph Company - Docket No. 9343, Subs. 5 and 9
- Organization and Operations Review
- Pacific Power and Light Company - Docket No. 9454, Sub. 11

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Report on Merger Synergies

September 2009

I. INTRODUCTION

Booz & Company was retained by Energy East Corporation (the Company) to perform an independent review of selected aspects surrounding its recently finalized acquisition by Iberdrola, S.A. (Iberdrola). Specifically, Booz & Company was requested to assess whether traditional utility combination synergies would potentially be available from a transaction of the scope, nature and structure as that completed by the two companies. This assessment was intended to provide a third-party perspective on the comparability of this transaction to those generally seen within the U.S. utilities industry and on the likelihood that the unique facts and circumstances underlying this transaction would lend themselves to the creation of typical merger synergies.

Booz & Company was retained for this assessment due to the prior experience of several of its partners in synergies identification and quantification in utility merger and acquisition transactions involving electric, gas and water operating companies, as well as holding companies. This prior experience has encompassed more than 350 proposed, announced and / or completed utility combinations in the U.S. since 1990. These transactions have included U.S. – to – U.S. company mergers, U.S. – to – U.S. company acquisitions, U.S. company cross-border acquisitions and, acquisitions of U.S. companies by foreign companies. In these prior transactions, Booz & Company partners have generally provided a variety of services, including: development of operating business models for combining companies; quantification of merger synergies; provision of synergies testimony before state regulatory agencies, and; post-merger integration, among other areas.

This report is intended to respond to the Order Dismissing the January 2009 Rate filings issued by the New York Public Service Commission (the Commission) on April 8, 2009. Among other discussions, that order reiterated a request from the Commission to include testimony addressing "…the costs and savings related to merger synergies, efficiency gains and the adoption of best practices that in any way affect the management, operation and underlying costs of NYSEG and RG&E's utility business…" resulting from their acquisition by Iberdrola. This requirement initially appeared in the Commission's January 9, 2009 Order approving the Iberdrola – Energy East transaction "in order to ensure that the ratemaking process accounts for savings and costs related to operational changes resulting from the transaction." The Commission went on to state that in the absence of information on identified synergies, information supporting how the operating companies and Iberdrola determined the non-existence of such benefits or the absence of related operational changes be provided, including a description of the decision-making processes that led to such a conclusion.

Accordingly, the scope of this assessment was structured around several key elements related to the above transaction and the request of the Commission:

- Discussion of traditional synergies in utility merger transactions
- Description of pre-Iberdrola - Energy East merger transaction accomplishments
- Review of the Iberdrola – Energy East transaction model
- Assessment of potential merger synergies from the Iberdrola transaction

Focusing on these four principal areas enabled the development of a comprehensive perspective on realistic expectations regarding merger synergies from the transaction. This scope: addressed the typical parameters that give rise to merger synergies; compared those to the circumstances prevailing in the current transaction; identified the nature and outcomes of prior Energy East transactions that would bear upon availability of potential synergies, and; evaluated how the governance model for Energy East has changed or is anticipated to change, if at all.

The remainder of this report is organized as follows:

II. Executive Summary
III. Approach to the Assessment
IV. Overview of Typical Merger Synergies
V. Iberdrola – Energy East Transaction
VI. Prior Energy East Integration
VII. Availability of Synergies
VIII. Conclusions
Exhibits

II. EXECUTIVE SUMMARY

The scope of the assessment to be conducted was clearly defined by Booz & Company prior to initiation of the project. To fulfill this scope, several key areas of analysis were undertaken to provide insights into the potential availability of traditional merger synergies from the Iberdrola - Energy East transaction. These analyses formed the backbone of the assessment conducted and are summarized below:

- Review of typical merger synergies
- Review of the profile of the current transaction
- Review of prior integration efforts at Energy East
- Review of the availability of potential merger synergies

The purpose of the assessment was to review the situation as it exists today and to address whether the specific facts of this transaction would give rise to the potential availability of typical merger synergies.

In our experience, a number of sources of merger synergies exist that may be available in any utility merger transaction. These sources relate to the corporate, business support and operations areas, as well as specific categories of synergies, such as capital expenditures or facilities. In addition, certain sources may be available depending on the nature of the transaction being pursued or the financial position of the individual companies, such as financing. The availability of these synergies sources depends on the characteristics of the companies involved and a number of the factors affecting synergies attainment enumerated earlier.

Our prior work also suggests that no two transactions are necessarily the same in enabling the realization of synergies as several factors affect their availability and level including: style and structure of the transaction, relative scale of the companies, relative business and asset mix of the companies, proximity of the companies, management philosophy of organization and operations and, emphasis on synergies attainment.

Each of these factors can either impact the nature of synergies available, i.e., which categories are relevant, and the level of synergies, i.e., the amount of synergies to be achieved. These factors are not wholly independent of one another; several factors can combine to impact the nature of synergies that may be available or the manner in which these synergies are pursued. In reviewing the relevant characteristics of the Iberdrola – Energy East transaction,

consideration was given to all of these factors in assessing potential synergies availability.

At the time of the announcement, Iberdrola stated that the acquisition of Energy East would enhance the company's international expansion into additional markets and provide stable returns to shareholders. The company indicated the acquisition represented an important growth element for its North American aspirations. As a practical consideration, the capture of synergies was not a driving force for the transaction. Rather, the intent of the acquisition was to establish a broader platform in the U.S. and to implement its standard governance model that enabled substantial operating independence at its owned subsidiaries, within a well-specified set of parameters related to alignment of key performance management and reporting processes. This governance model refers to the manner in which the subsidiaries are managed, i.e., how resources are centralized or decentralized, how decision-making is conducted, how reporting requirements are aligned and, how local operations occurs for the benefit of related customers.

Energy East itself was the end-product of multiple prior acquisitions transactions that it had conducted since 2000. The entity that Iberdrola acquired reflected the integration of these acquisitions and the prior capture of synergies related to common operating elements, particularly in the corporate center. As a first step to achieving these synergies from integration, Energy East created a subsidiary company, Energy East Management Corporation (EEMC), to focus on developing common policies, guidelines and principles that would govern the conduct of Energy East company activities and to coordinate corporate-wide initiatives, and provide corporate finance and treasury services. Subsequently, in connection with the implementation of SAP's enterprise system, Energy East created an additional subsidiary, Utility Shared Services Corporation, to provide consolidated administrative services to the regulated utilities, including accounting, human resources, information technology and, supply chain services.

To extract savings in supply chain, information technology and process reengineering areas, the company launched several enterprise-wide programs targeted at reducing costs and inefficiencies, increasing productivity and maximizing the capabilities across the combined companies. The major projects included the Data Center Consolidation Project, Project Spartan (Supply Chain Consolidation), and Integrating EExcellence (IEE). One of the important aspects of IEE was the decision to pursue a consolidated approach to offering administrative services to Energy East's regulated utilities. This has been implemented by using SAP's enterprise system to provide a common platform offering administrative services to all the regulated utilities. The first initiative in implementing SAP's enterprise system was the Back Office Project followed by

the Work Management project, which focused on field operations and maintenance.

At the conclusion of these initiatives in December 2005, Energy East had completed its integration objectives and met all cost reduction targets. Between 2001 and 2005, Energy East reported substantial savings across multiple areas: an 18% reduction in total workforce, and approximately $100 million in electric and gas O&M and capital savings.[1] The New York utilities' share of these savings were contemplated in the RG&E merger approval case and the customers' share was reflected in the new rates that were established. These savings from previous Energy East mergers directly benefit customers.

Recognizing the integrated model that had been previously implemented, a new integration planning process for Iberdrola and Energy East was commenced September 2008 that had as its main objective an issue free Legal Day 1 integration of Energy East into Iberdrola. As described previously, the proximity of service territories and commonality of business operations (network-focused) provided for the capture of cost based synergies from previous Energy East integration processes. By contrast, the lack of common business operations (network versus generating assets) between Energy East and Iberdrola shifted the integration focus to that of seamless integration of Energy East's functional activities into Iberdrola's established business processes.

The previous integration activities that Energy East performed provided a strong organizational foundation to operate the network businesses. The EEMC and Utility Shared Services organizations provided for the centralization of corporate support services across the EE operating companies. These entities were to remain intact subsequent to the close of the Iberdrola transaction and, therefore, the integration activities allowed for the preservation of the benefits gained from adopting this organizational model.

Through the Iberdrola - Energy East integration process, the companies implemented a management structure that provides for Iberdrola's governance and oversight of Energy East's performance while allowing the core Energy East business structure and operations to remain intact. The result of this integration effort did not identify the potential for obvious merger synergies to be captured. Rather, an ongoing effort to share information regarding best practices within and across the network operations of both Iberdrola and Energy East was identified as a focus area for the future, as well as adopting reporting processes that were similar to the Iberdrola standard.

[1] PSC Case 05-E-1222 Response No: 0032-0035 and Exhibit RRP2.

Given the work that had been performed by the joint Iberdrola and Energy East integration teams, our initial analytical activity was to ascertain the potential for merger synergies based on the circumstances of the current transaction. These activities were designed to provide perspective on: the nature of the transaction completed; the relationship of business elements within the companies; the operating model in effect; efforts within the companies to integrate operations, and; the availability of synergies in light of the above assessments.

Several views of traditional merger synergies were developed to test against the Iberdrola – Energy East transaction. These views first addressed both the types and sources of synergies and then assessed their availability based upon the presence of certain factors in the transaction to enable realization.

These identified merger synergies sources represent those typically found in other utility transactions in the past, although they are not universally available in all transactions. Most of the sources involve an impact on current and future costs, i.e., they are either reduced or avoided. Few transactions produce revenue synergies due to the differences in the business or the difficulty in measuring and realizing benefits in this area. For utility transactions in the U.S. involving similarly constructed companies, a number of synergies sources would typically be expected to be achieved.

However, aligning general synergies sources against general synergies types only defines the nature of potential benefits. It is also necessary to assess these synergies sources in terms of factors that could influence their realization. Several factors were identified that could create a "dependency" on the existence of certain facts and circumstances to enable potential synergies to actually occur. These "dependencies" include the structural similarities of the businesses, the complementary nature of the business and the locational proximity of operations.

While numerous synergies sources may generally be available in many transactions, fewer of these sources apply in the Iberdrola – Energy East transaction. Many of the traditional sources of synergies, particularly those that reflect the operating aspects of the business, will not be available absent certain fundamental characteristics which are not present in this transaction.

The lack of comparability to these other transactions initially extends to the structural similarities of the companies. Iberdrola is an international holding company that has operations throughout the world and an operating model and profile that reflects that dispersion. While Energy East has a holding company and corporate structure, it is more localized and simpler in design. For example, since Iberdrola maintains independent businesses all over the world, the ability to "match up" in many areas, like local facilities, fuel supply and capital

expenditures purpose is limited (capital expenditures) or non-existent (fuel supply).

In addition, differences in operations will complicate the portability of operating practices. For example, even though Iberdrola and Energy East maintain certain similar business unit operations, such as distribution, the businesses have certain elements of difference, e.g., system voltage design, local physical conditions, etc., that make operations less comparable than might be imagined. Thus, opportunities for formal integration would be limited.

Finally, a fundamental predicate for achieving operational synergies is not present in this transaction, i.e., geographic proximity. Where other transactions have been able to capitalize on location to share and leverage resources across similar work, no such opportunity exists in this transaction.

From this assessment, initial conclusions were reached that synergies from the operating areas, i.e., field operations, facilities, fuel supply and, capital expenditures, were not likely to be available given the dependencies identified. More specifically, the lack of geographic presence of a comparable business would be a limiting factor in any ability to create synergies opportunities.

However, several traditional synergies sources were identified as being "possible" areas of applicability in the current transaction. These areas, e.g., corporate and related support, were then reviewed more closely to determine whether they would potentially offer synergies with respect to Energy East. The purpose of this assessment was to determine whether the circumstances prevailing with respect to Iberdrola and Energy East would enable the capture of potential synergies given the circumstances of operating structure, cost incurrence and commonality in execution.

Certain non-labor A&G cost areas would, in fact, result in elimination of incurred costs at Energy East. These would include directors fees and shareholder services which amount to approximately $2 million in foregone costs for Energy East. In both these areas, Energy East has been able to forego the incurrence of costs since the close of the transaction. However, while cost reductions have been achieved, they do not create synergies in the traditional sense of flow-through in lower rates as these costs have been treated as below-the-line expenses for ratemaking and supported by shareholders rather than customers.

The insurance cost category was also identified as a source of "possible" synergies given the potential to leverage global insurance brokers for expanded coverage under an umbrella policy. As a result, Energy East has achieved reductions in broker costs and premiums of approximately $3.1 million across

the holding company and operating companies. Part of these reductions ($1.6 million) reflect the elimination of the need to provide D&O coverage to the Board of Directors since Energy East is no longer a publicly traded entity. This cost category also has been treated as a below-the-line item for ratemaking and historically supported by shareholders, rather than included in customer rates. Accordingly, the $3.6 million in reduced costs related to directors fees, shareholder services, and D&O insurance ($2.0 million for directors fees and shareholder services, and $1.6 million for D&O insurance) have not previously been allocated to Energy East's operating subsidiaries and, therefore, would not be allocable to customers.

Thus, those corporate and related support staffing and non-labor A&G areas where available synergies were determined most likely to be "possible" do not, in reality, lend themselves to any significant level of benefit. This occurs because: the businesses themselves have a sufficient degree of difference to preclude the same level of integration as normally observed in U.S. utility transactions. In addition, the operating model of Iberdrola has historically been built around substantial operational independence of its operating subsidiaries, reflecting their unique circumstances, thus broader integration has not been emphasized.

Finally, in those few areas where actual cost eliminations have been realized, these benefits will not flow to customers as related costs have not previously been included in rates. Thus, the potential for synergies that are actually attributable to Energy East's regulated operations is both limited to a modest number of areas and only reflects *de minimis* levels (~$1.5 million) across all of Energy East's operating companies. Thus, the value of these synergies is further diluted once allocation is reflected across all the operating subsidiaries within the Energy East system. This is consistent with our experience with international utility transactions whether in-bound to or out-bound from the U.S.

III. APPROACH TO THE ASSESSMENT

The scope of the assessment to be conducted was clearly defined by Booz & Company prior to initiation of the project. To fulfill this scope, several key areas of analysis were undertaken to provide insights into the potential availability of traditional merger synergies from the Iberdrola - Energy East transaction. These analyses formed the backbone of the assessment conducted and are summarized below:

- Review of typical merger synergies
- Review of the profile of the current transaction
- Review of prior integration efforts at Energy East
- Review of the availability of potential merger synergies

The purpose of the assessment was to review the situation as it exists today and to address whether the specific facts of this transaction would give rise to the potential availability of typical merger synergies. This approach did incorporate the consideration of the typical categories that normally comprise merger synergies and compared the current transaction against the circumstances that exist in other utility industry transactions. The assessment also identified under what circumstances such merger synergies could be attributed to Energy East and Iberdrola and whether those conditions were likely to prevail.

The analysis conducted focused on potential merger synergies that would impact the New York operating utilities. The analysis incorporated several fundamental assumptions:

- the operating model for Energy East would remain intact
- the previously adopted governance philosophy and model of Iberdrola would remain intact
- the Iberdrola – Energy East integration effort is complete
- the assessment focus would be on cost reductions created by the current transaction, rather than achievable by Energy East on a stand-alone basis

To frame the assessment, a series of questions were utilized to guide the ensuing analysis. These questions provided a basis for both scoping the analysis and defining how the evaluation would be conducted. The specific questions that were utilized included:

- How does the Iberdrola – Energy East transaction compare to traditional utility combination models?
- Does the Iberdrola – Energy East transaction lend itself to the creation of natural synergies?
- Are there any potential areas for synergies available through the Iberdrola – Energy East transaction?
- Does the governance model for post-close operations preserve overall management and local operations control at Energy East?
- Are there any plans to change the relative roles of Iberdrola or Energy East with respect to control of operations?

To support the analysis of the questions referred to above, several initial tasks were undertaken to provide a foundation for the subsequent assessment. These tasks included:

- **Review of prior Energy East regulatory filings:** testimony and orders from relevant Energy East dockets before the Commission were reviewed to provide background data and identify the nature of the issue(s) as discussed in these proceedings.

- **Interview of Energy East and Iberdrola management:** several discussions were held directly with management at the Company to discuss prior merger related actions taken, operating circumstances and conditions currently in place and expectations for subsequent changes, if any.

- **Review of internal Energy East documentation:** additional documentation on Company actions related to prior merger actions and outcomes, as well as underlying organization and governance material was obtained for review and support of analysis refinement.

The conduct of these preliminary tasks enabled the execution of a series of succeeding tasks that were more directly focused on specific areas of analysis regarding the Iberdrola – Energy East transaction and the scope of inquiry identified earlier. These specific analyses addressed the following topical areas:

- **Review of transaction structure:** an initial element of the analysis focused on the identification of the guiding parameters of the Iberdrola – Energy East transaction, such as the planned buyer – operator relationship between Iberdrola and Energy East. The purpose of this task was to understand the commitments made in any of the transaction documents

that would bear upon subsequent operations and relationships.

- **Review of current Energy East operating model:** the assessment also included a review of how Energy East and its operating companies are structured and where responsibilities reside for execution of activities. The purpose of this analysis was to identify the relative roles that existed between the levels of the organization and the location in which activities were performed on behalf of the enterprise as a whole.

- **Review of prior Energy East transaction integration experience:** since the Company had completed several prior transactions in the past, review was conducted of the process and outcomes relative to integration of these entities. The purpose of this activity was to provide an understanding of what had previously been accomplished to provide a baseline for assessing the extent to which further opportunities might exist.

- **Review of planned Iberdrola governance model:** the manner in which the Company presently interfaces with Iberdrola relative to decision-making was also identified. The purpose of this analysis was to understand the relative roles of each of the entities going-forward and the manner in which inter-entity interfaces were expected to occur and to potentially evolve.

- **Review of areas for potential synergies:** the final analysis focused on a high-level determination of the potential for synergies availability given the specific parameters of this transaction. The purpose of this task was to assess what, if any, areas would lend themselves to a reduction in costs given the alignment of oversight and / or operating areas between Energy East and Iberdrola.

The above activities reflect the scope of the analysis conducted by Booz & Company relative to the question of potential synergies availability. The results of these analyses are provided in subsequent sections of this report along with supporting information, where relevant and appropriate, to the conclusions reached.

IV. OVERVIEW OF TYPICAL MERGER SYNERGIES

This section of the report describes the nature of synergies that are typically captured in a utility merger or acquisition transaction. It is intended to provide a common starting place for merger synergies definition and discussion of the situations under which they typically are available for capture.

From our experience, no two transactions are necessarily the same in enabling the realization of synergies as several factors affect their availability and level including: style and structure of the transaction, relative scale of the companies, relative business and asset mix of the companies, proximity of the companies, management philosophy of organization and operations and, emphasis on synergies attainment. Each of these factors is explained below:

- **Style and structure of the transaction:** the manner in which the transaction is designed can heavily affect the opportunity for synergies. For example, a transaction intended to simply become part of a larger portfolio of businesses, with no direct similarity to other operating assets, will not generate synergies. Similarly, when a transaction is not intended to be integrated with similar businesses, no synergies will be created.

- **Relative scale of the companies:** the comparative size of the two companies can be a limiting factor on the level of synergies available. For example, a company substantially smaller than its acquirer will likely be absorbed into the larger company, where possible. In this case, the synergies will likely directly come from the smaller entity and be limited to a portion of the level of expenditures incurred by that entity, rather than from both entities. Conversely, two more similarly sized companies will offer a broader and a higher level of opportunities for integration and therefore greater synergies.

- **Relative business and asset mix of the companies:** the comparability of the lines of business will affect the sources of potential synergies. For example, a gas distribution utility merging with an electric distribution utility would not enjoy the nature and level of synergies that would other wise be available to two more closely composed companies. Similarly, a utility merging with a merchant generating company would find the options for synergies more constrained given the operating elements of the business that would remain unaffected, compared to a merger between two integrated utilities.

- **Proximity of the companies:** the geographic location of the companies involved in the transaction also can affect the nature and level of synergies

that can be attained. For example, two companies that are reasonably proximate to one another have the opportunity to share operating resources over a broader service territory than would be the case where the companies were farther apart in location. Similarly, where there is substantial distance between the two companies, both corporate and operating synergies may be constrained by an inability to conceive an effective operating model.

- **Management philosophy of organization and operations:** the manner in which management elects to align organizations and operate the business can directly impact the opportunity for synergies attainment. For example, an operating model that leaves the operating companies as fully stand-alone entities, i.e., relatively unchanged from their pre-merger status, would limit the potential for synergies. Conversely, an operating model that emphasizes full integration of similar functions would likely generate greater savings, all other things being equal.

- **Emphasis on synergies attainment:** a fundamental factor underlying the level of potential synergies that can be attained relates to whether the realization of merger synergies is a principal underpinning of the transaction's economics. If so, then management would be driven to ensure that attainment is maximized. On the other hand, when managements are concerned about the level of disruption that may affect their businesses, synergies achievement may be less emphasized, and resulting levels lower.

Each of these factors can either impact the nature of synergies available, i.e., which categories are relevant, and the level of synergies, i.e., the amount of synergies to be achieved. And, these factors are not wholly independent of one another; several factors can combine to impact the nature of synergies that may be available or the manner in which these synergies are pursued. In reviewing the relevant characteristics of the Energy East – Iberdrola transaction, consideration was given to all of these factors in assessing potential synergies availability.

Synergies Categorization: In a typical merger, there are several different categories of savings that can be realized from a transaction. These categories reflect the nature of the benefits that may be available from a range of actions taken by management. The distinction among these synergies categories is important, however, since the manner in which they are often treated in regulatory proceedings differs. The distinction between merger and non-merger related synergies is highlighted below:

- **Created synergies:** These are savings that are directly related to the completion of a merger and could not be obtained absent the merger. For example, the reduction of total cost through the avoidance of duplication or overlap and the ability to extend resources over a broader base of activity would naturally occur through the consolidation of similar functions. Without the combination, both companies would continue to expend amounts on related activities, and as a result, would incur stand-alone cost levels higher than in consolidation.

- **Enabled synergies:** These savings result from the acceleration or "unlocking" of certain events that could give rise to savings and therefore are considered merger synergies. For example, technology differences that exist between companies may provide an opportunity to share technology and achieve productivity improvements more rapidly and more cheaply than would have occurred on a stand-alone basis. For example, one company that has adopted an enterprise resource planning approach will likely enjoy more seamless operation and higher productivity than a company that has individual, customized packaged applications. While the company without the integrated technology environment can obtain such productivity benefit from independent investment, the merger enables an existing technology environment to be more rapidly deployed and costly stand-alone investment to be avoided.

- **Developed synergies:** Reductions in cost due to management decisions that could have been made on a stand-alone basis, e.g., incorporating certain best practices, are unrelated to the merger. For example, a decision to transform an organization will result in reduced costs, but likely would have been achieved without the merger. These categories are not dependent on a transaction to be completed and are generally not anticipated in traditional synergies analysis.

The distinction among the above synergies categories is relevant to the Energy East and Iberdrola transaction given the scope of the Commission's inquiry, particularly in light of the factors that can influence synergies availability and realization that were also enumerated above. For most traditional transactions, the "created" synergies category is the most relevant as it captures the normal sources of benefits from consolidation, centralization and economies of scale. For non-traditional transactions, such as Energy East – Iberdrola this category would be less relevant given the characteristics of the situation. In this transaction, synergies that relate to changes in operating model or operating practices would be a more likely source.

Synergies Types

Typically, the synergies from a transaction arise from one of three areas: cost reduction, cost avoidance or revenue enhancement. These types of benefits or outcomes reflect the manner in which two companies align their businesses and functions and are further discussed below:

- **Cost reduction:** the total cost of service is reduced as a result of the merger by avoiding duplication of the cost input required to achieve the same level of output. For example, similar operating functions, such as corporate planning, could now be integrated and would require less input to achieve results on a combined basis.

- **Cost avoidance:** the total cost of service is reduced due to the ability to forego certain types of parallel expenditures. For example, redundant capital expenditures required by both entities (e.g., information systems) could be avoided by selecting one set of development efforts to forgo duplication.

- **Revenue enhancement:** the creation of additional revenue streams by using existing regulated assets to supplement revenue sources could also be a means to increase benefits for shareholders and customers. These revenue streams would be related directly to integrating portfolio resources, such as products and services, in a more attractive manner, i.e., to align compatible offerings or extend market position, to grow the business.

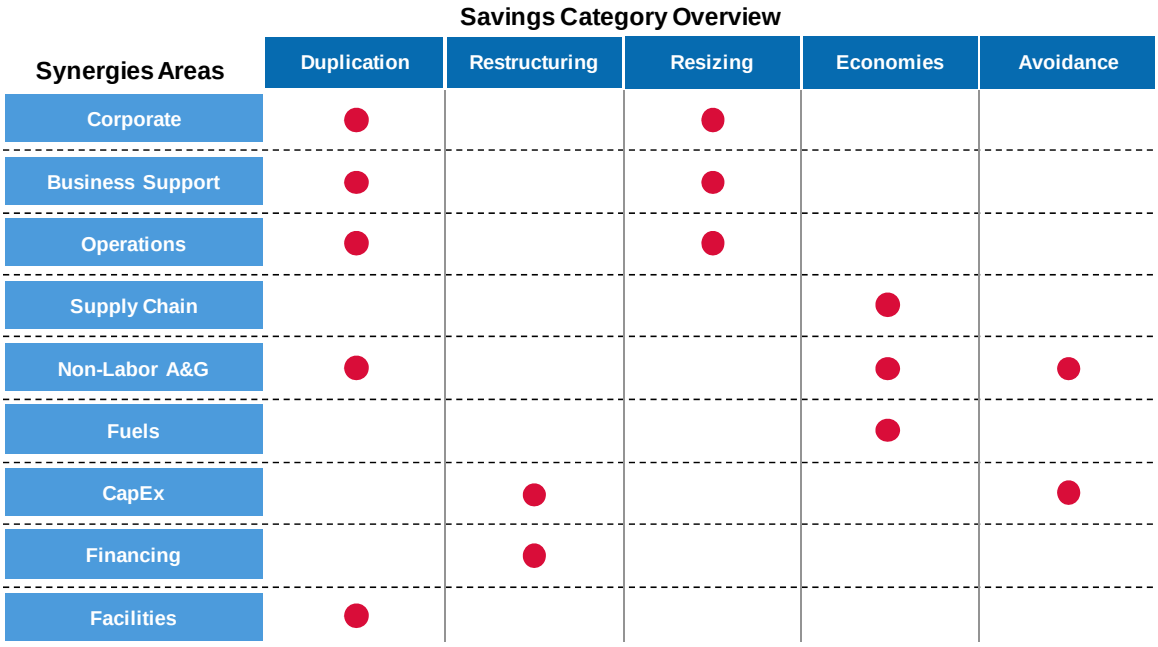
Each of these three types of synergies can occur in a transaction, with the circumstances dictating the relative level to be available. However, certain categories, such as revenue enhancement, may not be available in the typical utility-to-utility transaction given the nature of the business. For Energy East – Iberdrola, the factors enumerated above would limit the availability of potential synergies and have an impact on the ability to reduce or avoid costs.

Synergies Sources

Beyond the categories and types of potential synergies discussed above, it is important to recognize the specific operating sources from where these benefits can be derived. While the parameters of each transaction can be different for the reasons discussed earlier, there are several typical sources that contribute to the potential synergies that may be available.

These synergies sources generally relate to operating areas of the business and classifications of costs, both operating and maintenance expense and capital expenditures. The typical sources of merger synergies are captured in Figure 1 below:

Figure 1: Typical Synergies Sources



As the above illustration indicates, there are a number of sources of synergies that may be available in any utility merger transaction. These sources relate to the corporate, business support and operations areas, as well as specific categories of synergies, such as capital expenditures or facilities. The availability of these synergies sources depends on the characteristics of the companies involved and a number of the factors affecting synergies attainment enumerated earlier.

In addition, certain sources may be available depending on the nature of the companies involved in the transaction being pursued or the financial position of the individual companies, such as related to financing synergies. However, synergies in these areas are usually dependent on future events that have yet to occur. In addition, they often require speculation about market judgments and outcomes that are difficult to predict with certainty as they relate to conditions that cannot be reasonably anticipated based on the circumstances known.

The assessment conducted of the Iberdrola - Energy East transaction focused on the potential for synergies within the framework established above. The ensuing tests for synergies potential considered the specific categories and types of synergies and the manner in which this transaction would support their occurrence and capture. The following sections further assess the availability of synergies within the evaluative framework described above.

V. IBERDROLA – ENERGY EAST TRANSACTION

On June 25, 2007 Iberdrola and Energy East Corporation initiated a merger agreement under which Iberdrola S.A. (Iberdrola) sought to acquire 100% of Energy East for a total transaction value of approximately $8.6 billion. Upon completion of the transaction, Energy East would become a wholly owned subsidiary of Iberdrola S.A.

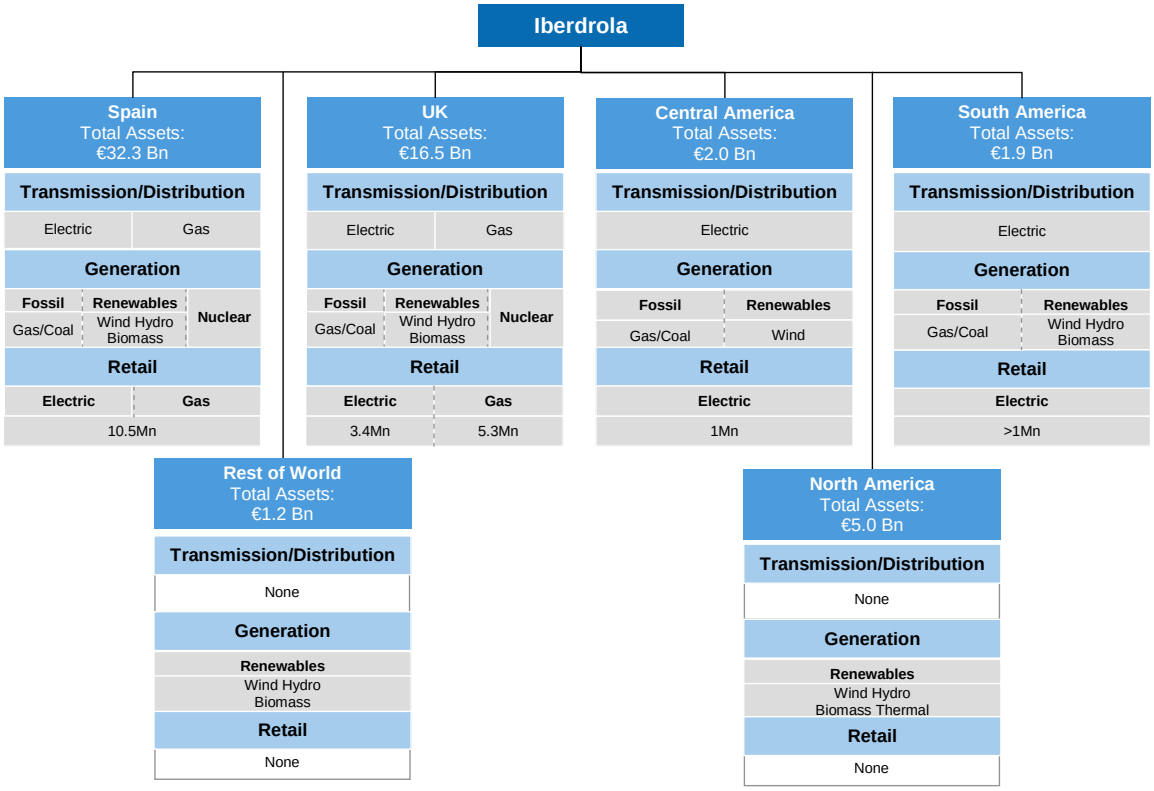
Subsequently, on August 1, 2007 a petition[2] was filed with the New York State Public Service Commission (the Commission) seeking approval for the transaction. The transaction was structured as a merger between Energy East and Green Acquisition Capital Inc., a wholly owned subsidiary of Iberdrola that was created solely for the purpose of integrating Energy East into Iberdrola.

At the time of the announcement, Iberdrola stated that the acquisition of Energy East would enhance the company's international expansion into additional markets and provide stable returns to shareholders. The Company believes the acquisition represented an important area for growth and a step forward in its strategy of building a broader North American platform.

Iberdrola is a global utility company headquartered in Bilbao, Spain with diversified operations in generation, transmission and distribution and electric and gas retail operations. Iberdrola's global holdings consist of over €86 billion in assets and a retail customer portfolio of over 22 million electric and gas customers in Spain, United Kingdom, Mexico, Guatemala, Brazil, Chile and Bolivia. Iberdrola is noted as a global leader in renewable wind energy generation with assets totaling €18 billion in wind, hydro, solar, and geothermal energy production. The company also maintains a global Engineering & Construction enterprise with a presence in over 40 countries and a real estate segment focused on land and property acquisition, primarily to support site selection and purchase of land for wind development. Figure 2 presents a view of Iberdrola's global operating footprint.

[2] Submitted to New York State Public Service Commission "Joint Petition of Iberdrola, S.A., Energy East Corporation, RGS Energy Group, Inc., Green Acquisition Capital, Inc., New York State Electric & Gas Corporation and Rochester Gas & Electric Corporation for the Approval of the Acquisition of Energy East Corporation by Iberdrola S.A."

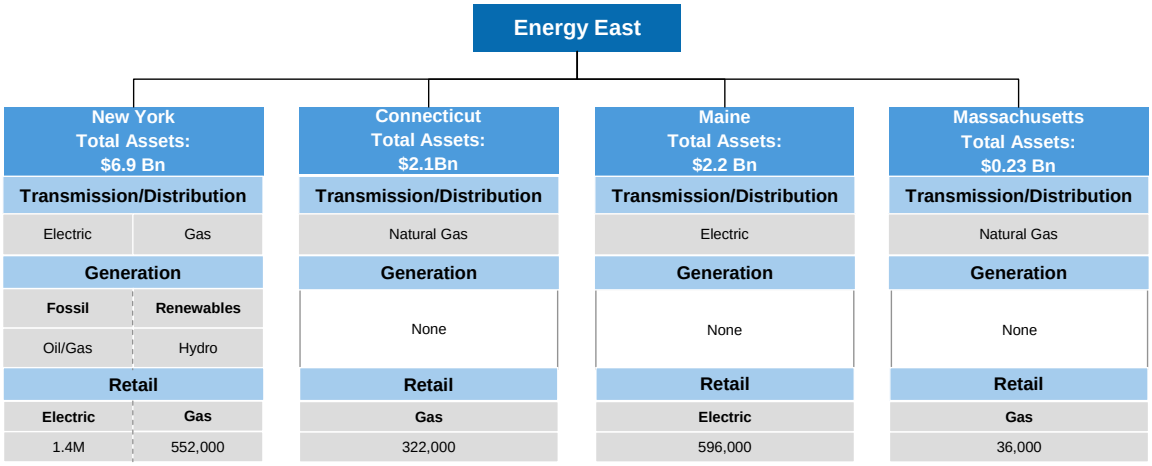
Figure 2: Iberdrola Global Operation



Energy East is a public utility holding company primarily focused on electric and gas distribution operations in the northeast portion of the United States. The company maintains its corporate headquarters in New Gloucester, Maine with administrative services centralized in Rochester, NY. Energy East serves approximately 1.9 million electric customers and 950,000 gas customers. The company's primary lines of business focus on regulated electric transmission, distribution and generation operations in New York and Maine, and in regulated natural gas transportation, storage and/or distribution operations in Connecticut, Maine, New York, Massachusetts and New Hampshire.

The current company has been created through several acquisitions over the past 10 years resulting in ownership of six northeast operating subsidiaries. Regulated network operations account for nearly 90% of Energy East revenues, with the remaining 10% coming from energy marketing operations in New York State. Energy East's New York presence includes the regulated utility companies RG&E and NYSEG. Figure 3 represents the consolidated operations of Energy East.

Figure 3: Energy East Operations



The Energy East acquisition represents Iberdrola's initial entry into United States regulated electric and natural gas utility operations. Iberdrola's prior platform in U.S. energy markets involves several ownership stakes in non-regulated renewable generation, gas storage, trading, and other energy management activities.

A brief summary of Iberdrola U.S. operating subsidiaries is included below:

Iberdrola Renewables, Inc. (IRI) is a non-transmission owning public utility engaged directly, and indirectly through its subsidiaries and affiliates, including Iberdrola Renewable Energies USA, Ltd, in the development and operation of wind and thermal energy facilities, natural gas and electric marketing, and in providing other energy services, including asset management and structured power solutions. IRI and its affiliates had, at the end of the first half of 2009, more than 3,000 MW of installed capacity of wind power, and more than 600 MW of gas-fired generation, in the U.S. IRI's wholly-owned subsidiary, Enstor Inc., is an independent natural gas storage company and, through its subsidiaries, acquires, develops and operates natural gas storage projects across North America that serve natural gas producers, energy marketers, utilities, electric power generators and natural gas pipeline companies.

The acquisition of Energy East is not a traditional utility transaction by U.S. standards. While certain of the elements of the Iberdrola global portfolio are similar to the scope of Energy East's utility business, none of these Iberdrola utility businesses reside in the U.S. Consequently, the manner in which the businesses would be able to align and integrate would be limited by structure, comparability and geography. Unlike other recent transactions involving international utility operators in the northeast, e.g., National Grid, no existing

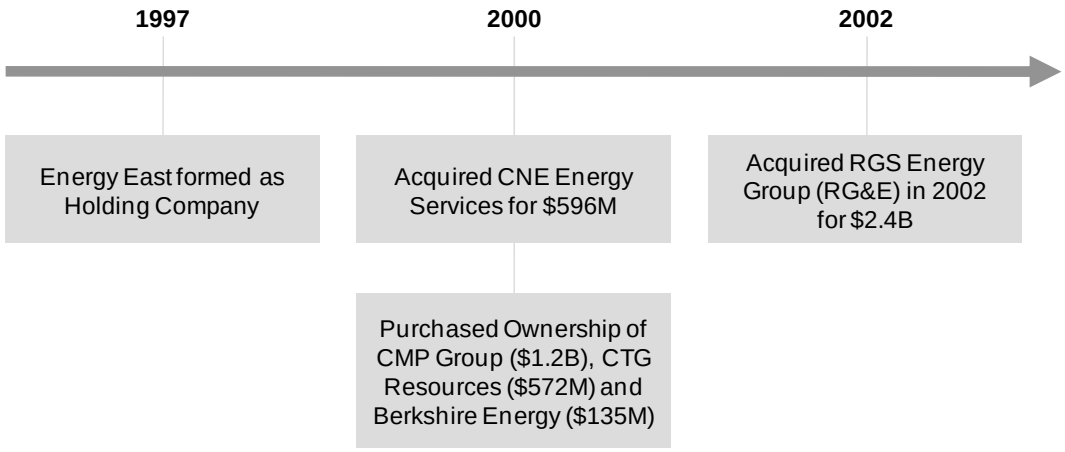
platform of comparable businesses exist for Iberdrola to leverage with respect to Energy East.

The combination of Iberdrola and Energy East closed in September 2008 after which time management began an integration process to fold Energy East in to the Iberdrola structure. The following section will describe the structure and results of that integration process.

VI. PRIOR ENERGY EAST INTEGRATION ACTIVITIES

Before describing the Iberdrola – Energy East integration process it is instructive to understand prior Energy East integration activities. Energy East was created as a holding company in 1997 to facilitate the inorganic expansion activities pursued during the late 1990s and early 2000s through a series of mergers and acquisition. The company focused on enlarging its geographic footprint across the northeast in network or "pipes and wires" businesses. As many states in the northeast required separation of generation from transmission and distribution to facilitate competitive wholesale markets, many of the acquisition targets Energy East pursued did not include generating assets. Figure 5 illustrates the major Energy East acquisitions during this time period.

Figure 5: Timeline of Major Energy East Acquisitions



Integration Activities Prior to Iberdrola Merger

The rapid expansion of the company through acquisition was driven by a philosophy that the smaller independent regional utilities in the northeast would operate more efficiently as part of a larger homogenized entity. Standardization of common processes and development of an integrated information technology infrastructure provided significant opportunities for the company to eliminate overlapping and duplicative activities and pursue economies of scale benefits. Management also recognized that certain synergies did not require standard process design or technology integration and, therefore, could be extracted without significant execution risk shortly after merger consummation (e.g., elimination of duplicate investor relations departments). Throughout its acquisition history and as these synergy opportunities became apparent, the

company developed a disciplined approach to merger integration to capture the benefits from consolidation.

Through each acquisition, a broad array of processes, system, personnel and assets were evaluated across the companies to determine the most likely areas to extract integration benefits. The Company's framework for synergy capture gave considerable weight to level of effort and the length of time to implement the solution. Projects that yielded quick returns for lower levels of effort were given top implementation priority. Ultimately, the company identified three areas as providing the greatest opportunity for synergy capture: information technology, supply chain and process reengineering and focused many of its integration activities in support of these areas.

As a first step in October 2000, Energy East created a subsidiary company, Energy East Management Corporation (EEMC), to quickly combine the corporate administrative functions of the regulated utilities. EEMC was created to focus on developing common policies, guidelines and principles that would govern the conduct of Energy East company activities and to coordinate corporate-wide initiatives. Corporate back office functions including certain finance, governance and consolidated accounting activities were centralized within a single structure that facilitated the development of common processes, where applicable.

To extract savings in supply chain, information technology and process reengineering areas, the company launched several enterprise-wide programs targeted at reducing costs and inefficiencies, increasing productivity and maximizing the capabilities across the combined companies. The major projects included the Data Center Consolidation Project, Project Spartan and Integrating EExcellence. Subsequently, SAP's enterprise system was implemented, including the Back Office and Work Management modules.

Data Center Project
The consolidation of Energy East subsidiaries began in 2002 and focused on the integration of information service systems and related personnel, networks and assets. The data center project integrated the information technology operations of six independent utilities into one streamlined organization capable of meeting the IT needs across the enterprise. Rochester, New York was selected as the data center location and the facility was completed in May 2003. A corporate network was created that linked all six utilities to this single data center.

After the physical centralization of IT operations was completed, the company focused on consolidating the IT department staff. From 2002 to 2004, the company reduced IT staff by 27%. Reductions were achieved in executive management, operations, technical services, contractor services, network

infrastructure and applications support. The effort also resulted in the standardization of operating systems and software across the company. For example, the use of Microsoft operating systems and software was mandated throughout the enterprise.

Integrating EExcellence
Integrating EExcellence was a 19 week initiative launched in 2003 and focused on process reengineering across all of Energy East's network operations. From its inception, the program incorporated several broad themes that served as objectives for the program:

- Eliminate unnecessary work
- Match salaries with corresponding level of responsibility
- Redesign work processes
- Reduce span of control
- Consolidate wherever possible
- Implement common IT systems

The project involved the efforts of approximately 100 employees and resulted in the identification, approval and implementation of over 1,000 improvement opportunities. One significant outcome was the creation of an additional support subsidiary that significantly changed Energy East's operating structure. Utility Shared Services (USS) was created to consolidate support functions for the regulated utilities in areas such as treasury, information services, accounting, accounts payable, payroll and supply chain functions. This shared services entity allowed transactional related activities (e.g., volume-based) to be consolidated and standardized in one entity. This provided for efficiency gains to be extracted through consolidation and Energy East subsidiaries realized the benefit of lower cost from the provision of these services in a central organization.

The Integration EExcellence program resulted in significant savings through the adoption of best practices across the enterprise. Other benefits were realized including the alignment of middle and senior management into a cohesive governing body focused on enterprise-wide performance.

SAP's Back Office Project
The Back Office Project, launched in January 2003, created a singular system for transactions involving finance, HR, payroll, treasury and a host of other back office functions. It was successfully completed on-time and under budget in January 2004. The project resulted in significant savings through process

efficiencies and the reduction of employees in the impacted functional areas. The outcome of the program resulted in:

- Reductions of 36% in total shared service staff including reductions in accounting and finance (51%) and supply chain (49%)
- Identical organizational structures, titles, and business processes across the six utilities
- Single general ledger system
- Identical pay schedules for all employees
- Real-time spend data available for all utilities
- Common performance metrics across the utilities
- Elimination of 50 legacy back office systems

SAP's Work Management System Program
The Work Management System program, initiated in April 2004, continued the effort to reduce cost and eliminate redundancies across the enterprise. The initiative consolidated functions for plant maintenance, engineering operations, asset management, and training into a single tool that would serve to drive uniform processes across the enterprise. The system improved trouble call response rates and reduced repetitive outages and customer complaints. By the end of the initiative in April 2005, a total of 156 legacy applications were eliminated.

Project Spartan
Project Spartan, which was initiated in 2002, initially focused on the identification of the annual spending levels at each of the utilities to work toward consolidated purchasing functions that would leverage the enhanced purchasing power of the consolidated entity. Project Spartan also looked for efficiencies in warehousing, inventory management and in fleet management. A consolidated supply chain organization was established in 2003. Project Spartan utilized a number of strategies to reduce annual spending levels, including:

- Expanding the number of vendors to promote competitive bidding
- Segmenting and concentrating the volume of materials purchased
- Improving product specification processes
- Standardizing and consolidating basic supply chain processes across utilities
- Restructuring relationships with vendors
- Avoiding unnecessary spending

At the conclusion of all these initiatives in December 2005, Energy East indicated that it had met all its cost reduction targets. In particular, between 2001 and 2005, Energy East reported substantial savings across multiple areas: an 18% reduction in total workforce, and approximately $100 million in electric and gas O&M and capital savings.[3] The New York utilities' share of these savings were contemplated in the RG&E merger approval case and the customers' share was reflected in the new rates that were established. These savings from previous Energy East mergers directly benefit customers.

Energy East was able to achieve these benefits without an erosion in reliability and customer service. In 2005 JD Power and Associates acknowledged Energy East's service and reliability performance by ranking the company second out of fifteen utilities in residential customer satisfaction. The New York Public Service Commission also acknowledged the success of the Back Office Project and Work Management System Project by noting that NYSEG "has made very substantial progress implementing its Integrated Back Office Program and its Work Management System." The Commission also stated that, "Both of these will produce efficiencies well beyond the amounts that were previously incurred for these functions."[4]

Iberdrola - Energy East Integration Activities

In September 2008, an integration planning process for Iberdrola and Energy East was commenced that had as its main objective an issue free legal day-1 integration of Energy East into Iberdrola. As described previously, the proximity of service territories and commonality of business operations (network-focused) provided for the capture of cost based synergies from previous Energy East integration processes. By contrast, the lack of common business operations (network versus generating assets) between Energy East and Iberdrola shifted the integration focus to that of seamless integration of Energy East's functional activities into Iberdrola's established business processes.

Additionally, the previous integration activities that Energy East performed provided a strong organizational foundation to operate the network businesses. The EEMC and USS organizations provided for the centralization of corporate support services across the EE operating companies. These entities were to remain intact subsequent to the close of the Iberdrola transaction and, therefore, the integration activities allowed for the preservation of the benefits gained from adopting this organizational model.

[3] PSC Case 05-E-1222 Response No: 0032-0035 and Exhibit RRP2.
[4] Case 05-E-1222 Proceeding on the Motion of the Commission as to the Rates, Charges, Rules and Regulations of New York State Electric & Gas Corporation for Electric Services August 23, 2006.

Senior executives from both Iberdrola and Energy East were tasked with defining the integration objectives. The Energy East executive responsible for the company's prior integration activities was again asked to lead the effort on EE's behalf. The joint Iberdrola / Energy East team defined the integration goals and principles as follows:

Goals

- Business assurance from day 1
- Integration in the shortest time possible
- Iberdrola Group's operational model implementation

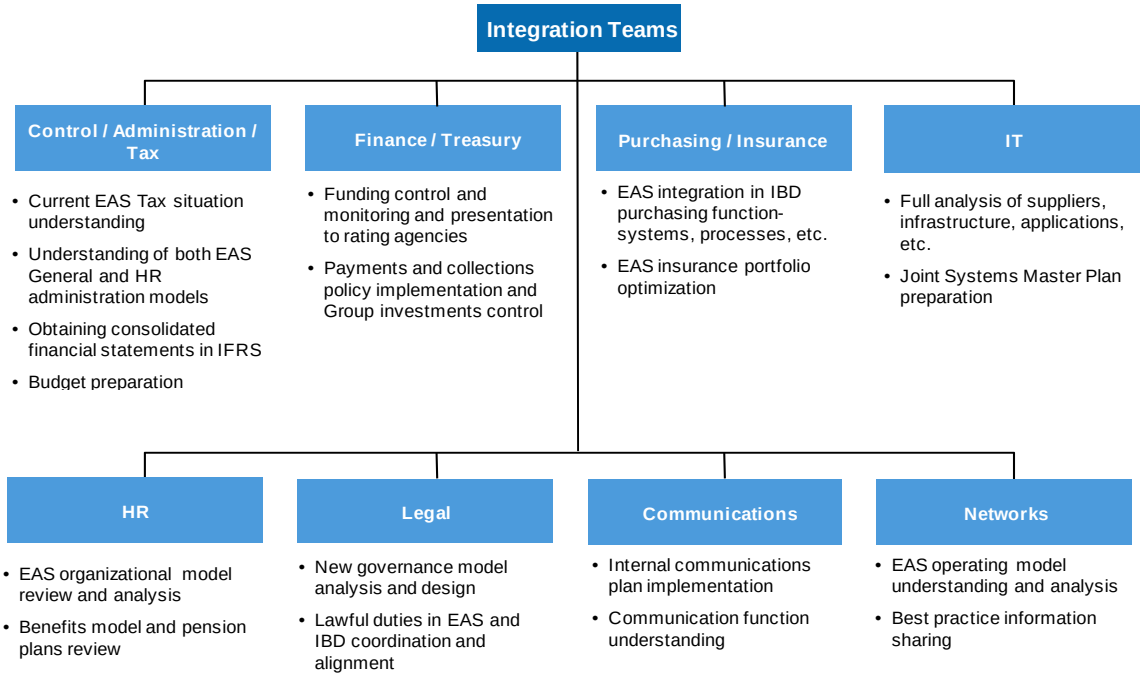
Principles

- People respect
- Corporate functions centralization
- Business unit independence

It is clear from these statements that management intended to quickly address mission critical processes and activities that would provide for the extension of Iberdrola's operating model while maintaining independent business units and organizations. This focus recognizes that both companies have well defined operating models that did not require major restructuring but rather linkages needed to be developed that assured critical businesses support activities would receive the appropriate consideration.

As depicted in Figure 8 below, ten integration teams comprising over 40 individuals were established to develop detailed integration plans. Each integration team developed a project charter that included: 1) the mission and objectives of the team; 2) the scope and baseline assumptions; 3) key workstreams required to execute against the project scope including identification of workstream owner, dependencies, timing and milestone dates and 4) major risks including probability and impact. Subprojects within each team activity lists were also planned at a detailed level. Over the course of this planning period, over 70 individual projects and 500 associated tasks were identified to achieve the integration objectives.

Figure 8: Iberdrola - Energy East Integration Structure



During the course of three months ending in December 2008, the tasks identified in the integration plans were completed. Interim team meetings were held through this time period to monitor progress, resolve issues, and develop strategies to mitigate risks. Results of the activities performed and the status of each team's workplan was reviewed by the senior Energy East and Iberdrola executive team to determine project completeness. Certain longer lead activities were identified that required extended time through 2009 to complete. These activities included projects such as approval of the 2009 Energy East budget, approval of monthly external reporting packages, and Sarbanes Oxley policies and procedures adoption. Responsible managers have been identified to lead these initiatives through to completion. At the end of three month period management deemed the formal integration process to be complete and the formal integration teams were disbanded.

Through the Iberdrola/Energy East integration process, the companies implemented a management structure that provides for the governance and oversight of Energy East's performance while allowing the core Energy East business structure and operations to remain intact. Additional opportunities to share information regarding best practices within and across the network operations of both Iberdrola and Energy East remain available and have been identified as a focus area for the future.

VII. AVAILABILITY OF SYNERGIES

This section of the report assesses the opportunity for synergies in the current transaction based on the characteristics and circumstances prevailing for both companies. The focus of this assessment was to determine whether the combination of the two companies would create reductions in cost at Energy East and / or its operating companies that could be attributable to the transaction.

To ascertain this potential, a variety of activities were undertaken as described in the Approach to the Assessment section. These activities were designed to provide perspective on: the nature of the transaction completed; the relationship of business elements within the companies; the operating model in effect; efforts within the companies to integrate operations, and; the availability of synergies in light of the above assessments.

The purpose of this assessment was not to undertake an independent analysis and quantification of potential synergies levels. Rather, the intent of the assessment was to apply the traditional synergies framework described earlier and determine whether these benefits could arise from any aspects of existing business integration between Energy East and Iberdrola or its subsidiaries.

Framework for Assessment

The assessment of the availability of synergies from the Iberdrola – Energy East transaction focused on a rapid determination of synergies potential given the facts of the situation. Several evaluative attributes were adopted to support this analysis as defined below:

- The comparability of operations between the companies
- The extendability of an operating model across the companies
- The overlap or duplication in functional performance
- The natural opportunities for integration

These attributes provided a basis for assessing whether the style and structure of the transaction would lend itself to creating an opportunity to combine, leverage or streamline operating costs as a result of the manner in which the Energy East business was to be operated and managed post-close.

Several areas of assessment were also conducted to understand the circumstances of the transaction and the availability of synergies. These assessment areas included:

- Initial consideration of synergies
- Applicability of typical synergies sources
- Rationale for potential synergies
- Review of potential synergies opportunities
- Governance model impacts

Initial Synergies Consideration

As previously mentioned, the Iberdrola – Energy East transaction is not a typical utility merger or consolidation event. Its structural aspects, e.g., strategic underpinnings, geographies, business constructs, etc., are different than those of the traditional transaction. Consequently, the companies did not focus on synergies quantification as a necessary input to the valuation process or as an expected outcome to support deal economics.

As described earlier, while Iberdrola has other U.S. based operating entities, none of them have utility operations. Further, there is no U.S. holding company that owns or oversees the assets presently owned and operated. Consequently, the fact situation for this transaction relative to operational similarity is dissimilar from most utility transactions that are normally completed in the U.S.

During the front-end transaction analysis, the focus for Iberdrola was on the manner in which Energy East would enable it to establish a broader U.S. platform to take advantage of other areas of opportunity, whether utility-based or non-regulated. Thus the intent was to leverage the Energy East operating platform as a "potential" growth vehicle, rather than a mechanism to simply extract value through traditional consolidation and integration.

This point was reinforced as discussed in the section on Energy East integration activities. As mentioned, the focus of the effort was directed to "alignment" of purpose and performance, rather than integration and execution of processes. This effort thus focused on how to bring certain aspects of the Energy East management processes into line with Iberdrola's preferred manner of operating its business. Synergies were not a primary consideration relative to achieving a

more seamless alignment of priorities, performance goals and reporting protocols.

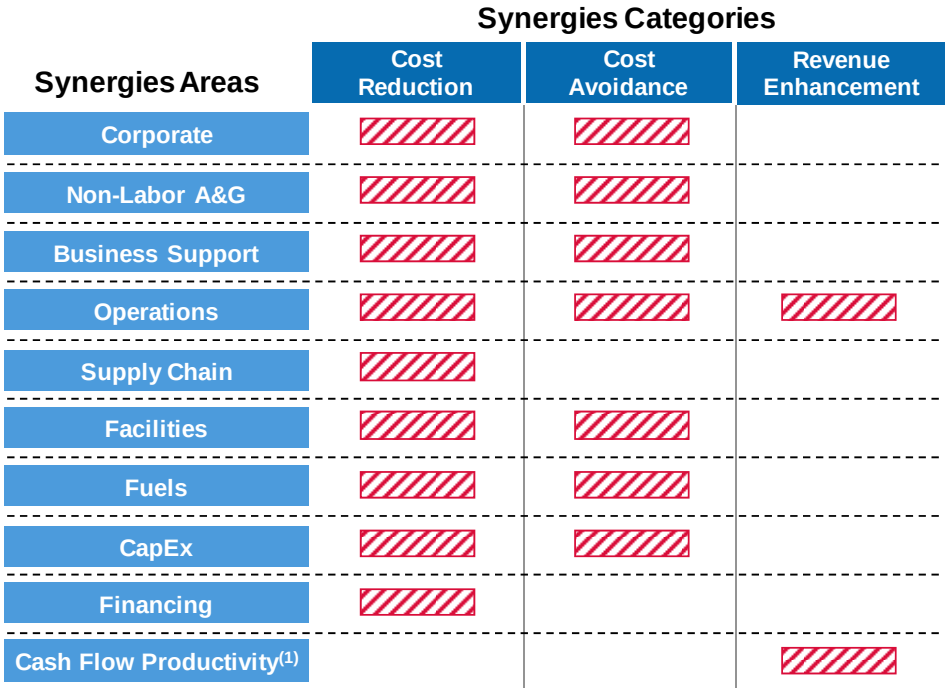
Applicability of Typical Synergies Sources

The first specific task related to the assessment of synergies availability was to review the traditional sources of merger synergies and determine the applicability of these areas against the circumstances of this transaction. This task involved leveraging the prior utility transaction experience of Booz & Company as a basis for understanding the relative applicability of synergies in the Iberdrola – Energy East transaction.

Several views of traditional synergies were developed to test against the Iberdrola – Energy East transaction. These views first addressed both the types and sources of synergies and then assessed their availability based upon the presence of certain factors in the transaction to enable realization.

Figure 9 illustrates the traditional sources of synergies against the types of benefits described earlier in this report. As illustrated in the figure below, there are several fundamental sources of synergies that give rise to the impacts of cost reduction, cost avoidance or revenue enhancement.

Figure 9: Typical Synergies Elements



(1) Cash reinvested in the business

As the above chart indicates, for utility transactions in the U.S. involving similarly constructed companies, a number of synergies sources would typically be expected to be achieved. These synergies sources represent those typically found in other utility transactions in the past, although they are not universally available in all transactions. As noted, most of the sources involve an impact on current and future costs, i.e., they are either reduced or avoided. However, few transactions produce revenue synergies due to the differences in the business or the difficulty in measuring and realizing benefits in this area.

However, aligning general synergies sources against general synergies types only defines the nature of potential benefits. The next step in the evaluation process assesses these synergies sources in terms of factors that could influence their realization. Several factors were identified that could create a "dependency" on the existence of certain facts and circumstances to enable potential synergies to actually occur. These "dependencies" include the structural similarities of the businesses, the complementary nature of the business and the locational proximity of operations. The relevance of each of each of these dependencies is discussed below:

- Structural similarity: the manner in which the business is organized and operated enables synergies to be attained through the alignment of functions across the business

- Complementary operations: the compatibility of business mix is a principal underpinning of synergies as it provides for an integration of comparable operating processes and functions

- Locational proximity: geographic closeness provides an opportunity to more closely align field resources and capture synergies from resource integration

The synergies sources noted above were aligned against these dependencies as illustrated in Figure 10 below:

Figure 10: Synergies Application to Energy East

Synergies Areas	Synergies Dependencies: Structural Similarity	Complementary Operations	Locational Proximity
Corporate	Yes	Possible	No
Non-Labor A&G	Yes	Possible	No
Business Support	Possible	Possible	No
Operations	No	No	No
Supply Chain	Possible	Possible	No
Facilities	No	No	No
Fuels	No	No	No
CapEx	No	No	No
Financing	Possible	N/A	N/A
Cash Flow Productivity(1)	N/A	N/A	N/A

(1) Cash reinvested in the business

As the above figure represents, while numerous synergies sources may generally be available in many transactions, fewer of these sources apply in the Iberdrola – Energy East transaction. Many of the traditional sources of synergies, particularly those that reflect the operating aspects of the business, will not be

available absent certain fundamental characteristics which are not present in this transaction.

The lack of comparability initially extends to the structural similarities of the companies. Iberdrola is an international holding company that has operations throughout the world and an operating model and profile that reflects that dispersion. While Energy East has a holding company and corporate structure, it is more localized and simpler in design. For example, since Iberdrola maintains independent businesses all over the world, the ability to "match up" in many areas, like local facilities, fuel supply and capital expenditures purpose is limited (capital expenditures) or non-existent (fuel supply). Moreover, Iberdrola's other businesses in the U.S. are focused on renewables, gas storage and energy marketing, none of which are similar to Energy East's transmission and distribution business profile.

In addition, differences in operations will complicate the portability of operating practices. For example, even though Iberdrola and Energy East maintain certain similar business unit operations, such as distribution, the businesses have certain elements of difference, e.g., system voltage design, local physical conditions, etc., that make operations less comparable than might be imagined. Thus, opportunities for formal integration would be limited.

Finally, a fundamental predicate for achieving operational synergies is not present in this transaction, i.e., geographic proximity. Where other transactions have been able to capitalize on location to share and leverage resources across similar work, no such opportunity exists in this transaction.

From this assessment, initial conclusions were reached that synergies from the operating areas, i.e., field operations, facilities, fuel supply and, capital expenditures, were not likely to be available given the dependencies identified. More specifically, the lack of geographic presence of a comparable business would be a limiting factor in any ability to create synergies opportunities.

Another factor limiting the availability of synergies applies in the area of any tax related benefits. One of Energy East's unregulated subsidiaries (which has no operational connection or contractual relationship with the New York operating utilities) has made a tax equity investment in the holding company of certain Iberdrola Renewables' project companies with unregulated wind power operations located outside of New York State. This investment will not, however, create any potential tax savings for these New York utilities. The tax liability of each of Energy East's operating companies is based upon each company's separate taxable income, which, with or without this tax equity investment, remains unchanged.

Another area identified for "possible" synergies exists relative to financing. This area would anticipate that lower costs for obtaining capital could be obtained either through access to a corporate pool of funds or from an enhanced credit rating. Both of these areas were considered speculative based on information available at this time and not further considered for review. In any event, were they to occur, there are existing ratemaking mechanisms that would capture the impacts of these events in the future. In addition, cash flow productivity was not further considered as it is derived from the impacts from other synergies and, in this case, would generally be reflected as a benefit in future rate cases.

However, several traditional synergies sources were identified as being "possible" areas of applicability in the current transaction. These areas, e.g., corporate and related support, were then reviewed more closely to determine whether they would potentially offer synergies with respect to Energy East. The purpose of this assessment was to determine whether the circumstances prevailing with respect to Iberdrola and Energy East would enable the capture of potential synergies given the circumstances of operating structure, cost incurrence and commonality in execution.

Based on the first level review, a more detailed view into the corporate and related support functions that typically are strong candidates for some level of consolidation was developed. Again, several attributes were identified for use in evaluating the potential for synergies from the respective areas.

- Operating model: a common manner of aligning and delivering certain processes or functions, e.g., on a centralized basis, offers the potential for consolidation and standardizing performance

- Scope overlap: the broader and more generic the process or function, the more likely the opportunity to align certain elements across multiple businesses

- Process commonality: similar processes or functions that are not localized in execution provide an ability to integrate how they are delivered and thus create opportunity for consolidation

- Degree of integration: the ability to practically and effectively align and execute functions based on their scope and purpose defines the achievability of synergies

As Figure 11 below shows, the corporate and related support functions were individually reviewed against the attributes described above. This review

provided an additional level of insight into how these discrete functions could provide opportunity for consolidation and synergies.

Figure 11: Corporate Center Area Availability

Functional Areas	Availability Dependencies			
	Operating Model	Scope Overlap	Process Commonality	Degree of Integration
Executive	Yes	No	No	None
Finance & Accounting	Yes	Partial	Partial	Possible
Human Resources	Yes	Partial	Partial	Possible
Information Technology	Yes	Partial	Partial	Possible
Supply Chain	Yes	Partial	Partial	Possible
External Affairs	No	No	No	None
Communications	No	No	No	None
Regulatory	No	No	No	None
Administrative Services	No	No	No	None
Legal	No	No	No	None

This view into the principal sources of synergies in most transactions provided several perspectives. First, many of the corporate and related support functions would not lend themselves to deriving synergies due to the nature of the work performed. For example, external affairs and regulatory are localized in their purpose and execution. Global processes would not be transferable to these functions. Second, local management would be unaffected by the transaction as the scope of this function remains intact. Third, several traditional "shared services" functions could be "possible" sources of synergies, although perhaps not in the traditional manner in most transactions.

The availability of synergies from these categories reflects the application of the attributes identified earlier. Although both Iberdrola and Energy East are structured around delivery of certain common business processes in their respective organizations, the operating models and nature of requirements do not enable locally directed functions to be combined. Similarly, the execution of many market-focused functions, although related in scope, do not overlap in purpose and substance to enable integration. The same outcome is true with respect to the commonality in processes, where similar activities might be performed, but specific conditions would limit standardization given the particular needs of the businesses. Finally, the degree of potential integration

differs by function, with only those typical, broad corporate level functions potential sources of synergies in this transaction.

The above assessment focused on whether some of the functions would lend themselves to potential integration. In addition, there are additional sources of potential synergies that relate to the corporate areas, but reflect the incurrence of non-labor costs, i.e., administrative and general (A&G) expenses that are also traditional source of synergies in many transactions. These individual areas were also assessed to determine whether they might lend themselves to the creation of synergies the current transaction.

Similar attributes were adopted to guide the evaluation in this area as well as defined below. These attributes provided a basis for understanding how the traditional non-labor synergies categories could be leveraged with respect to Energy East.

- Overlapping: where duplicative A&G costs are incurred, a transaction can enable the elimination of certain expenditures

- Avoided: when a transaction occurs, certain categories of current and future expenditures may be totally displaced

- Economies: certain categories of expense exist where supplier leverage may be obtained to reduce unit and total costs

Figure 12 below summarizes the results of screening these attributes against the traditional A&G synergies sources. Similar to the previous assessment of corporate functions, the results are mixed in terms of synergies availability.

Figure 12: A&G Synergies Application to Energy East

A&G Areas	Synergies Availability		
	Overlapping	Avoided	Economies
Administrative Overhead	No	Possible	No
Association Dues	No	No	No
Benefits	No	No	No
Credit Facilities	No	Possible	No
Directors Fees	Yes	Yes	No
Facilities	No	No	No
Information Technology	Partial	Possible	Possible
Insurance	Partial	Possible	Possible
Professional Services	Partial	Possible	Possible
Shareholder Services	Yes	Yes	No
Supply Chain	Partial	No	Possible
Transportation	No	No	No

The summary above indicates that most of the areas of typical A&G synergies would not be applicable to Energy East in this transaction. This result again occurs because of the specific and differentiable needs of Energy East from an operating perspective; they reflect differences in fundamental business structure, or; are localized in their incurrence and application. For example, Energy East incurs expenses solely to support local operations, e.g., facilities, transportation, etc. that solely support local operations and would not be impacted by this transaction. Additionally, Energy East A&G, such as administrative overhead and benefits, relate to support of the broad business which several of the previous figures illustrated would either be unaffected or not lend themselves to any appreciable degree of integration. Consequently, the number of potentially applicable A&G synergies sources is somewhat limited.

Rationale for Potential Synergies

Based on the analysis conducted above, several areas were identified where it may be "possible" to achieve synergies from the Iberdrola – Energy East transaction. In evaluation the actual potential for these synergies to be available, it is first necessary to understand the underlying rationale for their possible availability.

As mentioned elsewhere in this report, utility synergies typically arise from the opportunity to combine similar functions or processes to reduce or avoid costs. As Figure 13 illustrates, the potential for operating alignment that could enable such outcomes lies in the corporate center, rather than field operations or operating support functions.

Figure 13: "Possible" Synergies Summary

Corporate and Support Functions	Staffing Impact	Non-Labor Impact	Description
Finance and Accounting	▨		▪ Potential to integrate selected activities
Human Resources	▨		▪ Potential to integrate selected activities
Information Technology	▨		▪ Potential to integrate selected activities
Supply Chain	▨		▪ Potential to integrate selected activities
Corporate A&G			
Information Technology		▨	▪ Potential to combine platforms and / or avoid expenditures
Insurance		▨	▪ Potential to leverage broker relationships and integrate programs
Professional Services		▨	▪ Potential to avoid expenditures
Shareholder Services		▨	▪ Potential to eliminate expenditures
Directors Fees		▨	▪ Potential to eliminate expenditures
Supply Chain		▨	▪ Potential to leverage supplier relationships

The corporate center provides the highest potential for synergies given the closer commonality involved with design and performance of these functions. On the surface these functions would appear to possess a degree on commonality (as in most U.S. utility mergers) that would allow for either integration and shared resources or absorption of certain functions by Iberdrola.

The rationale for such integration or absorption is that economies of scale and / or scope could be obtained due to the similarity of the underlying activities. This commonality would enable the reduction or elimination of certain activities or costs currently incurred by Energy East. Thus, some presumption of overlap or duplication may exist among external observers given this commonality, prior to the next stage assessment of the portability of philosophy, policies, processes and, practices from Iberdrola to Energy East. The validity of this premise thus is critical to the determination of synergies availability in the current transaction.

Review of "Possible" Synergies Opportunities

Given the identification of the areas contained in the figure above as potential candidates for synergies, the next step in the assessment was the review of each of the areas to determine whether the applicable circumstances would, in fact, support the potential for synergies at Energy East.

All of the areas where "possible" synergies may be identified relate to the corporate center or related support functions. Thus, the focus of the assessment was on the degree of commonality of the function and the extent to which portability or economies of performance could be expected to create either staffing or non-labor A&G synergies. Each of the corporate center staffing areas is briefly described below.

- Finance and Accounting: this area within Energy East consists of activities related to: financial planning, budgeting, treasury, reporting, general accounting, capital allocation, internal audit, and related functions. All of these activities are performed by publicly traded companies, regardless of location.

- Human Resources: in this function, activities performed relate to: compensation, benefits administration, recruiting, leadership development, HRIS administration, employee communications and, related functions. All of these activities are performed by utilities, regardless of location.

- Information Technology: this category includes architecture development, applications management, telecommunications, data security and data center management, among other activities. All of these activities are performed by utilities, unless they are partially or wholly outsourced.

- Supply Chain: this area includes those activities related to: materials planning, strategic sourcing, warehousing, inventory management and, disposal, among others. All of these activities are also generally performed by utilities.

From the above description, it would appear that great commonality would exist between Iberdrola and Energy East with respect to activity performance. If such commonality were to exist, then it may be possible for Iberdrola to absorb these functions on behalf of Energy East, thus creating synergies in execution. Similarly, if Energy East were to support the other Iberdrola U.S. businesses, then synergies would be created among these companies. However, these

premises do not hold true once more specific attention is directed toward the portability of these activities, rather than just their commonality.

In particular, it is important to consider the current position of Iberdrola relative to Energy East in North America. First, as mentioned elsewhere, Iberdrola does maintain other businesses in the U.S., however, these businesses are non-regulated and different from the operational focus of Energy East. These businesses are also small, dispersed and currently operated in an independent manner by Iberdrola. More importantly, Energy East is a relatively small entity among the Iberdrola family of companies. Given the broader requirements and existing infrastructure of the total enterprise, it is not likely that necessary changes to accommodate U.S. and / or Energy East requirements would be undertaken to any meaningful degree just to produce synergies in that part of the business. Thus, there are not natural opportunities to combine related functions in these other U.S. based businesses with those in Energy East due to the differences in business focus and location.

Second, the practical requirements of operating businesses in the U.S., as well as globally, should not be assumed as easily achieved. The "national" requirements of the countries in which the business operates, particularly their principal domains, can be quite specific regarding their focus, e.g., with respect to compliance with laws and regulations. Accordingly, leveraging resources in Spain to perform activities on behalf of Energy East in the U.S. is not easily accomplished. This problem was also faced by U.S. utilities when they acquired foreign utilities in the United Kingdom and Australia. The differences outweighed the similarities and precluded taking advantage of seemingly common functions.

Finally, the ability to capture potential synergies in the identified areas, depends on the nature of the operating model to be adopted between Iberdrola and Energy East. As discussed in the earlier section on prior Energy East integration activities, the conclusion was reached that Iberdrola's objective was not to integrate Energy East in the traditional fashion, but to align management processes to enable consistency in design and execution. For synergies in the identified areas, to be available, Iberdrola would have to modify its intent and move toward a more explicitly stated objective of integration. For many of the reasons identified above, that option was discarded during the integration planning in favor of ensuring process transparency and consistency.

- Finance and Accounting: the differences in baseline requirements between U.S., European and other global markets, i.e., financial standards, accounting standards, predominant currencies and, underlying operations requirements combine to obviate the opportunity for meaningful

consolidation and integration synergies from a staffing perspective.

- Human Resources: the underlying activities in this area reflect the requirements associated with administering to a workforce that is predominantly focused in Europe and South America with its attendant requirements; thus, it is unlikely that substitution of Iberdrola headquarters personnel for U.S. resources would occur.

- Information Technology: while SAP is used by both companies as the base applications platform, differences in account structures, reporting requirements, user interfaces and, data configurations all combine to limit any meaningful transfer of technology support capability to Iberdrola on behalf of Energy East.

- Supply Chain: both companies are active purchasers of materials and services from vendors, however, the differences in system design, vendor market presence, local purchase requirements and, contracting differences effectively limit the ability to combine staffing resources to achieve synergies at Energy East.

For the reasons mentioned above, it is highly unlikely that staffing related synergies can be gained through the substitution of Iberdrola resources for those of Energy East. Similarly, the extension of Energy East capabilities to other Iberdrola U.S. companies would require a change to the existing operating model in place today which has not been contemplated.

With respect to non-labor A&G cost categories, a similar assessment was undertaken to determine whether the combination would create synergies from elimination of activities or the presence of economies of scale. Each of the identified areas of "possible" synergies in this category are described below.

- Directors fees: these costs relate to costs incurred for an independent Board of Directors as a publicly traded entity and consist of compensation and expenses.

- Information technology: actual costs for seat licenses, workstations, servers, data centers and, training, among other areas, are reflected here and relate to the specific environment, architecture and applications in place at the companies.

- Insurance: fees paid to brokers and / or providers to obtain D&O, general liability, workers compensation and, fiduciary insurance are expenses

incurred by both companies.

- Professional services: fees paid to third-parties for audit, consulting, legal and other services may be overlapping in terms of scope or subject to economies of scale.

- Shareholder services: costs include those related to fulfilling requirements as a publicly traded entity for stock registration, transfer agents, annual meeting, proxies, annual reports and, dividend administration, among other areas.

- Supply chain: opportunities to capture to obtain lower unit and total costs for materials, supplies and contracted services may be available from consolidation of vendors.

As with the corporate and related support staffing areas discussed above, expectations could exist that all of the above areas could provide possible synergies as a result of the transaction. However, this premise is also not practically accomplishable due to a variety of structural and market limitations that exist.

Certain non-labor A&G cost areas would, in fact, result in elimination of incurred costs at Energy East. These would include directors fees and shareholder services. In both these areas, Energy East has been able to forego the incurrence of cost of approximately $2 million since the close of the transaction. However, while cost reductions have been achieved, they do not create synergies in the traditional sense of flow-through in lower rates as these costs have been treated as below-the-line expenses for ratemaking and supported by shareholders rather than customers.

The insurance cost category was identified as a source of "possible" synergies given the potential to leverage global insurance brokers for expanded coverage under an umbrella policy. As a result of pursuit of this area, Energy East has achieved reductions in broker costs and premiums of approximately $3.1 million across the holding company and operating companies. Part of these reductions ($1.6 million) reflect the elimination of the need to provide D&O coverage to the Board of Directors since Energy East is no longer a publicly traded entity. This cost category also has been treated as a below-the-line item for ratemaking and historically supported by shareholders, rather than included in customer rates.

The remaining three areas of non-labor A&G costs are further discussed below.

- Information technology: although the underlying platform is common between Iberdrola and Energy East, the differences described earlier with respect to local requirements for support, location of the support infrastructure, existing contracts and, vendor protocols combine to preclude obtaining synergies from sourcing leverage.

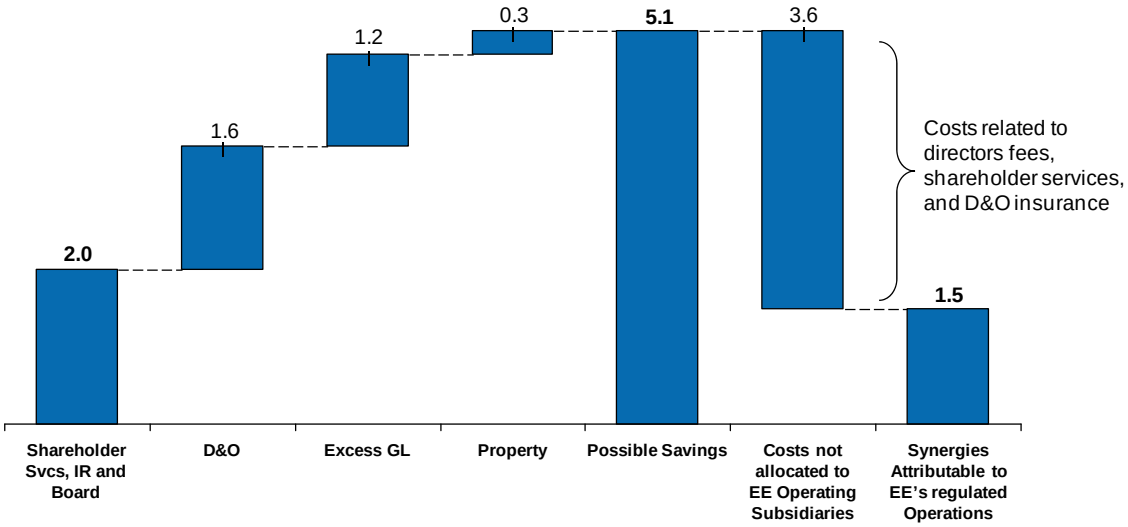
- Professional services: the nature of services obtained, e.g., consulting or legal, usually reflect a response to the local regulatory requirements placed upon the business or business litigation that results from local matters, thus effectively limiting any opportunity for synergies in this area. Since Energy East is still issues public debt, and is required to continue to comply with the provisions of the Sarbanes-Oxley Act pursuant to terms and conditions of the Commission's merger approval order, audit services will still be required.

- Supply chain: the differences between Iberdrola and Energy East in system design, vendor presence and equipment standards provide a practical constraint on the ability to capture synergies from common sourcing in this area, despite the inherent similarity in certain operational aspects of the business.

Thus, those corporate and related support staffing and non-labor A&G areas where available synergies were determined most likely to be "possible" do not, in reality, lend themselves to any significant level of benefit. This occurs because: the businesses themselves have a sufficient degree of difference to preclude the same level of integration as normally observed in U.S. utility transactions. In addition, the operating model of Iberdrola has historically been built around substantial operational independence of its operating subsidiaries, reflecting their unique circumstances, thus broader integration has not been emphasized.

The summary of the above identified and captured synergies is presented in the figure below. This figure indicates that the total identified synergies of $5.1 million are subject to adjustment (to ~$1.5 million), as explained below.

Figure 14: Summary of Synergies



However, it is my understanding that $3.6 million of these costs ($2.0 million for directors fees and shareholder services, and $1.6 million for D&O insurance) have not previously been allocated to Energy East's operating subsidiaries (or included in rates) and, therefore, would not be allocable to customers. Thus, the potential for synergies that are actually attributable to Energy East's regulated operations is both limited to a modest number of areas and only reflects *de minimis* (~$1.5 million) levels across all of Energy East's subsidiaries, where realized. In addition, the value of these synergies would be further diluted once allocation is reflected across all the operating subsidiaries within the Energy East system. This is consistent with our experience with international utility transactions whether in-bound to or out-bound from the U.S.

Governance Model Impacts

Iberdrola has adopted a governance model that provides for substantial operating independence and autonomy by its owned operating subsidiaries, within specified parameters. This governance model refers to the manner in which the subsidiaries are managed, i.e., how resources are centralized or decentralized, how decision-making is conducted, how reporting requirements are aligned and, how local operations occurs for the benefit of related customers.

Consequently, Iberdrola's focus has been on pursuing the alignment of decision-making protocols and reporting regimes from its acquisitions to ensure that common models for management and information communication are adopted. This emphasis has the practical effect of ensuring that a single, common model for many processes is established which simplifies the task of managing across a broad portfolio and improves operational transparency.

For the Energy East transaction, Iberdrola has continued this model with the intent to achieve operational efficiency through standardization of critical processes. In its initial presentation material presented to Energy East employees, Iberdrola clearly laid out the relevant parameters of this philosophy: decentralized operations with integration for corporate functions. The respective objectives for each of these operating areas is summarized below:

- Operations: three key objectives were laid out: decentralized operational management; continuous exchange of information regarding best practices, and; alignment with corporate strategy and reporting, which were designed to ensure seamless operation of the business while enabling continuous information sharing and transparent reporting.

- Corporate Functions: three key objectives were defined: integration of functional management; communization of procedures, and; harmonization of policies, which were collectively intended to achieve alignment with Iberdrola's corporate governance model.

The import of this model is that it allows substantial operating independence to Energy East, similar to how other subsidiaries are handled, within the proscribed protocols for process alignment, decision-making and reporting. This model is consistent with other models utilized for international transactions with which *I am* familiar, particularly given the circumstances of this transaction with respect to the nature of other owned assets in the U.S.

The model implemented by Iberdrola is consistent with the actions taken by the companies with respect to integration planning and the evaluation of potential synergies. While opportunities for potential synergies were sought and considered, the inability to achieve closer integration (and therefore synergies) due to the fundamental differences in the businesses and local considerations, enabled the focus to concentrate on how to effectively align Energy East with existing Iberdrola protocols. Within these protocols, Energy East is able to focus on effective and efficient service delivery and meeting the needs of customers without conditions or constraints that limit the deployment of resources or the flexibility of response.

VII. CONCLUSIONS

The results of the high-level review of "possible" synergies from the Iberdrola - Energy East transaction indicates that meaningful synergies from traditional sources as seen in other utility mergers are simply not available. The unavailability of these synergies is due to a variety of factors:

- The absence of comparable operations to integrate with Energy East. There is no comparable U.S. based utility owned by Iberdrola that would enable operations to be fully combined and integrated.
- The inability to overcome structural, proximity and physical differences in operating business and asset design. The lack of comparability between U.S., Spain and UK utility networks precludes the ability to think about global integration.
- The lack of comparability to Iberdrola's other 80% owned U.S. businesses, which also constrains the capture of synergies. The other businesses operating in the U.S. are focused on wholesale marketing and trading and renewables, neither of which are similar to Energy East's profile.
- The governance model adopted by Iberdrola across its global businesses, which allows for substantial operating independence within defined parameters. This model has not been focused as closely on operational integration as it has process alignment, standardization of reporting and harmonization of policies.
- The lack of natural opportunities to capture economies of scale across the businesses. Given the differences in operations, markets and requirements, normal opportunities for synergies are not available.
- The limited number of areas of eliminated activities, which constrain the affectable cost pool. And, even when they exist, the level of associated dollars is small.
- The prior regulatory treatment of certain types of activity costs. Even when synergies have been identified, certain of these opportunities have historically been treated as below-the-line and supported by shareholders rather than recognized in customer rates.
- The allocation of synergies across the operating companies, which further limits the level of benefit that can be reflected for customers. Where certain synergies have been realized, they relate to costs incurred across all of Energy East's operating companies and, when allocated, are *de minimis*.

These factors, individually or in combination, dramatically limit the nature of opportunities available for synergies from the current transaction. Expectations that significant synergies would be available from this combination cannot be fulfilled based on our review of the facts of the transaction.